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International Investment Law Protection of Foreign Portfolio Investments: ‘To be, or not to be’?

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Abstract

The view that foreign portfolio investments (FPI) are investments within the contemplation of the international investment law regime led to a foreign ETF holder bringing an investment arbitration claim challenging Malaysia's foreign exchange policy to deal with the Asian Financial Crisis. This same belief led to tens of thousands of foreign holders of Argentine sovereign bond security interests bringing various investment arbitration claims against Argentina's public expenditure policy decision to restructure its public debt during the Argentine economic crisis. Thus, the sustenance of this belief can lead foreign holders of emerging/frontier economies' FPIs to challenge their macroeconomic measures for dealing with economic distress or full-blown economic crisis. Hence the relevance of this thesis.

This thesis argues against the extension of international investment law recognition and protection of FPIs in emerging and frontier economies for policy and legal reasons. Firstly, though quite arguable, unrestricted FPI movement seems to be correlated with economic distress or crisis. Bolstering this narrative is the IMF's recognition of the necessity for imposing some controls, even pre-emptive controls on FPI movement. Secondly, the international investment law regime is infamous for its effect of constraining regulatory autonomy. Extending investment law protection will only serve to constrain macroeconomic independence and flexibility with severe consequences during economic distress and crisis. Thirdly, FPIs are not investments within the contemplation of the ICSID Convention and ought not to be accorded jurisdictional recognition. The potential for investment law protected FPI to constrain macroeconomic policymaking can detract from economic development contrary to the objectives of ICSID. Finally, even if jurisdiction is found the substantive protection standards considered are likely to fall short. Also, a balancing of the competing rights between host States and FPI will tilt in favour of the host States, owing to the greater costs that would be incurred if it tilts otherwise.

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List of Abbreviations

BIT	Bilateral Investment Treaties
CIL	Customary International Law
CFM	Capital Flow Management
DSSI	Debt Service Suspension Initiative
FET	Fair and Equitable Treatment
FDI	Foreign Direct Investment
FPI	Foreign Portfolio Investment
IMF	International Monetary Fund
ICSID	International Centre for the Settlement of Investment Disputes
ISDS	Investor-State Dispute Settlement
LRM	Least Restrictive Means
MFN	Most Favoured Nation
MST	Minimum Standard of Treatment
NPM	Non-precluded Measures
OECD	Organisation for Economic Cooperation and Development
RSIWA	Responsibility of States for International Wrongful Acts
UNCTAD	United Nations Conference on Trade and Development

Statement of Copyright

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Chapter One

General Introduction

This thesis substantially argues against extending international investment law protection to foreign portfolio investment (FPI) based on law and policy reasons. The question of whether foreign portfolio investments should be recognised as investments and protected by the international investment law regime, is basically a question of choosing between the option of recognising and protecting volatile, short term and speculative investments potentially at the expense of the social wellbeing and economic growth of emerging and frontier economies.[1] It is a question of whether to prioritise investments allegedly of dubious quality,[2] or economic development in emerging and frontier economies. It is a question of determining whether to potentially compensate foreign portfolio investors for risks they contemplated and willingly undertook, without any premium (benefit) to emerging and frontier economies, but at the cost of their economic welfare.

Putting it in context, despite some benefits, FPI has been said though arguably[3] to be a less qualitative and potentially disequilibrating investment owing to its volatility, and propensity for reversals at the change of global and domestic economic conditions. Also, international investment law protection of foreign portfolio investment has the potential to incapacitate host state macroeconomic flexibility necessary in times of economic distress and economic/financial crisis.

1.1 Foreign Portfolio Investment as Disequilibrating and Crisis Prone Investments

Foreign portfolio investments, particularly debt portfolio investments have been viewed as "bad cholesterol".[4] According to Hausmann & Fernandez Arias, foreign portfolio investments are 'driven by speculative considerations based on interest rate differentials and exchange rate

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[1] An Emerging Market is a capital market in a developing country with high growth expectation, characterized by high level of risk and volatility but with possibility of high returns. A frontier market is also a capital market in a developing country, but it is less established compared to an emerging market because of its size, higher risk, and lower liquidity, though owing to its potential for long term growth they are attractive to foreign investors. See generally, Morgan Stanley Capital International (MSCI), Market Classification https://www.msci.com/market-classification..

[2] Barry Eichengreen, *Globalising Capital: A History of the International Monetary System* (Princeton University Press 2nd edn, 2008) 196.

[3] Peter Blair Henry, 'Capital Account Liberalisation: Theory, Evidence and Speculation' (2007) 45(4) Journal of Economic Literature; M. Ayhan Kose, et al, 'Financial Globalization: A Reappraisal' (2006) IMF Working Paper WP/06/189.

[4] Ricardo Hausmann & Eduardo Fernandez Arias, 'Foreign Direct Investment: Good Cholesterol?' (2000) Inter-American Development Bank Research Department Working Paper No. 417, 3.

expectations, not on long-term considerations'[5]. Similarly, Arthur Bloomfield while commenting on the necessity for controlling unrestricted movement of foreign portfolio investment which he termed as 'hot money'[6] owing to their destructive effects, said:

> It is now highly respectable doctrine, in academic and banking circles alike, that a substantial measure of direct control over private capital movements, especially of the so called 'hot money' varieties, will be desirable for most countries not only in the years immediately ahead but also in the long run as well…Unfettered freedom of individuals to transfer funds across national boundaries…has long been a hallowed dogma of traditional economic thought…This doctrinal *volte face* represents a widespread disillusionment resulting from the destructive behaviour of these movements in the interwar years.[7]

While highlighting the rationale for capital controls, Rawi Abdelal pointed out that State capital controls are meant to apply to and regulate unrestricted mobility of short-term speculative capital (FPI) owing to their volatility, capacity to be disequilibrating, and potential to cause crisis.[8] Unsurprisingly, a study conducted on the impact of capital liberalisation on economic growth in seventeen (17) emerging economies in 2017 found that only FDI had a significant positive impact on economic growth, while other aspects of capital liberalisation including FPI had statistically insignificant impacts on economic growth. The paper went on to recommend that emerging economies avoid hasty financial liberalisation where their financial system is fragile.[9] Pending the development of the financial system, emerging economies need to preserve their regulatory space to exercise some control over capital flows.[10] However, a number of studies demonstrate that liberalising equity FPI markets fosters growth,[11] increases

[5] Ibid.
[6] Arthur I Bloomfeld, 'Post-war Control of International Capital Movement' (1946) 36(2) American Economic Review p 687.
[7] Ibid.
[8] Rawi Abdelal, *Capital Rules* (Harvard University Press, 2007) 45-46.
[9] Muhammad Atiq ur Rehman and Muhammad Azmat Hayat, 'Capital Account Liberalisation and Economic Growth' (2017) 55(1) Pakistan Economic and Social Review 299-313. S Kalemli–Özcan, B Sorensen and V Volosovych, 'Deep financial integration and macroeconomic volatility' (2014) 12 (6) Journal of European Economic Association 1585.
[10] Ibid.
[11] N Gupta and K Yuan, 'On the growth effect of stock market liberalizations' (2009) 22(11) The Review of Financial Studies 4715.

investments,[12] boosts exports[13] and wages.[14] Debt FPIs, though they are generally considered as being less beneficial as demonstrated *ad nauseam*, it has been contended that removal of the restrictions on foreign borrowing by firms has a positive effect on investment and productivity[15] with the imposition of controls negatively affecting investment and productivity.

Similarly, according to Peter Blair Henry, the crisis does not only occur in economies with liberalised capital movement. Rather poor macroeconomic policies can cause the emergence of crisis.[16] Similarly, Ayhan Kose, argue that very little empirical support is found to support the claim that capital account liberalisation is the sole cause of crisis. Rather, implementation of capital liberalisation without the necessary financial/economic institutions and condition can render a country vulnerable to crisis.[17] Nevertheless, capital liberalisation, particularly debt FPI has been shown to pose risks of capital misallocation where capital goes to where it is least productive, sudden stops in capital inflows during banking or financial crisis which exacerbates the situation[18]; and financial stability. Peter Blair Henry recognises that short-term foreign denominated debt portfolio investments play a major role in emerging economy crisis, like the Asian Financial Crisis.[19]

It is hardly in dispute that most foreign portfolio investments are motivated by the speculative search for favourable macroeconomic conditions like interest rates, and exchange rates, and are usually the first to move at the earliest sign of trouble. As a result, they are usually responsible for boom-bust cycles.[20] This freedom of movement is now amplified by the proliferation of financial technology which has facilitated the ease with which financial assets could be accessed, acquired, and disposed of by mostly inexperienced retail investors.

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[12] L Alfaro and E Hammel, 'Capital flows and capital goods' (2007) 72(1) Journal of International Economics 150.

[13] K Manova, 'Credit constraints, equity market liberalizations and international trade' (2008) 76(1) Journal of International Economics 33.

[14] A Chari, A, P Henry, and D Sasson, 'Capital market integration and wages' (2012) 4(2) American Economic Journal:
Macroeconomics 102.

[15] L Varela, 'Reallocation, competition, and productivity: evidence from a financial liberalization episode' (2017) 85(2) The Review of Economic Studies 1279.

[16] Peter Blair Henry, 'Capital Account Liberalisation: Theory, Evidence and Speculation' (n 3) 924

[17] M. Ayhan Kose, et al, 'Financial Globalization: A Reappraisal' (n 3) 7-8.

[18] J Joyce and M Nabar, 'Sudden stops, banking crises and investment collapses in emerging markets' (2009) Journal of Development Economics 314; M Hutchison and I Noy, 'Sudden stops and the Mexican wave: currency crises, capital flow reversals and output loss in emerging markets' (2006) 79(1) Journal of Development Economics 225.

[19] Peter Blair Henry, 'Capital Account Liberalisation: Theory, Evidence and Speculation' (n 3) 926

[20] Ricardo Hausmann & Eduardo Fernandez Arias, 'Foreign Direct Investment: Good Cholesterol? (n 4) 3; UNCTAD Trade and Development Report 1999 112-113.

Currently, access to foreign portfolio investments can be done electronically either through mobile brokerage trading platforms[21] such as Charles Schwab, Robinhood, Fidelity etc or through instructions to traditional brokers. These transactions are mostly done outside the host State's territorial jurisdiction, and often, without the host State directly receiving proceeds of the transactions especially when they exchange hands extra-territorially. However, the proceeds accruing to such investments leaves the territory of the host State to wherever the investor resides thereby augmenting the disequilibrating and crisis potential of foreign portfolio investments when such movement is *en masse*.

The reason for the boom-bust cycle associated with foreign portfolio investments especially debt portfolio investments is because of their search for favourable economic conditions. Historically, high interest rates and improved growth prospects in emerging and frontier markets, alongside low interest rates and monetary expansion in developed economies accounts for the boom phase of capital flows.[22] Also, reliance on short-term debt financing denominated in foreign currency by emerging/frontier economies accounts for this boom. However, tightening of global conditions especially in developed countries like the US and the UK, results in massive and sudden flow reversals, sell-offs, and repayment demands which can account for the bust phase of capital flows.[23] The effect of this massive and sudden reversals if not contained could be crisis.[24] Economic and financial crises of the past 40 years have followed this template.[25] Hence, the relevance of this thesis. The world is currently experiencing tightening of financial conditions owing to the effect of Covid-19, after a period of massive capital movement to emerging and frontier economies. In the past ten (10) years,

[21] The proliferation of mobile brokerage trading platforms with its adoption of game interfaces has led to loads of retail investors starting trading including day trading without the requisite knowledge and experience to manage the risk. It is like an addiction. Though the interface is not coercive, it is considered as being capable of influencing decisions. See Madison Darbyshire, 'Traders Phone Up Gambling Helplines as Game-like Broker Apps Spread' *Financial Times* October 6, 2021.

[22] Yilmaz Akyuz, 'Capital Flows to Developing Countries in a Historical Perspective: Will the Current Boom end with a Bust?' (2011) South Centre Research Paper 37, 1

[23] Ibid 23. The bust phase can be because of short-term capital going into host States and creating investments in foreign currency or in domestic currency. Where an investment is denominated in foreign currency (Original sin), depreciation in local currency value can lead to reversals and decline in foreign capital which will render debt servicing difficult, and eventually result in a default. Where an investment is denominated in local currency, the foreign investor bears more risk such that tightening of global economic conditions will make the investments in emerging economies no longer attractive, thereby resulting in reversals and sell-offs.

[24] Guillermo A. Calvo and Carmen M. Reinhart, Capital Flow Reversals, the Exchange Rate Debate, and Dollarization (1999) 36(3) IMF Finance and Development; Pablo Emilio Guidotti, Federico Sturzenegger, Agustin Villar, 'On the Consequences of Sudden Stops' (2004) 4(2) Economia Journal 171-214.

[25] Yilmaz Akyuz, 'Capital Flows to Developing Countries in a Historical Perspective' (n 22) 5.

emerging and frontier markets have seen increased capital flows.[26] The increase in FPI capital flows into emerging markets in the past decade is attributable to their higher interest rates compared to developed countries, and the slow narrowing of risk perception between developed and emerging and frontier economies.[27] Monetary easing in developed countries after the global financial crisis resulted in significant capital movements into emerging/frontier economies.[28] However, with the Covid-19 pandemic, and the consequential supply chain crisis and high inflation, there has been a tightening of global economic conditions which saw massive capital flows out of emerging and frontier economies.[29] To address this and prevent systemic risk, emerging/frontier economies adopted macroeconomic and capital flow measures.[30] Even the International Monetary Fund (IMF) recently recognised the necessity for pre-emptive capital flow control measures.[31] The World Bank and G20 led a Debt Service Suspension Initiative (DSSI) following the effect of Covid-19 on the global economy. Only one international private creditor participated.[32] Consequently, international investment law protected foreign portfolio investments negatively affected by these macroeconomic capital flow management measures can challenge these measures before investment arbitration tribunal despite their recognised necessity.

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[26] Emerging and Frontier Markets: Capital Flows, Resiliency, Risks, and Growth https://bankinglibrary.com/emerging-and-frontier-markets-capital-flows-resiliency-risks-and-growth-2/

[27] Yilmaz Akyuz, 'Capital Flows to Developing Countries in a Historical Perspective' (n 22)15.

[28] Gaston Gelos et al., 'Capital Flows at Risk: Taming the Ebbs and Flows' file:///C:/Users/rxxn34/Downloads/CapitalFlowsAtRisk_TamingTheEbbsA_preview.pdf

[29] Patrick Schnieder et al., 'Managing volatile capital flows in emerging and frontier markets' CEPR https://cepr.org/voxeu/columns/managing-volatile-capital-flows-emerging-and-frontier-markets; Gaston Gelos et al., 'Capital Flows at Risk: Taming the Ebbs and Flows'

[30] https://mronline.org/2022/07/27/capital-flight-from-emerging-markets/

[31] International Monetary Fund, 'Review of the Institutional View on the Liberalisation and Management of Capital Flow' (2022).

[32] World Bank, 'Debt Service Suspension Initiative' https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative Accessed 11/11/2022

1.2 Capacity of Protected Foreign Portfolio Investments to Incapacitate Macroeconomic Flexibility

Macroeconomic policies including Capital Flow Management measures[33] (CFM), are designed to address macroeconomic challenges within the wider economy.[34] To this end, macroeconomic policies drafted to address macroeconomic risks and challenges in times of economic distress or crisis must be timely, decisive, and flexible.[35] Macroeconomic policies are timely where immediate action is taken to prevent the erosion of the financial market and the economy. Delays in policy adoption and implementation will only serve to compound the risks, and complicate further actions. The IMF suggests that macroeconomic measures such as capital controls when applied as a precaution before the onset of crisis 'lowers risks to financial stability' for vulnerable economies.[36] Macroeconomic policies are decisive where it is resolute and unequivocal, without any form of prevarication or uncertainty as to its effects. They are flexible where policy makers have the capacity to pre-emptively change policy in the face of economic distress or crisis to protect the economy, to reverse policy where the economy has stabilised, or to stem adverse externalities such as high inflation which may be the consequence of macroeconomic policies designed to address a crisis.

Economic theories support macroeconomic flexibility and intervention. Keynesian as well as Monetarist economics advocates for macroeconomic flexibility, whereby the Keynesians advocate flexibility for internal and external balance,[37] the Monetarist are more focused on internal balance[38]. It is fundamental for host State's to have macroeconomic policy flexibility, and monetary policy independence to deal with economic situations including distress and financial crisis. Even the Trilemma theory recognises free movements of capital with macroeconomic flexibility as one of the options.[39] Additionally, legal support for

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[33] Capital Flow Management measures (CFM) are host State measures to manage sudden and large destabilising capital inflows and outflows.

[34] Federic Mishkin, 'Financial Instability and Monetary Policy' A Speech delivered at the Risk USA 2007 Conference in New York on 05 November 2007 https://www.federalreserve.gov/newsevents/speech/mishkin20071105a.htm

[35] Federic Mishkin, 'Monetary Policy Flexibility, Risk Management and Financial Disruptions' A Speech delivered at the Federal Reserve Bank of New York on 11 January 2008. See also, Federic Mishkin, 'Financial Instability and Monetary Policy'.

[36] International Monetary Fund, 'Toward an Integrated Policy Framework' (2020) IMF Policy Paper.

[37] Internal balance includes employment and price stability, while external balance includes balance of payment equilibrium and exchange controls. See Deepak Nayyar, 'Rethinking Macroeconomic Policies for Development' (2011) 31(3) Brazilian Journal of Political Economy 340

[38] Internal balance here involves price stability.

[39] Christina Majaski & Michael J Boyle, 'What is a Trilemma and How is it used in Economics? With Examples' https://www.investopedia.com/terms/t/trilemma.asp

macroeconomic flexibility can be found in host State economic sovereignty and economic mandates of monetary authorities.[40]

As demonstrated above, the stakes in macroeconomics policymaking are quite significant for any State, thus it becomes expedient to explore the relationship between international investment law and macroeconomics,[41] especially as international investment law is sought as protection for foreign portfolio investments against allegedly erring macroeconomic policymaking. It is contended that international investment law stands the risk of threatening macroeconomic flexibility owing to its documented propensity for regulatory chill. The result of which can have massive implications on macroeconomic conditions within emerging/frontier economies.

Foreign investment protection, including foreign portfolio investment protection exemplifies capital liberalisation situated within the neoclassical growth model.[42] According to this model, it assumes that welfare can be maximised where there exists unrestricted movement of capital.[43] To then guarantee free movement of capital, there must be protection of foreign capital.[44] This is in an ideal world. However, this model of unrestricted movement of capital for development is not perfect and has challenges.[45] It has been argued that an adoption of this model can result in market failures such as economic and financial crisis when adopted without supporting policies.[46] Thus, elevating the need for State intervention to bring about equilibrium where crisis or threat of crisis ensues following the adoption of unrestricted capital movement without supporting policies. Interestingly, during the World Bank and IMF Annual Meeting in

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[40] What economic goals does the fed seeks to achieve with its monetary policy https://www.federalreserve.gov/faqs/what-economic-goals-does-federal-reserve-seek-to-achieve-through-monetary-policy.htm#:~:text=As%20a%20result%2C%20the%20goals,maintaining%20a%20stable%20inflation%20rate. 6/12/2021. Price stability with moderate long-term interest rates; and maximum employment are the congress delegated mandates to the US Federal Reserve. Similarly, other monetary authorities like the European Central Bank, Bank of England, etc. provide statutory recognition for independence and flexibility.

[41] Yair Listokin, 'A Theoretical Framework for Law and Macroeconomics' (2016) Yale Law & Economics Research Paper 567 p 30

[42] Robert Solow, 'A Contribution to the Theory of Economic Growth' (1956) 70(1) Quarterly Journal of Economics 65.

[43] See Robert Solow, 'A Contribution to the Theory of Economic Growth' (1956) 70(1) Quarterly Journal of Economics 65; Lawrence Summers, 'International Financial Crises: Causes, Prevention and Cures' (2000) 90(2) American Economic Review 1; M. Ayhan Kose and Eswar Prasad, 'Capital Accounts: Liberalise or Not?' https://www.imf.org/external/pubs/ft/fandd/basics/capital.htm Assessed 11/112022

[44] Antony Anghie, *Imperialism, Sovereignty and the Making of International Law* (2004) 224

[45] Dani Rodrik, 'Who Needs Capital-Account Convertibility?' In Peter Kenen (ed) Should the IMF Pursue Capital Account Convertibility? Essays in International Finance (Princeton University Press 1997).

[46] M. Ayhan Kose and Eswar Prasad, 'Capital Accounts: Liberalise or Not?' (n 43).

Honk Kong in October 1997[47], it was cautioned that for liberalisation to take place, host State must have strong and stable financial institutions and strong regulatory framework. This is very significant because some emerging and particularly frontier economies do not have the institutional and regulatory structures necessary to support capital liberalisation policies[48], nor do they have the adequate safety nets for supporting their citizens should crisis deteriorate. Financial and economic crisis has distributional consequences in emerging and frontier economies such as unemployment, lower income etc which is made worse by the lack of or unavailability of social safety nets when compared to developed States.[49] Additionally, a developed and deep financial market improves capital flow prospects and reduces the incidences of sudden and massive capital outflows.[50] According to the IMF, the chances of significant outflows when financial market depth improves by a standard deviation, reduces to less than 10%.[51]

Instructively, none of the academic advocates for a broad definition of investments took into consideration the capacity of emerging/frontier economies to manage FPI externalities, and by extension, the necessity for a developed financial and economic system to reduce the externalities of foreign portfolio investment movements, or the need for State intervention to curtail the movement and deal with crisis. State interventions are basically 2nd best policies/equilibrium.[52] Some BITs/Investment Chapters recognise the imperatives for these 2nd best options in the form of exceptions/safeguards.[53] Unfortunately, this is mostly not the case, given the very limited number of BITs/Investment Chapters with such exceptions and safeguards. Rather, what is common in most BITs/Investment Chapters are broad definitions of investments which can cover foreign portfolio investments and potentially even cryptocurrencies depending on how far the tribunal is willing to go, and unrestricted movement

[47] World Bank Group-IMF Annual Meeting in Hong Kong 1997

[48] Barry Eichengreen & Michael Mussa, 'Capital Account Liberalisation and the IMF' *Finance & Development* December 1998 35(4) https://www.imf.org/external/pubs/ft/fandd/1998/12/eichen.htm

[49] Joseph Stiglitz, 'Capital Market Liberalisation, Economic Growth and Instability' (2000) Columbia Business School https://www0.gsb.columbia.edu/mygsb/faculty/research/pubfiles/1479/Stiglitz_CapMktLiberaliz.pdf p 4. Accessed 11/11/2022.

[50] International Monetary Fund, *Global Financial Stability Report: Financial Stress and Deleveraging Macro-financial Implications and Policies* (October 2008)

[51] International Monetary Fund, *Global Financial Stability Report: Markets in the Time of Covid-19* (April 2020) Chapter 3 p 55

[52] 'The Theory of the Second best' https://saylordotorg.github.io/text_international-trade-theory-and-policy/s12-03-the-theory-of-the-second-best.html

[53] This is in the form of specialised exceptions like Prudential carve-outs and Balance of Payment Clauses, or general exceptions in non-precluded measures clauses which provides various degrees of safeguards for host State measures.

of funds. Often with no exceptions to cater for possible macroeconomic flexibilities in times of crisis.

Most developed countries favour foreign portfolio investment protection under BITs based on the acceptance of capital liberalisation. Manifestly observable in their BIT practice, and Model BITs[54] which still adopt broad definitions of what constitutes an investment without any exclusion of foreign portfolio investments, and Transfer of Funds clauses without any safeguards. BITs/Investment Chapters mostly between the major developed home States, and emerging/frontier economies under review embody this extreme, often non-derogable form of capital liberalisation. Most of them create obligations without any possible or potential safeguards.[55] However, BITs between mostly emerging/frontier economies are now currently being executed with express exclusion of foreign portfolio investments.[56]

A broad definition of investment with guarantee of unrestricted transfer of funds without any safeguards but with investment arbitration protection is the most radical and farthest reaching international economic framework for entrenching capital liberalisation on emerging and frontier markets. Such that, any form of macroeconomic interference will be the subject of investment arbitration, even if such interference is meant to mitigate or avert crisis. The effect is that where there are no express or implied exclusion of foreign portfolio investments, or no available safeguards, foreign portfolio investments may be considered as investments in these BITs/Investment Chapters and extended substantive protection without any corresponding rights in favour of the host States[57]. It is noteworthy that some BITs, as well as the IMF[58] and the Organisation for Economic Cooperation and Development (OECD)[59] contains safeguards.

[54] UK Model BIT (2008).

[55] Rachel D Thrasher, Sarah Sklar, Kevin P Gallagher, 'Policy Space for Capital Flow Management: An Empirical Investigation' (2021) 24(4) Journal of International Economic Law 780

[56] There are about 31 BITs out of over 2000 that exclude FPI. For instance, see the Agreement between The Government of the Republic of Rwanda and the Government of the Republic of Turkey Concerning the Reciprocal Promotion and Protection of Investments (2016) Article 1, which excludes share acquisition of less than 10%, and requires lasting economic relations in host state. See also, Mapping of IIA Content | International Investment Agreements Navigator | UNCTAD Investment Policy Hub

[57] Arcuri, Alessandra, 'The Great Asymmetry, and the Rule of Law in International Investment Arbitration' in Lisa Sachs, Lise Johnson and Jesse Coleman, eds., *Yearbook on International Investment Law and Policy* (OUP, 2019) Available at SSRN: https://ssrn.com/abstract=3152808 or http://dx.doi.org/10.2139/ssrn.3152808 p 6

[58] International Monetary Fund Articles of Agreement, Articles VIII (2), VII(3)(b) & Article XIV (2) for current transactions, and Article VI (3) for capital account transactions.

[59] Organisation for Economic Cooperation and Development, Code on Capital Account Liberalisation, Article 7.

Thus, permitting international investment law foreign portfolio investment protection without providing exceptions, can give investment arbitration the vires to review host State macroeconomic policies including monetary policies like interest rates, exchange rates etc, and fiscal policies like public debt restructuring when they affect portfolio investments negatively. It goes without saying how this can hamper host State macroeconomic flexibility in times of crisis[60] contrary to the economic independence of finance and monetary authorities as well as the principle of economic sovereignty of host States.[61]

Consequently, this thesis argues against the extension of investment law regime protection to foreign portfolio investments because they are potentially destabilising and are sensitive to host State macroeconomic changes, thereby increasing the risk of host State macroeconomic measures being challenged by foreign investors before investment arbitration. Protecting foreign portfolio investments using international investment agreements that broadly define 'investments,' but does not contain any safeguard clause will entrench capital liberalisation in its most extreme form because it will mean that any kind of asset will enjoy protection without any regulation by the host State. Emerging/fronter economies will be constrained to maintain only favourable policies reflective of capital liberalisation, even if those policies make no sense at all.

To address this, this thesis identifies and discusses jurisdictional and substantive concerns within the international investment law regime which challenges the entrenchment of this extreme type of capital liberalisation to enable emerging/frontier economies effectively maintain macroeconomic flexibility and independence.

Consequently, this thesis seeks to propose a normative doctrinal framework for the interpretation of broad meaning of investments under ICSID and in BITs/Investment Chapters, as well as for the analysis of the substantive standards of protection in BITs in relation to foreign portfolio investments. The Thesis will argue that a teleological interpretation of the Article 25 of the ICSID convention and its preamble will deny FPI, foreign investment protection. It contends that foreign portfolio investments ought not to be considered as

[60] Rachel D Thrasher, Sarah Sklar, Kevin P Gallagher, 'Policy Space for Capital Flow Management: An Empirical Investigation' (n 55) 783.
[61] See Adaeze Agatha Aniodoh, 'Host States' Monetary Sovereignty Within the Construct of Bilateral Investment Treaties' (2021) 65 (1) Journal of African Law 5-6.

investments at all within ICSID because they complain against macroeconomic policies, which are necessary for economic growth and development.[62] Thus, recognising foreign portfolio investments will constrain macroeconomic policymaking, and undermine economic growth, inconsistent with the objectives of ICSID as contained in its preamble. In the event, that BITs provide for broad definitions, and do not provide for dispute settlement under ICSID, then emerging/frontier economies may argue for the application of the typical characteristics test to determine if FPIs are investments, or they may rely on Article 32 VCLT to argue that their subsequent State practice of excluding foreign portfolio investments in subsequent BITs should be considered interpretating the meaning of investments. Nevertheless, emerging/frontier economies without ICSID access can question how protective the substantive protection standards alleged to have been breached are of portfolio investments.

A review of substantive protection standard provisions will reveal that under certain situations recognised within the BITs, foreign portfolio investments may not be protected. It is contended that emerging/frontier economies macroeconomic measures to deal with present or impending crisis may not be in breach of substantive protection standards, when reviewed on their merits. Situations within BITs/Investment Chapters that can exclude FPI protection range from the uphill requirement for macroeconomic measures to meet the threshold of bad faith, arbitrariness etc., to satisfy the standard for Fair and Equitable Treatment (FET) analysis,[63] to the inclusion of specific economic crisis safeguards in transfer of funds clauses[64] which justifies capital restriction measures. However, where none of the following situations exists within the substantive protection provisions, BITs/Investment Chapters may provide for general exceptions which can apply to exclude FPI protection. The presence of general exception safeguards should deny foreign portfolio investment protection amidst impending or existing economic/financial crisis.

Finally, where there are no general or specialised exception safeguards justifying macroeconomic policy flexibility, which is mostly the case with extant BITs/Investment

[62] In times of economic crisis, or in situations where crisis is imminent, extending protection to foreign portfolio investments at the detriment of macroeconomic policy independence will be tantamount to tying the hands of the host State, which may have severe economic consequences for the social welfare and economic growth of the State.
[63] Marcela Klein Bronfman, 'Fair and Equitable Treatment: An Evolving Standard' in A Von Bogdandy & R Wolfrum (eds) *Max Planck Yearbook of United Nations Law* 10 (Brill, 2006) 649
[64] Andrew Mitchell et al., 'Dear Prudence: Allowance under International Trade Law and Investment Law for Prudential Regulations' (2016) 19(4) Journal of International Economic Law.

Chapters, proportionality analysis should be adopted to ensure the conflicting protection rights of investors, and sovereign rights of host States are objectively reviewed. This is to ensure that investment tribunals take into consideration the fact that the macroeconomic policy decisions taken by emerging/frontier economies are based on their economic rights and for the benefit of its citizens. Here, foreign portfolio investment rights to protection will be balanced against emerging/frontier economies right to intervene for the benefit of its citizens. Proportionality analysis will seek to review these conflicting rights taking cognizance of the costs and benefits of upholding each right, to decide on balance which right should be upheld. Where such analysis is properly done, the balance should tilt in favour of denying portfolio investment protection.

1.3 Case Studies on the Necessity for Macroeconomic Flexibility in times of Economic Distress and Crisis

1.3.1 Asian Financial Crisis

Low interest rates in developed countries saw the move to emerging and frontier economies with higher interest rates. Asia was particularly attractive to foreign investors in the early 90's since most Asian currencies were pegged to the dollar thereby reducing the currency risks[65] of yields, and since capital liberalisation started to be widely adopted.[66] The outcome was a deluge of capital, including short-term speculative capital (foreign portfolio investments) into Asian economies. Thereby exposing these economies to the 'most volatile form of foreign capital'.[67]

According to Eichengreen, the Asian governments believed they derived legitimacy from delivering economic growth. Since foreign capital equates economic growth, they were hesitant about restricting capital movements, even short-term speculative foreign portfolio capital. Additionally, since exports spurred growth, they were reluctant in adopting a flexible exchange rate based on the belief that export led growth, requires stable exchange rate regime.[68]

[65] Exchange rate fluctuations.

[66] With the widespread adoption of capital liberalisation, Asian banks and firms took advantage of foreign portfolio short-term capital. By 1996 East Asia had attracted inflows of about $96 Billion. In 1997, about $12 billion had already fled the region. See Jagdish Bhagwatti, 'Capital Myths: The Difference between Trade in Widgets and Dollars' (1998) 77(3) *Foreign Affairs* 8; Barry Eichengreen, *Globalising Capital: A History of the International Monetary System* (Princeton University Press 2nd edn, 2008) 193.

[67] Barry Eichengreen, *Globalising Capital* (n 2) 193.

[68] Ibid.

The equilibrium changed with the rise in the value of the dollar, and the competitiveness of China. The pegging of their currencies to a rising dollar made their currencies overvalued,[69] affected export receipts, slowed down export led growth and increased current account deficits.[70] The inflow of foreign capital, including capital of 'dubious quality' according to Eichengreen, created a boom but increased inflation. However, the International Monetary Fund consistently warned the Thai government that their currency was overvalued. Yet, they hesitated for fear of slowing down growth and damaging confidence. However, the high inflation triggered movement of short-term capital out of Thailand. It was when the foreign reserves had significantly depleted owing to the massive movement of Capital out of Thailand that led the government to devalue and float the currency.

Following the experience in Thailand, short-term speculative foreign portfolio investors concerned that a similar policy change may ensue in other Asian economies, began to take flight from Malaysia, Philippines, Indonesia etc. Though initially hesitant, the Malaysian government eventually had to change foreign exchange policy and float their currency to avert the incoming crisis. It is noteworthy that the Malaysian change of foreign exchange policy was the subject of International Investment Arbitration Claim in the investment arbitration case of *Gruslin v Malaysia*[71] where a foreign investor in exchange traded funds (ETFs) instituted investment arbitration claims against the Malaysian government for changing the foreign exchange policy. This case will be extensively discussed in Chapter Four and Six of this thesis and referenced in the entire work. Clearly, the status quo of pegging the currency to the dollar was favourable to the foreign portfolio investor, and the decision to float was detrimental, even though it was done to save the economic and financial system of Malaysia.

The situation was different in Indonesia. Indonesia refused and neglected to change macroeconomic currency policy to a floating regime. Indonesia held on to their liberalization policy and fixed exchange rate. Rather than more investments coming in, they saw massive capital movements out of Indonesia which affected their currency value and led to a run on their domestic banks. Citizens moved from deposits to cash with the Central Bank unable to

[69] The Thai Baht was particularly overvalued.
[70] Pegging currencies for example to the dollar can lead to the local currency being overvalued, and the economy experiencing current account deficits (import value exceeding export value). Since a higher currency value will make exports more expensive thereby reducing the value obtained from exports, but imports are cheaper, because a higher currency can purchase more goods.
[71] *Gruslin v. Malaysia* ICSID Case No. ARB/99/3 Award (27 November 2000)

meet the cash demands of its citizens. The entire banking system had to be shutdown to avoid contagion, but with implications for production, thereby leading to a recession.

1.3.2 Argentine Economic Crisis

In the 1980's, Argentina was plagued by hyper-inflation. To deal with this, the Carlos Menem government in 1989 replaced the old currency with the Peso and pegged the peso to the dollar. The pegging policy was passed into law, and strict restrictions on exchange were imposed. It was the law that contracts, including investment contracts can be denominated and executed in dollars. Thereby allowing dollars to co-exist with the peso. Resultantly, there was a drop in inflation to US levels, and rise in GDP. However, the pegging of the peso to the dollar made it overvalued and the economy started experiencing current account deficits.

To finance the deficits, Argentina had to rely on foreign capital including foreign portfolio bond investments issued by the government and acquired by investment banks, and domestic banks. The bonds were acquired by domestic banks because to ensure subscription, the government made sovereign bond acquisitions as sufficient to satisfy bank liquidity requirements. However, by the late 90's the experience of the Asian Financial Crisis of 1997 and the Russian default of 1998 resulted in global financial turbulence and apathy towards emerging and frontier market assets. Furthermore, Brazil's devaluation of its currency also affected the competitiveness of Argentinian exports thereby deepening the current account deficits, and ultimately slowing down growth.

Ideally, the logical option was to lose the peg, and float the peso. However, this was not that simple owing to the legislated and contractually bound exchange rate policy. Rather than devaluing, Argentina chose to cut down on public expenditure. Consequently, growth fell further, and State revenue also fell. Yet, Argentina chose not to devalue. As the economic situation became worse, Argentina imposed a multi-currency peg, and issued more public debt with interest in some rising to 35%. Banks were directed to limit withdrawals to 250 pesos per week to avert a bank run, capital restrictions on foreign transfer of funds (corralito) was imposed, and foreign exchange trading was suspended to avert the haemorrhage of foreign exchange and foreign capital out of the country. The country was in full economic crisis at this point. Eventually, the peso was devalued with bank deposits and loans in dollars converted to pesos. The devaluation as well as Argentina's default in paying up due sovereign bonds owing to worsening economic conditions led to the bankruptcy of banks that were significantly exposed to such debts.[72]

In the end, the cocktail of macroeconomic measures including devaluation of the peso, capital controls, forex trading suspension, limiting the total amount that can be withdrawn weekly and sovereign bond restructuring helped to stabilise the economy and improve economic conditions including easing the fiscal burdens on the country. However, these macroeconomic decisions taken in the overall interest of the economy and welfare of the citizens in times of crisis were the subject investment of Arbitration claims. For instance, the sovereign debt restructurings were the subjects of claims in investment arbitration such as *Abaclat v Argentina;*[73] *Uficio v Argentina;*[74] *Postova v Greece*[75] brought by holders of sovereign bond security entitlements (foreign portfolio investments). Also, the Capital Controls measures were challenged by FDI investors in *CMS v Argentina;*[76] and *Continental Casualty v Argentina*[77] etc. It is instructive to note that in all these claims, the status quo was favourable to the foreign investors despite the degeneration of the Argentinian economy because macroeconomic policy change was detrimental to their bottom line. They demanded compensation for such change at the expense of the host State and her people.

1.3.3 Global Economic Distress from Covid-19 Pandemic

In the first quarter of 2020, the World was in the throes of the Covid-19 pandemic.[78] The ease in transmission and wide spread of the Covid-19 led to the adoption by most countries of health and safety policy measures such as social distancing and lockdown measures. Following from the adoption of these measures, economic, social, educational, and professional activities were brought to a halt to stop the spread and flatten the curve.[79] The measures imposed by countries

[72] Barry Eichengreen, *Globalising Capital* (n 2) 209
[73] *Abaclat & Others v. Argentine Republic* ICSID Case No. ARB/07/5 Decision on Jurisdiction and Admissibility (4 August 2011).
[74] *Ambiente Ufficio SPA & Ors v. Argentina* (ICSID Case No. ARB/08/9) Decision on Jurisdiction.
[75] *Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic* ICSID Case No. ARB/13/8 Award (15 April 2015)
[76] *CMS Gas Transmission Company v. The Republic of Argentina* (ICSID Case No. ARB/01/8) Award 12 May 2005
[77] *Continental Casualty Company v. The Argentine Republic* (ICSID Case No. ARB/03/9) Award, 5 September 2008.
[78] Abel Brodeur et al, 'A Literature Review of the Economics of Covid-19' (2021) 35(4) Journal of Economic Survey p 1007.
[79] Ibid 1008.

to stop the spread and transmission of the covid-19 virus not only resulted in a halt in economic activities, but a decline in economic outlook.[80]

The economic implications of these measures ranged from global supply chain disruptions as demand for manufactured goods increased with supply challenges owing to lockdown and social distancing measures,[81] to financial market volatility arising from large capital outflows of portfolio capital.[82] The efforts at flattening the transmission curve brought about the steepening of the macroeconomic recession curve owing to the afore-mentioned economic implications of the lockdown and social distancing policies.[83]

Within emerging and frontier economies, the economic implications were quite significant especially given the decline in oil prices (for exporters), global risk aversion arising from the decline in asset prices and sell-offs in a flight to safety by foreign investors, and the prospect of a global recession.[84] IMF estimates that foreign portfolio equity and debt outflows during this period was more than $100 billion with equity prices falling by 20%. South Africa and Thailand witnessed outflows of more than 1% of their respective GDPs in the first two (2) months of the pandemic.[85]

In response, emerging/frontier economies began to adopt and implement macroeconomic and capital flow management measures to deal with the economic effect of the pandemic and limit its damage. Emerging/frontier economies adopted policies like foreign currency interventions, injection of liquidity into the financial markets and cut in interest rates.[86] The IMF supported these measures, and even went further to recognise the pre-emptive adoption of capital flow measures to stem the haemorrhaging of flows from emerging and frontier economies.[87]

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[80] International Monetary Fund, *Global Financial Stability Report: Markets in the Time of Covid-19* (April 2020) Chapter 1, 1.

[81] Jing Zhou et al, 'Supply disruptions added to inflation and undermined the recovery of 2021' (2021) https://cepr.org/voxeu/columns/supply-disruptions-added-inflation-and-undermined-recovery-2021. Accessed 11/11/2022

[82] International Monetary Fund, *Global Financial Stability Report: Markets in the Time of Covid-19* (April 2020) Chapter 3, 47.

[83] Pierre Olivier Gourinchas, 'Flattening the Pandemic and Recession Curves (2020) https://cepr.org/voxeu/columns/flattening-pandemic-and-recession-curves Accessed 11/11/2022.

[84] International Monetary Fund, *Global Financial Stability Report: Markets in the Time of Covid-19* (April 2020) Chapter 1, 8

[85] Ibid 7-8.

[86] Ibid 2; 21-22.

[87] International Monetary Fund, 'Review of Institutional View on the Liberalisation and Management of Capital Flows' (March 2022) IMF Policy Paper.

However, the supply chain disruptions arising from lockdown increased global inflation resulting in a tightening of global conditions and increase in interest rates in developed economies leading to a slowdown in growth.[88] The effect of this was capital flow reversals in emerging/frontier economies[89] which then necessitated the deployment of macroeconomic measures to stem these outflows. Naturally, these measures will be detrimental to foreign portfolio investments as can be deduced. Consequently, it will be unsurprising if holders of FPI seek to challenge these measures by emerging/frontier economies before investment arbitration. Hence the relevance of this thesis.

1.3.4 Switzerland's Intervention in the Credit Suisse Crisis

An even more recent exercise of macroeconomic and macroprudential policy which is challengeable before investment arbitration can be seen in the Swiss Financial Market Supervisory Authority Decision to write down Credit Suisse' Additional Tier 1 bonds to prevent collapse and forestall systemic risk.[90]

Credit Suisse a systemically important bank had been besieged by scandal and internal crisis for several years. The result of which culminated in the last three (3) months of 2022 where over $110 Billion had been pulled out from the bank by investors and customers. The 1st quarter of 2023 saw the continued outflow of capital which created pressure over a potential run, and collapse of the bank leading to global contagion owing to its connectivity with the major financial markets of the US and the UK. To nip this, the Swiss government through the Financial Market Supervisory Authority (FINMA)[91] and the Swiss National Bank proposed a merger between UBS and Credit Suisse wherein UBS will pay about $3 Billion to Credit Suisse shareholders, and Credit Suisse Additional Tier 1 bonds (AT1) will be written down to zero.[92] To the Swiss government, the collapse of Credit Suisse posed a greater risk to the Swiss nation

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[88] Tightening financial conditions will slow global economic growth and inflation https://www.spglobal.com/marketintelligence/en/mi/research-analysis/tightening-financial-conditions-slow-global-economic-growth.html

[89] Octaviano Canuto, 'Quantitative Tightening and Capital Flows to Emerging Markets' (2022) Policy Centre for the New South Policy Brief PB-42/22 p 7-8. https://www.policycenter.ma/sites/default/files/2022-06/PB_42-22%20%28%20CANUTO%20%29.pdf

[90] George Steer, 'The inside story of Credit Suisse's collapse, by Credit Suisse' *Financial Times* (April 24, 2023) https://www.ft.com/content/857567b8-775c-496a-8578-c7b6419c9c96

[91] https://www.reuters.com/business/finance/switzerlands-secretive-credit-suisse-rescue-rocks-global-finance-2023-03-21/#:~:text=In%20the%20end%2C%20the%20Swiss,hit%20from%20a%20bank%20failure.

[92] Additional Tier 1 (AT1) bonds were created in the aftermath of the Global financial crisis to provide stability for the European Banking System. Subject to their terms and conditions, they can be temporarily or permanently written down during times of crisis.

and global financial stability. Therefore, it resolved to write down the AT1 bonds to facilitate the merger between UBS and Credit Suisse to avert the collapse of Credit Suisse and the incidental crisis that will ensue. To this end, an emergency ordinance was passed to provide the conditions for FINMA to write down the Credit Suisse AT1 bonds. As a result, AT1 bondholders decided to challenge the Swiss government in Investment Arbitration.[93] Most prominent of whom are Singapore based holders of the AT1 bonds.[94] It is instructive to note that within AT1 bonds prospectus, it is not uncommon for it to contain terms and conditions empowering regulators to write down these bonds.[95] At the time of writing, bondholders are planning on challenging Switzerland's macroprudential decision done to avert financial crisis before ICSID despite that by the nature of their portfolio investments, FINMA is empowered to write down these bonds.

1.4 Research Question and Methodology

The research questions which this thesis seeks to resolve are:

1. Whether foreign portfolio investments should be recognised as investments under the International Investment Law regime?

If the answer is yes,

2. To what extent can foreign portfolio investments be protected substantively on the merits under the International Investment Law regime?

To adequately answer these questions will require a combination of legal research methods which are relevant in uncovering what the law is, and in providing additional information for evaluation and gaining a wider context for analysing and enhancing the understanding of the law. To this end, this thesis will rely on doctrinal, interdisciplinary, and historical methods of legal analysis.

Doctrinal analysis or 'Black Letter' analysis requires conducting research and analysis of legal instruments and jurisprudence to resolve legal issues[96]. This demands the ability to search for, examine and critically analyse relevant legal instruments with a view to answering the research

[93] https://www.ft.com/content/6e4f4f02-3d83-4299-a9e0-0725116bfb35#post-ad698fd6-66e1-41e0-ac73-58be694fb27c
[94] Mercedes Ruehl, 'Singapore Bondholders Prepare to Sue Switzerland Over Credit Suisse' *Financial Times* (April 20, 2023) https://www.ft.com/content/438fa6de-92f8-4d41-a169-c7e9ecada1bd
[95] https://www.legalbusiness.co.uk/blogs/pallas-partners-files-suits-against-swiss-regulator-over-credit-suisse-bond-write-down/.
[96] Edward L. Rubin, 'Law and the Methodology of Law' (1997) Wisconsin Law Review 525

questions. Doctrinal methodology is relevant to answering both research questions of this thesis. This is because it will require examining, interpreting, and analysing multilateral and bilateral international instruments such as:

1. the Convention on the Settlement of Investment Disputes[97] (ICSID Convention), to determine if foreign portfolio investments are investments under Article 25, and its Preamble.
2. the Vienna Convention on the Law of Treaties (VCLT),[98] to determine how to interpret the meaning of investment under the ICSID convention and Bilateral Investment Treaties; as well as to determine if emerging and frontier economies can rely on the fundamental change of circumstances safeguard under Article 62 VCLT;[99]
3. Bilateral Investment Treaties between emerging and frontier economies and developed economies to know what kind investments, constitute investments;
4. substantive protection provisions within Bilateral Investment Treaties between emerging and frontier economies and developed economies, to know how protective they are; and
5. Exception/Safeguard provisions within Bilateral Investment Treaties between emerging and frontier economies and developed economies.

The Doctrinal methodology will also require the examination and analysis of investment arbitration jurisprudence on the meaning of investments, particularly whether portfolio investments are investments such as *Abaclat v Argentina;*[100] *Uficio v Argentina;*[101] etc; as well as jurisprudence on the Fair and Equitable Treatment standard,[102] Transfer of Funds standard,[103] and exceptions[104] to know how protective they may be of foreign portfolio investments.

[97] Convention on the Settlement of Investment Disputes between States and Nationals of other States 1965, 575 UNTS 159.
[98] United Nations, Vienna Convention on the Law of Treaties, 23 May 1969, United Nations, Treaty Series, vol. 1155 Entry into force: 27 January 1980, Articles 31 & 32
[99] United Nations, Vienna Convention on the Law of Treaties, 23 May 1969, United Nations, Treaty Series, vol. 1155, Article 62(1).
[100] *Abaclat & Others v. Argentine Republic* ICSID Case No. ARB/07/5 Decision on Jurisdiction and Admissibility (4 August 2011)
[101] *Ambiente Ufficio SPA & Ors v. Argentina* (ICSID Case No. ARB/08/9) Decision on Jurisdiction
[102] *Waste Management, Inc. v. United Mexican States* ("Number 2") (ICSID Case No. ARB (AF)/00/3) Award 30 April 2004.
[103] *Gruslin v. Malaysia* ICSID Case No. ARB/99/3 Award (27 November 2000)
[104] *Continental Casualty Company v. The Argentine Republic* (ICSID Case No. ARB/03/9) Award, 5 September 2008

This thesis traverses the intersections between finance, economics, and international investment law. As a result, it requires the consumption and digestion of finance and economics resources relevant to understanding the concepts at play to wit: foreign portfolio investments and macroeconomic policies, and how they affect each other. An interdisciplinary methodology[105] is relevant in answering both research questions of this thesis because it provides additional information from finance and economics on what foreign portfolio investments are, their short-term and volatile nature,[106] their sensitivity to macroeconomic conditions and policies for their movements[107], their capacity to distress and destabilise an economy due to their boom-bust cyclical nature,[108] and their herd behaviour.[109] This is necessary in providing context in answering the question of whether they should be seen as investment for protection, and to what extent should State measures be deemed to have breached the substantive standards of protection, especially in view of the necessity of such measures. Additionally, the thesis will draw from case studies on economic and financial crisis such as the Asian Financial Crisis and the Argentine Economic Crisis to demonstrate the macroeconomic effects foreign portfolio investments have on crisis, and how macroeconomic measures are necessary to achieve equilibrium.

The Historical methodology is also relevant in answering the first question, because it aids in exposing the history of portfolio investments and the changing attitudes towards their regulation. It demonstrates how foreign portfolio investment risks were managed by Merchant Banks and the Corporation of Foreign Bondholders. It also illustrates how the investment regime was geared towards direct investment protection in terms of protection foreign direct assets, but the entrenchment of capital account liberalisation in Bilateral Investment Treaties through broad definitions of investments seemingly extended protection to foreign portfolio investments.

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[105] Douglas W. Vick, 'Interdisciplinarity and the Discipline of Law' (2004) 31(2) Journal of Law and Society 163, 164-165.
[106] United Nations Conference on Trade and Development (UNCTAD), *Trade and Development Report* (1999) 112.
[107] William Sharpe, 'Risk, Market Sensitivity and Diversification' (1972) 28(1) Financial Analyst Journal 74; G. K. Gumus, A. Duru & B. Gungor, 'The Relationship between Foreign portfolio investments and Macroeconomic Variables' (2013) 9(34) European Scientific Journal.
[108] Ricardo Hausmann & Eduardo Fernandez Arias, 'Foreign Direct Investment: Good Cholesterol?' (n 4) 3
[109] David S. Scharfstein & Jeremy C. Stein, 'Herd Behaviour and Investment '(1990) 80(3) The American Economic Review 465; Robert J Shiller, 'From Efficient Market Theory to Behavioural Finance' (2003) COWLES Foundation Paper 1055.

1.5 Scope of Study

The subject matter scope of this thesis borders on the interaction between foreign portfolio investment (FPI) and international investment law. This thesis focuses on BITs/Investment Chapters between developed and emerging/frontier economies with broad definitions of investment. For instance, in the course the thesis, we will encounter BITs like the Bangladesh – US BIT, which defines an investment in Article 1(c) as:

> (c) "Investment" means every kind of investment owned or controlled directly or indirectly, including equity, debt; and service and investment contracts; and includes;
>
> (i) tangible and intangible property, including rights, such as mortgages, liens and pledges;
> (ii) a company or shares, stock, or other interests in a company or interests in the assets thereof;
> (iii) a claim to money or a claim to performance having economic value, and associated with an investment;
> (iv) Intellectual property, including rights with respect copyrights and related patents, trade marks and trade names, industrial designs, trade secrets and know-how, and goodwill.
> (v) Licenses and permits issued pursuant to law, including those issued for manufacture and sale of products.
> (vi) any right conferred by law or contract, including rights to search for or utilize natural resources, and rights to manufacture, use and sell products; and
> (vii) returns which are reinvested.
>
> Any alteration of the form in which assets are invested or reinvested shall not affect their character as investment.

This thesis does not focus on BITs/Investment Chapters which expressly excludes foreign portfolio investments, but it refers to them for analytical and comparative purposes where relevant.

There is no consensus on the definition of foreign portfolio investments. Bearing this in mind, Mira Wilkins[110] did a deep dive into various definitions of foreign portfolio investment to uncover the difficulties in consensus. However, the broadest definition that could be gleaned was all investments going into a host state, whether long term or short-term investments[111], that are not classified as FDI.[112] Thus, if it is not FDI, it is foreign portfolio investment. The problem with this is that it would include foreign aid and official flows which though may be invested in assets, does not create an obligation to pay dividend or interest to a foreign investor.[113] Others have limited foreign portfolio investment to only equity and equity-like

[110] Mira Wilkins, 'Two literatures, two storylines: is a general paradigm of foreign portfolio and foreign direct investment feasible?' (1999) 8(1) Transnational Corporations 57

[111] Long-term investments are investments where the original maturity is more than one year or no stated maturity, while short-term investments refer to where the original maturity is one year or less, or on demand

[112] Roy Ruffin & Farhad Rassekh, 'The Role of Foreign Direct Investment in US Capital Outflows' (1986) 76 American Economic Review 1126-1130.

[113] Mira Wilkins, 'Two Literatures, two storylines:' (n 110) 57.

capital flows[114] but excludes debts (bonds and loans) from their categorization.[115] However, the International Monetary Fund (IMF) considers as foreign portfolio investment: equity securities; debt securities in the form of bonds and notes; money market instruments; and financial derivatives such as options, regardless of whether they constitute short term or long term investment; but excluding instruments that fall under direct investments.[116] For consistency, and to ensure coherence within international economic law, this thesis will adopt the IMF definition with minor modifications from the United Nations Conference on Trade and Development.[117]

Consequently, for the purpose of this thesis, a foreign portfolio investment is **any financial investment in debt security entitlements (bonds), equity securities evidenced in shares/units less than 10%, and options, which the investor *intends to be a passive, short-term held investment for dividends, coupons/yields, capital gains through speculation, carry-trade, and foreign exchange arbitrage*.** Usually but not always, the investor does not have experiential knowledge of the operations of the firm or government, rather reliance is had to financial statements, annual reports, investment reports, advice from financial intermediaries[118] and herd behaviour for acquisition and sale. Also, the investment involves a largely anonymous relationship between the issuers and holders and possesses a degree of market liquidity.[119]

The scope of this work does not include shareholder direct and reflective losses claims. This is because, this thesis focuses on host State macroeconomic measures that has systematic/market effects, rather than idiosyncratic effects on a specific firm which is usually the remit in shareholder claims. Shareholder claims involves the right of standing of shareholders to claim

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[114] Stijn Claessens et al, 'Portfolio Capital Flows; "Hot or Cold" (1995) 91 World Bank Economic Review 153-174.

[115]K. Krabaeva & A. Razin, 'Composition of International Capital Flows: A Survey' in Gerard Caprio et al eds., *The Evidence, and Impact of Financial Globalisation* Vol 3. (Elsevier Inc, 2013) 106

[116] International Monetary Fund, *Balance of Payment Manual* BPM6 (IMF 6th edn, 2010) 91.

[117] According to United Nations Conference on Trade and Development (UNCTAD), *Trade and Development Report* (1998), 'volatile flows are driven by international arbitrage opportunities arising from large international interest-rate differentials and by prospects of short-term capital gains.' See also, United Nations Conference on Trade and Development (UNCTAD), *Trade and Development Report* (1999) 112.

[118] International Monetary Fund, *Balance of Payment Manual* BPM6 (IMF 6th edn, 2010) 91; See also Jun Wu et al, 'Foreign Direct Investment vs Foreign Portfolio Investment: The Effect of the Governance Environment (2012) 52 Management International Review 645.

[119] Market liquidity is the extent to which an asset can be bought and sold quickly based on the number of buyers and sellers present in the market. See, IMF, 'Functional Categories' in IMF *Balance of Payment and International Investment Position Manual* (Chapter 6) https://www.imf.org/external/pubs/ft/bop/2007/pdf/chap6.pdf 12

for injury to shareholder rights like right to vote, or injury to Company (reflective losses).[120] Secondly, this thesis focuses on whether foreign portfolio investments are investments i.e., *Jurisdiction rationes materiae;* and how protective the substantive protection standards are on the merit? Owing to time and space, it does not deal with the question of who an investor is, and what are their rights of standing? Which is where more or less the issue of shareholder claims falls under. However, this question of *jurisidtction rationes personae* will constitute 'future work' which will be examined subsequently in this thesis. Regardless, it must be stated that the Shareholder claims that were considered during research involved shareholders with more than 10% of direct or indirect equity interest, which automatically rules them out as foreign portfolio investments, and from the scope of this work.[121] Additionally, a finding that foreign portfolio investments are not investments will render moot a question of investor's right of standing.

The geographical scope of this thesis is emerging and frontier markets[122]. The reason for this is that since the turn of the new millennium, international capital flow into emerging and frontier economies grew significantly owing to improved economic prospects for higher returns, though with less developed market and institutions. In the past ten years, foreign portfolio investors investments in emerging and frontier economies financial assets have increased significantly.[123] For instance, foreign portfolio investment flows into frontier economies like Nigeria accounted for about 2.7% of GDP as of 2012.[124] However, these flows

[120] David Gaukrodger, 'Investment Treaties and Shareholder Claims: Analysis of Treaty Practice' (2014) OECD Working Papers on International Investments 2014/03. Ordinarily in Corporate Law, shareholders are denied claims for reflective losses however, Investment Arbitration seems to allow such claims. There has been calls for a review of that approach. See Shareholder Claims for Reflective Loss in Investment State Dispute Settlement: A "Component-by-Component" Approach to Reform Proposals (December 2021) OECD Informal Discussion Paper.

[121] *Webuild S.p.A. (formerly Salini Impregilo S.p.A.) v. Argentine Republic*, Decision on Jurisdiction and Admissibility, (23 Feb. 2018; *BG Plc v Argentina*, Award, (24 Dec. 2007). etc

[122] An Emerging Market is a capital market in a developing country with high growth expectation, characterized by high level of risk and volatility but with possibility of high returns. A frontier market is also a capital market in a developing country, but it is less established compared to an emerging market because of its size, higher risk, and lower liquidity, though owing to its potential for long term growth they are attractive to foreign investors. See generally, Morgan Stanley Capital International (MSCI), Market Classification https://www.msci.com/market-classification. Emerging markets include Argentina, Brazil, Bulgaria, Chile, Colombia, Czech Republic, India, Indonesia, Israel, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Turkey, and United Arab Emirates. Frontier markets include Angola, Belarus, Costa Rica, Dominican Republic, Ecuador, Egypt, El Salvador, Georgia, Ghana, Guatemala, Jamaica, Jordan, Mongolia, Mozambique, Namibia, Nigeria, Pakistan, Paraguay, Sri Lanka, and Tanzania. See IMF Global Financial Stability Report on Covid 19 (April 2020) Online Annex to Chapter 3 p 20.

[123] International Monetary Fund, *Global Financial Stability Report: Markets in the Time of Covid-19* (April 2020) Chapter 3, 48.

[124] Trevor Alleyne, Mauro Mecagni et al, *Managing Volatile Capital Flows: Experiences and Lessons for Sub-Saharan African Frontier Markets* (IMF Washington D.C, 2014). 4.

into emerging, and particularly frontier economies have been volatile. Since 2013, FPI inflows have been shorter, while FPI outflows have sustained for longer periods.[125] Owing to these FPI sell-offs especially during the tightening of financial conditions following distress arising from situations such as the pandemic, emerging and frontier economies will have to deal with the capital flows, as well as adjust their macroeconomic situations to prevent, or manage crisis. Where these measures affect international investment law protected FPI, they can be challenged in investment arbitration to the detriment of emerging and frontier economies' policy space, and socio-economic wellbeing.

1.6 Original Contribution to Knowledge and Impact

There is little existing research on the interaction between foreign portfolio investment (FPI) and international investment law. However, the available research primarily centres on the threshold question of whether foreign portfolio investments are investments under international investment law. Jeswald Salacuse also contended that by virtue of broad asset-based definitions of an 'investment' in BITs, portfolio investments are investments and subject to BIT protection.[126] Julian Mortenson while exploring the *Travaux* of ICSID to determine the meaning of Investment under ICSID contended that since the drafters of the Convention refused to include a definition of an investment, they intended for a wide definition of investments which includes portfolio investments which were incidentally sought to be excluded by developing States but denied.[127] Similarly, Michail Dekastros argued for a reconceptualisation of the meaning of investment within ICSID convention. Michail Dekastros argued that the tribunal interpretations of the meaning of investment were analytically weak because they were inconsistent with the provisions of the ICSID convention. He argued that both from an economic point of view, and the interpretation of the ICSID convention, portfolio investments are investments and ought to enjoy international investment law protection.[128]

Initially, Sornarajah considered arguments for and against protecting portfolio investments, and concluded that the decision either to protect or not to protect will depend on the attitude of the

[125] International Monetary Fund, *Global Financial Stability Report: Markets in the Time of Covid-19* (April 2020) Chapter 3 p 50.
[126] Jeswald Salacuse, *The Law of Investment Treaties* (OUP, 2015) 163.
[127] Julian Mortenson, 'The Meaning of "Investment": ICSID's Travaux and the Domain of International Investment Law [2010] 51 Harvard International Law Journal 257-298.
[128] Michail Dekastros, 'Portfolio Investment: Reconceptualising the Notion of Investment under the ICSID Convention' (2013) The Journal of World Investment and Trade 286.

tribunal towards portfolio investments.[129] However, he eventually argued against protection. M. Sornarajah contends that portfolio investments are not investments and should be denied treaty protection. He contends that their beneficial effect is not sufficient to warrant protection because their reversibility can precipitate crisis.[130] He goes on to say that from a policy point of view, they ought not to be covered under ICSID because they do not satisfy the characteristics of foreign investment deserving protection under ICSID.[131] Similarly, Giorgio Risso, argues for the exclusion of portfolio investments from ICSID protection on the basis of the uncertainty over their contribution to development credentials. He concedes that there are instances where portfolio investments may contribute to development, consequently the issue of contribution must be taken on a case-by-case basis with the other typical characteristics being deployed to evaluate the impact of the portfolio investment on development.[132] Finally, Michael Waibel, argues against the recognition of sovereign bonds as investments. He contends that sovereign bonds, which are a category of portfolio investments are commercial transactions governed by domestic law. No privity exists between the State and the bondholders, but between the State and intermediaries, and sovereign bonds are tradable at the secondary market. He further argued that sovereign bonds are not investments under Article 25 of ICSID because they do not meet the typical characteristics of an investment. Additionally, even if the BIT lists sovereign bonds as an investment, it remains immaterial since BITs cannot extend ICSID jurisdiction.[133]

After reviewing the existing research on the intersection between foreign portfolio investment and international investment law, this thesis discovered the following gaps in knowledge that it attempts to fill. Firstly, aside Girogio Risso, no attempt was made to define in depth the scope of what foreign portfolio investments is. This thesis goes further in curating existing definitions. It adopts a workable definition for its analysis that is consistent and coherent with international economic law and considers the nature of foreign portfolio investments, which forms the basis for exclusion, such as its capacity for speculation, carry-trade transactions, and search for arbitrage.

[129] M. Sornarajah, 'Portfolio Investments and Definition of Investment' (2009) ICSID Review - Foreign Investment Law Journal.
[130] M. Sornarajah, *The International law on Foreign Investments* (CUP, 2010) 196-197
[131] Ibid 314-315.
[132] Giorgio Risso, 'Portfolio Investment in ICSID Arbitration: Just A Matter of Consent?' (2020) 37(3) Journal of International Arbitration.
[133] Michael Waibel, 'Opening Pandora's Box: Sovereign Bonds in International Arbitration (2007) 101 American Journal of International Law.

Secondly, aside M. Sornarajah who mentions it without going further, no other work explored in depth the disequilibrating and disruptive capacity of FPI. Though Michael Waibel pointed out the effect holdout actions can have if protected. This thesis explores the nature and disruptive tendency of FPI in terms of its involvement in boom-bust cycles. It demonstrates that foreign portfolio investments are complex financial assets which are sensitive to host State macroeconomic measures, and FPI sensitivity to macroeconomic measures can determine whether they (FPI) experience loss of value or profit. FPI sensitivity to macroeconomic conditions, results in its volatility. This volatility is what makes FPI potentially dangerous. Therefore, this thesis argues that protecting FPI will aggravate the FPI volatility, ensure macroeconomic constriction, and affect economic development.

Thirdly, most of the researchers in this space have focused on the meaning of investments generally, and in their analysis did not consider that protecting FPI will put host States especially emerging and frontier economies macroeconomic policy space at risk; and that the effect will be policymaking constriction which will be detrimental to the economy in terms of crisis resolution, growth, and development. This is because the measures at risk of challenge before investment arbitration are host State macroeconomic and capital flow management policies. Therefore, defining 'investment' to include FPI where they suffer losses from State macroeconomic measures will frustrate financial/economic crises prevention or mitigation, and truncate economic development of the State contrary to the objectives of the Preamble, and Article 25 of ICSID convention.

Finally, aside Michael Waibel, none of the other works considered the substantive protection standards in relation to how protective they may be for FPI. Michael Waibel briefly evaluated the likelihood of succeeding in relation to sovereign bonds. He considered Fair and Equitable Treatment, National Treatment, Most Favoured Nation treatment and Expropriation. Meanwhile, this thesis extensively examines the Fair and Equitable Treatment (FET) standard, which is the most common standard, the Transfer of Funds standard which is hardly considered and Most favoured Nation Treatment standard in relation to FPI protection. It finds that these protection standards are likely to fall short in protecting FPI. For instance, FET is amorphous with different elements. FET as minimum standard of treatment will be a lot difficult to establish because of the high threshold for egregiousness, while FET as Legitimate Expectation will require the claimant to establish express guarantees which led to undertaking the investment etc. Additionally, claimants will have to contend with specific and general exceptions where present, and where absent, this thesis suggests reliance on proportionality analysis which is an interpretative and analytical tool currently applied within International Law institutions like the World Trade Organisation, European Court on Human Rights etc, to deal with disputes concerning competing rights of investors and host States.

Given that the geographical scope of this thesis is emerging and frontier economies, the thesis will have the most relevance within those economies, though it is relevant to global investment law and policymaking. From the findings of this thesis, there has been large volume of capital flows in and out of emerging and frontier economies in the last 10 years, with most foreign capital outflows taking place in the wake of the Covid pandemic, and global economic tightening. As a result of this, macroeconomic and capital flow management measures were taken to curb the flow, to avoid economic distress and crisis. Following from this, emerging/frontier economies will be made aware that most of their extant BITs/Investment Chapters contains clauses that entrenches the most extreme forms of capital liberalisation arising from the broad definitions of investments which allows portfolio investment protection, and enforcement through Investor -State Arbitration. Consequently, emerging and frontier economies are at risk of their macroeconomic and capital flow management measures including those undertaken most recently in the wake of the Covid-19 pandemic being challenged by foreign portfolio investors for perceived breaches of BIT standards of protection. Nonetheless, this thesis proffers law and policy solutions which could be adopted by emerging and frontier economies to ensure they are not crushed by the yoke of extreme capital flow liberalisation perpetuated by the international investment law regime.

1.7 Chapter Breakdown

Chapter One introduces the Thesis. It identifies the policy reasons why foreign portfolio investments should not be protected by foreign investment law, especially its effect on macroeconomic policy-making; and briefly discusses the procedural and substantive foreign investment law limitations to extending protection to foreign portfolio investments which will be fully unpacked in this thesis. It references real-world instances to underscore the necessity for host state flexibility. Chapter One also sets out the scope of the Thesis and its relevance and contribution to knowledge.

Chapter Two goes on to demonstrate that foreign portfolio investments are volatile assets, and sensitive to macroeconomic conditions. It argues that extending foreign investment protection to foreign portfolio investments will expose emerging and frontier economies' macroeconomic policies and policymaking to investment arbitration review. To do this, the Chapter highlights the nature and differences between foreign direct investment and foreign portfolio investment. It discusses the drivers influencing foreign portfolio investment movements, particularly macroeconomic factors and how these macroeconomic factors may bring about volatility and market risks. It then concludes that extending protection to foreign portfolio investments will only make the macroeconomic policy choices the subject of investment claims.

Chapter Three traces the alternating evolution of the norms and rules in international capital movements from regulated to liberalised to regulated. It examines why capital liberalisation was adopted and promoted by the developed countries through organisations like the EU, OECD, and the IMF, and how it subsequently became absorbed within the international investment regime of developed and emerging and frontier markets reflected in their Bilateral Investment Treaty (BIT) practice. The Chapter reveals that capital liberalisation are expressed in BITs/Investment Chapters of Trade Agreements through broad definitions of investment which can be interpreted to allow short term and speculative portfolio investments to be considered as investments, as well as in unrestricted movement of funds clauses with no State policy space safeguards in the event of crisis. The Chapter contends that such blanket recognition of investments without restrictions is flawed because it recognises and protects all capital movements by default which will include portfolio in search of high interests even though such types of capital are potentially detrimental to the economy. Additionally, it confers foreign portfolio investments with rights to challenge host State macroeconomic measures which carries dire economic and social implications for emerging and frontier economies.

Chapter Four considers the meaning of 'investment' under the Convention for the Settlement of Investment Disputes,[134] and in Bilateral Investment Treaties without ICSID. In relation to ICSID. It argues against a BIT party autonomy definition of 'investment' because it is this narrative of BIT deference that has led to the expansion of the meaning of investment to encompass foreign portfolio investments. Rather, the Chapter supports a definition of

[134] Convention on the Settlement of Investment Disputes between States and Nationals of other States 1965, 575 UNTS 159.

investment under Article 25(1) of the ICSID convention consistent with the object and purpose of ICSID (ICSID consent). It contends that extending ICSID coverage to volatile foreign portfolio investments with doubtful economic growth credentials, yet sensitive to macroeconomic conditions will expose the State to challenges of its macroeconomic policies. The access of macroeconomic policies for review can only result in undermining host State economic development contrary to the objectives of ICSID contained in the preamble. Therefore, it contends that owing to the volatility of portfolio investments, and the direct impact portfolio claims can have on a host State's economic policymaking, especially macroeconomic policies amidst crisis, it ought not to be conceived of as an investment, and consequentially, protected because of the effect on economic growth and development. Regarding BITs without ICSID, it is contended that emerging/frontier economies may argue for the application of the typical characteristics test to determine if FPIs are investments, or Article 31(3)(b) of the Vienna Convention on the Law of Treaties may be construed to recognise subsequent unilateral practice of emerging/frontier economies expressly excluding foreign portfolio investments from BITs, as satisfying the requirements of subsequent state practice.

Chapter Five zooms in on the Fair and Equitable substantive standard of protection and its applicability to portfolio investment protection on the merit. It argues that host State macroeconomic measures deployed to avert or mitigate economic and financial crisis which may incidentally affect foreign portfolio investments, may not to be in breach of the Fair and Equitable Treatment (FET) standard of protection. This is because in several cases the circumstances of each case, and context of each situation (such as the economic condition of the host State) are usually considered by the tribunals when denying FET protection. Am evaluation of the requirements of each constituent of FET demonstrates that an FPI challenge of macroeconomic policies ought not to succeed. Additionally, most US and Canadian treaties contains a stricter standard where FET is tied to the minimum standard of treatment under customary international law. Thus, it places a higher threshold which foreign portfolio investors may be unable to meet.

Chapter Six assesses the applicability of the Transfer of Funds clause to portfolio investment protection on the merit. It reveals that in a bid to attract foreign capital, emerging and frontier economies adopted capital liberalisation and entrenched it in BITs by guaranteeing portfolio investments unrestricted transfer rights in relation to capital gains, dividends, and interest payments without safeguards/exceptions in most BITs, even though these investments have destabilising effects and are mostly unconnected to the State. However, some BITs contain specialised exceptions which forms part of the transfer clause. This Chapter contends that where specialised exceptions are contained in transfer of fund clauses in BITs/Investment Chapters, they tend to confer space for macroeconomic flexibility in terms of imposing transfer restrictions on capital and current account convertibility in times of economic crisis, or in accordance with domestic law. It contends that sometimes these specialised exceptions contained in the transfer of funds clauses provides more extensive policy safeguards than for instance, International Monetary Fund (IMF) because they may allow for current account restrictions. Finally, the Chapter considers policy options to deal with unrestricted transfer of funds clauses without safeguards such as expressly excluding them. However, the Most Favoured Nation (MFN) clause where present can render such exclusion pointless.

Chapter Seven examines other means and options for macroeconomic flexibility which are relevant and applicable under investment arbitration. The Chapter considers the customary international law plea of necessity; plea of fundamental change of circumstances codified under Article 62 of the Vienna Convention on the Law of Treaties; non precluded measure clauses in BITs/Investment Chapters and proportionality analysis to identify the best option for host State macroeconomic policy flexibility. It is contended that where safeguards exist in the form of general and/or specialised exceptions (non-precluded measures) clauses within BITs/Investment Chapter, macroeconomic measures affecting foreign portfolio investments can be justified. This is plausible through the analysis of exceptions with necessity requirements based on the 'Least Restrictive Means' approach within proportionality analysis. This is to determine whether a contested host State macroeconomic measure is the most objectively necessary means to effectively achieving its objective, or whether an equally effective but lesser restrictive alternative is available. However, where no exception is contained in BITs/Investment Chapters, which happens to be the case in most BITs, this Chapter argues that a general proportionality analysis approach should be adopted. This s because a proportionality analysis will demand a consideration of the objectives and purpose of the macroeconomic measure in issue towards a balancing of private rights with public welfare.

Chapter Eight concludes the thesis.

Chapter Two

Macroeconomic Policy and the Nature, Drivers and Volatility of Foreign Portfolio Investments

2.0 Introduction

Foreign portfolio investments are highly volatile, and sensitive to macroeconomic policies and change,[1] as well as natural disasters such as the Covid-19 pandemic,[2] and man-made disasters such as the War in Ukraine.[3] Owing to this sensitivity and volatility, international investment law protection of foreign portfolio investments will open host States macroeconomic policies especially in times of crisis, to investment arbitration challenges which can have dire consequences for the wellbeing of the State especially emerging and frontier economies.

The world has witnessed rapid growth in the movement of international capital such as foreign direct investment (FDI) and foreign portfolio investments, from industrialised developed economies to emerging and frontier economies in Africa, Asia, the Middle East, and South America.[4] Low yield in industrialised economies in contrast to the potential for sizable returns on investments in emerging and frontier markets explains the shift in international capital movement from developed to emerging economies.[5] Initially, FDI was at the forefront of global capital movement.[6] However at the close of 2000,[7] foreign portfolio investments,[8] also known as foreign securities or international portfolio investments caught up, and outpaced foreign

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[1] G. K. Gumus, A. Duru & B. Gungor, 'The Relationship between Foreign portfolio investments and Macroeconomic Variables' (2013) 9(34) European Scientific Journal 209, 210-212.

[2] M. Giofré. 'COVID-19 stringency measures and foreign investment: An early assessment' (2021) The North American Journal of Economics and Finance 58.

[3] Eastern European emerging economies such as Serbia were substantially affected by the Russian invasion. See OECD, 'International investment implications of Russia's war against Ukraine' (4 May 2022) OECD Policy Responses: Ukraine Tackling the Policy Challenges 3.

[4] Yilmaz Akyuz, 'Capital Flows to Developing Countries in a Historical Perspective: Will the Current Boom end with a Bust?' (2011) South Centre Research Paper 37, 1

[5] Chukwuemeka P. Ekeocha et al, 'Modelling the Long Run Determinants of Foreign portfolio investments in Nigeria' (2012) 3(8) Journal of Economics and Sustainable Development 195; A. Siamwalla et al, 'Foreign Capital Flow to Thailand: Determinants and Impacts' (1999) Thailand Development Research Institute.

[6] Bartram M Sohnke & Gunter Dufey, 'International Portfolio Investment: Theory, Evidence and Institutional Framework' (2001) WBS Finance Group Research Paper No. 8, 1.

[7] At the end of 2000, the world's total Foreign Portfolio Investment amounted to US$1,561 billion and FDI amounted to US$1,301 billion. See, International Monetary Fund, (IMF) Balance of Payments Yearbook, Parts I, II and III. Washington, DC, 2001: 64, 70.

[8] Foreign Portfolio Investment (FPI) is a category of international capital which involves the acquisition of intangible financial assets like non-controlling interests in shares, and bonds across borders in search of profits. However, for the purpose of this thesis, FPI is 'any financial investment in debt security entitlements (bonds), equity securities evidenced in shares/units less than 10%, and options, which the investor intends to be a passive, short-term held investment for dividends, coupons/yields, capital gains through speculation, carry-trade, and foreign exchange arbitrage.'

direct investments in goods and services. Since then, foreign portfolio investment has consistently maintained this lead except in 2008 and 2018.[9] In 2020, owing to the Covid 19 pandemic total global FDI stood at about $399 billion which represents a 49% drop from 2019,[10] while foreign portfolio investment has undulated up and down following the initial sell-off in reaction to Covid.[11] However, owing to macroeconomic monetary policies adopted by Central Banks such easing controls on inflows,[12] foreign portfolio investment flows are beginning to recover.[13]

Currently, capital globalization, seen in the movement to a free-market infrastructure and advancements in information communication technology takes credit for the rapid increase in foreign portfolio investment movements.[14] Asset prices information are more readily and cheaply available in real time, which has led to a seemingly more 'efficient financial markets'.[15] Individuals with little to no expertise, can have access to foreign portfolio investments at the palm of their hands thanks to the proliferation of online brokerage platforms[16] offering DIY investing. Furthermore, emerging and frontier markets' economic policy changes from a centralized standpoint, to capital market liberalization,[17] as well as the abandonment of currency exchange/capital controls in some economies also incentivised unrestricted global foreign portfolio investment flows.[18] Sohnke and Dufey holds that population disparities among countries of different income classes also contributes to the increase in foreign portfolio investment movements.[19] According to them, developed countries with increasing older population possess a greater need for private capital accumulation in the form of pensions. Thus, investments in capital markets within emerging and frontier markets

[9] See UNCTAD, *World Investment Report: Investment and New Industrial Policies* (2018) 11-12; UNCTAD, *World Investment Report: Special Economic Zones* (2019) 11.
[10] UNCTAD Investment Trends Monitor Issue 36 (27 October 2020).
[11] Sundar Sethuraman, 'Foreign Portfolio Flows in 2020 turns Positive after Covid 19 Jitters' *Business Standard* 12 August 2020 https://www.business-standard.com/article/markets/foreign portfolio investment-flows-in-2020-turn-positive-thanks-to-stimulus-action-by-central-banks-120081200320_1.html
[12] Like India and Peru. See, https://www.oecd.org/coronavirus/policy-responses/oecd-investment-policy-responses-to-covid-19-4be0254d/ 10/10/2022.
[13] Ibid.
[14] Martin Feldstein, *International Capital Flows* (University of Chicago Press, 1999). 1
[15] Steven L. Jones & Jeffry M. Netter, 'Efficient Capital Markets' https://www.econlib.org/library/Enc/EfficientCapitalMarkets.html; Eugene F. Fama, 'Efficient Capital Markets: A Review of Empirical Work' (1970) 25(2) Journal of Finance.
[16] Such as Trading 212, Robinhood, Hargreaves Lansdown etc.
[17] Martin Feldstein, *International Capital Flows* (n 14)
[18] Bartram M Sohnke & Gunter Dufey, 'International Portfolio Investment: Theory, Evidence and Institutional Framework' (2001) WBS Finance Group Research Paper No. 8, 2.
[19] Ibid.

in Asia, South America, and Africa,[20] serve as appropriate investment destinations owing to their prospect for higher returns.[21] Following the belief that emerging and frontier markets with their relatively young population requires high levels of investments to create jobs and raise the standard of living,[22] they also present a higher risk/higher reward dynamic.[23]

Instructively, emerging and frontier markets adopt more flexible macroeconomic policies such as foreign exchange policies, interest rates policies, sovereign debt repayment policies etc., because of the state of their economic and financial development. As a result, they adopt a cocktail of macroeconomic policies (monetary and fiscal) to attract and improve the quantity of their investments rather than quality.[24] The effect is massive capital movement, especially of unregulated foreign portfolio capital which can lead to economic and financial crisis such as was the case in the Asian Financial Crisis etc., owing to the volatility of foreign portfolio investments arising from its high sensitivity to macroeconomic policy changes.[25]

The macroeconomic changes inevitably contribute to high portfolio volatility which poses a higher risk of loss to foreign portfolio investors at worst, and higher rewards at best. For instance, a change to low interest rates has a positive effect on equity foreign portfolio investors, and for long-term bond investors because if the bondholders choose to sell, it will be at a premium[26]. The reverse will be the case if interest rates are increased. Meanwhile, public expenditure policies on restructuring of public debt repayment are terrible for holders of sovereign bond security interests.

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[20] An Emerging Market is a capital market in a developing country with high growth expectations, characterized by a high level of risk and volatility but with the possibility of high returns. Examples of emerging markets in Africa are Egypt and South Africa. A frontier market is also a capital market in a developing country, but it is less established compared to an emerging market because of its size, higher risk, and lower liquidity, though owing to its potential for long-term growth they are attractive to foreign investors. Examples of frontier markets in Africa include Nigeria, Kenya and Morocco. See generally, Morgan Stanley Capital International (MSCI), Market Classification https://www.msci.com/market-classification

[21] Trevor Alleyne, Mauro Mecagni et al, *Managing Volatile Capital Flows: Experiences and Lessons for Sub-Saharan African Frontier Markets* (IMF Washington D.C, 2014).

[22] Bartram M Sohnke & Gunter Dufey, 'International Portfolio Investment' (n 18).

[23] Livia Yap & Courcoulas, 'What Are Frontier Markets and Why Invest in Them' Bloomberg 8 July 2020 https://www.bloomberg.com/news/articles/2020-07-08/what-are-frontier-markets-and-why-invest-in-them-quicktake. Accessed 30/09/2020.

[24] Barry Eichengreen, *Globalising Capital: A History of the International Monetary System* (Princeton University Press 2nd edn, 2008) 196.

[25] FDI and FPI: Making Sense of It All (investopedia.com) Accessed 04.10.2022

[26] Long-term bonds will usually have a higher interest rate compared to the new interest rate, which is lower, thus it will be more valuable than new bonds with lower interest rates. See, 'How does rates affect performance' https://global.pimco.com/en-gbl/marketintelligence/navigating-interest-rates/how-do-rates-affect-bond-performance#:~:text=In%20the%20short%20run%2C%20rising,new%20bonds%20with%20higher%20yields.a

Consequently, this chapter will demonstrate that foreign portfolio investments are volatile assets, and sensitive to macroeconomic conditions. Thus, extending foreign investment arbitration protection to them will expose host State macroeconomic policies and policymaking to investment arbitration review. To do this, the Chapter will highlight the nature and differences between FDI and foreign portfolio investment. It will discuss the drivers influencing foreign portfolio investment movements, particularly macroeconomic factors and how these macroeconomic factors may bring about volatility and market risks. Extending protection will only make these macroeconomic choices the subject of investment claims. To this end, this chapter is divided into four (4) parts. Part A examines the nature of foreign direct investments and its determinants. Part B considers the nature, history, types, benefits, and risks of foreign portfolio investment. Part C examines the role of macroeconomics in determining foreign portfolio investment flow and volatility, and the risks posed by FPI. Part D concludes.

PART A

2.1 Analysis of Foreign Direct Investment and Foreign Portfolio Investment

Foreign investments or international capital are capital flows from one state (exporting) to another (importing).[27] It usually but not always, requires long term commitment of substantial resources by the foreign investor in the territory of the host State.[28] Foreign investments are traditionally divided into two categories, namely: Foreign Direct Investment (FDI) and Foreign Portfolio Investment. In direct investments, the foreign investor invests capital in a firm for a return on the investment, and a right to participate in the management of the firm. However, in portfolio investments, the foreign investor acquires securities (equity, debts, or derivatives) from the importing state's capital market, for return on the investments.[29] Official flows are also considered as types of foreign investments,[30] but will not be discussed, as they do not constitute direct investment or portfolio investment but other investments,[31] thus they are outside the scope of this thesis.

Nevertheless, the distinction between what constitutes FDI and foreign portfolio investment is increasingly not so clear cut owing to arrangements such as: contractual agreements on

[27] James Chen, 'Foreign Investment' *Investopedia* 30 April 2020 https://www.investopedia.com/terms/f/foreign-investment.asp Accessed 31/08/2020.
[28] Rudolf Dolzer and Christopher Scheurer, *Principles of International Investment Law* (OUP 2nd edn, 2012) 20.
[29] Jun Wu et al, 'Foreign Direct Investment vs Foreign Portfolio Investment: The Effect of the Governance Environment (2012) 52 Management International Review 643, 645.
[30] James Chen, 'Foreign Investment' (n 27).
[31] See UNCTAD, *World Investment Report: Investment and New Industrial Policies* 2018; International Monetary Fund, *Balance of Payment Manual* BPM6 (IMF 6th edn, 2010).

franchising; or technical service agreement which may include short or long term debt investments in a host state domestic firm in which a Multinational corporation (MNC) controls and influences how the capital in the firm is to be spent;[32] or financial engineering techniques adopted by MNCs to convert FDI into foreign portfolio investment.[33] Interestingly, Dunning and Dilyard[34] have argued that FDI and foreign portfolio investment may be seen as parts of a common paradigmatic approach to explain private capital flows moreso since the *de facto* distinctions between FDI and foreign portfolio investment are becoming blurred and largely difficult to draw. For clarity in Balance of Payment analysis, and to address this potential obscurity, the International Monetary Fund (IMF)[35] and the Organisation for Economic Cooperation and Development (OECD)[36] adopted the arbitrary 10% and above threshold for equity FDIs as a means for distinguishing between FDI and foreign portfolio investments.[37]

2.1.1 Foreign Direct Investment

Foreign Direct Investment (FDI) involves the ownership of assets by foreign investors for the purposes of controlling and influencing the use of those assets.[38] The key features of FDI include foreign investor management, ownership, and control.[39] Here, the investor usually has firsthand information on the operations of the firm and does not need to rely on publicly available information like annual reports or investment reports. The investor is an insider. The investor is an active investor and intends to have continued participation in shaping how assets will be used abroad.[40]

FDI consists of two main forms: greenfield investments which are newly established enterprises within the host state; and mergers & acquisition of existing enterprises within the host state for the purpose of: obtaining strategic assets such as intellectual property, production

[32] John H. Dunning & John R. Dilyard, 'Towards a General Paradigm of Foreign Direct and Foreign Portfolio Investment' (1999) 8(1) Transnational Corporation 11.
[33] UNCTAD, 'Report of the Expert Meeting on the Growth of Domestic Capital Market Particularly in Developing Countries, and its Relationship with Foreign portfolio investments' 27-29 May 1998. See also UNCTAD, *World Investment Report: Transnational Corporation, Market Structure and Competition Policy* 1997 107-120
[34] John H. Dunning & John R. Dilyard (n 32)
[35] International Monetary Fund, *Balance of Payment Manual* BPM6 (IMF 6th edn, 2010).
[36] Organisation for Economic Cooperation and Development (OECD), Benchmark Definition of Foreign Direct Investment (OECD Paris, 4th edn 2008).
[37] India in 2020 similarly adopted the 10% threshold for Foreign Portfolio Investment.
[38] Edward Graham & Paul Krugman *Foreign Direct Investment in the United States (*Institute for International Economics, 1991) 7.
[39] D. Ball et al, *International Business: The Challenge of Global Competition* (McGraw-Hill, 2002) 69.
[40] Mira Wilkins, 'Two Literatures, Two Storylines : Is A General Paradigm of Foreign Portfolio and Foreign Direct Investment Feasible'? (1999) 8(1) Transnational Corporation 56.

or distribution systems, customer relationships etc; and improving efficiency through technology transfer and management skill.[41] Between 1998 and 2016, it is estimated that mergers and acquisitions accounted for over 60% of all FDI flows.[42]

The Organisation for Economic Development (OECD) and the IMF considers FDI as direct investments which reflect the objectives of the foreign investor to obtain a long-term interest in an enterprise resident in the host State. A long-term interest implies the existence of a long-term relationship between the foreign investor and the direct investment enterprise, with a scope of influence in the management of the latter.'[43] The United Nations Conference on Trade and Development (UNCTAD) similarly defines FDI as a direct investment involving a long term relationship, reflecting lasting interest and control of an enterprise in a host state, by a resident of another state.[44] FDI requires the transfer of financial and non-financial assets like technology, IP etc., from the investor into the investment in the host state. FDI are less fungible and mostly indivisible than portfolio investments, and it is usually directed by multinational corporations (MNCs) which exercise control and influence over their assets.[45]

The United States Department of Commerce defines FDI in relation to ownership of 10% or greater equity interest[46] to ensure that the idea of control and influence or potential influence is maintained.[47] Similarly, as mentioned above, the IMF and OECD subscribes to this distinction. Perhaps, the rationale behind this is that outside the primary markets, the most common way to own shares is through the secondary capital market since firms do not always issue new shares, (firms obtain most of their financing from retained earnings[48]), thus, already existing shares circulating, are traded at the stock markets directly, or through online

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[41] Charles W.L Hill & G. Tomas M. Hult, *International Business: Competing in the Global Market Place* (McGraw-Hill 12 edn, 2018).
[42] UNCTAD, *World Investment Report: Investment and the Digital Economy, 2017.*
[43]Organisation for Economic Cooperation and Development (OECD), Benchmark Definition of Foreign Direct Investment (OECD Paris, 4th edn 2008); International Monetary Fund, *Balance of Payment Manual* BPM6 (IMF 6th edn, 2010) 85
[44] UNCTAD, *World Investment Report: Transnational Corporation, Market Structure and Competition Policy* 1997 295.
[45] John H. Dunning & John R. Dilyard (n 32) 4.
[46] United States Department of Commerce, 'Foreign Direct Investment in the US' https://www.commerce.gov/news/fact-sheets/2017/10/foreign-direct-investment-united-states
[47] Mira Wilkins, 'Two Literatures' (n 40) 56.
[48] Retained earnings is a firm's profit that is not allocated for payment of dividends to shareholders but to be reinvested into the firm as working capital, capital expenditure (fixed asset purchase) or debt repayment.

brokerage.[49] The circulating shares may be too small, or insufficient to have any effective voice or influence on the firm and its management. It is also advantageous because of the ease with which it can be implemented cross-nationally. However, it is worthy of note that the 10% shareholding threshold distinction is not a hard and fast rule. It is a numerical guideline, fixed for statistical purposes to facilitate global Balance of Payment (BOP) measurement and comparison of FDI flows.[50] A criticism of the threshold is its potential for being conceptually inconsistent with FDI theory. Theoretically, FDI is associated with capital coming into the host state with the aim of building an enterprise and creating employment. However, the IMF recognizes as FDI in its categorization, foreign firm re-invested earnings in host states as well as funds raised from host state' capital markets.[51] Furthermore, Lukas Linsi argues that although FDI traditionally are meant to be long term with the aim of economic growth, and are mostly immune to short term fluctuations in the capital market caused by macroeconomic changes like monetary policy, short term transactions susceptible to monetary policy changes such as Special Purpose Entities (SPE),[52] which satisfies the threshold requirements i.e. more than 10% equity may be categorized as FDI even though they are more akin to foreign portfolio investment.[53]

Instructively, the IMF recognizes that the 10% and above shareholding requirement does not automatically signify influence and effective voice in management. Similarly, less than 10% shareholding does not imply lack of influence and effective voice in management because in some firms, controlling interest may be less than 10%.[54] Bearing this in mind, host state's may choose to exclude as FDI, circumstances where shareholding meets the 10% rule but lacks effective voice and influence; or may choose to include as FDI, circumstances where shareholding is below the 10% threshold but effective voice in management and influence

[49] Adam Hayes et al, 'How to Buy and Sell Stocks for your Account' https://www.investopedia.com/ask/answers/108.asp 10/10/2022. See also, https://www.forbes.com/uk/advisor/investing/best-trading-platforms-october-2022/

[50] International Monetary Fund, Direct Investment Technical Expert Group, Direct Investment-10 Percent Threshold of Voting Power /Equity Ownership, Employment' IMF Committee on Balance of Payment Statistics and OECD Workshop on International Investment Statistics Issues Paper 2 April 2004, 2

[51] Lukas Linsi. 'Fickle Formulas: Measuring Foreign Direct Investments' (2017) University of Amsterdam Working Paper 8-9

[52] Special Purpose Entities (or letterbox companies) are established in host states to hold shares in other companies. They do not engage in any industrial or commercial activities.

[53] Ibid, Olivier Blanchard & Julien Acalin, 'What Does Measured FDI Actually Measure?' (2016) Peterson Institute for International Economics: Policy Brief No. PB16-17, 1.

[54] Maitena Duce, 'Definitions of Foreign Direct Investment (FDI): A Methodological Note' Banco De Espana https://www.bis.org/publ/cgfs22bde3.pdf Accessed 30/09/2020

nevertheless remains present.[55] States may even choose to impose a higher threshold for FDI.[56] The percentage threshold is only meant to be a basic dividing line for Balance of Payment (BOP) statistics, and States may choose to adopt a combination of the threshold requirement, as well as the control and influence subjective requirement, but total value of all transactions must be highlighted.[57] It is important to note that previously, the IMF took a bottom-up approach to determining FDI, with States allowed to use their own criteria in determining what constituted direct investment.[58]

(i) <u>What Are the Determinants of FDI Movement?</u>

FDI theory considers why MNCs engage in cross border capital flows through FDI. It considers why MNCs set up subsidiaries in host states, and why they acquire existing value-adding firms or products within the host State rather than producing at home and exporting products to other receiving countrie;[59] or granting licenses to foreign companies to produce and sell their goods to domestic markets in exchange for royalt.[60] Trade protectionist barriers such as high tariffs and quotas; transportation costs and production costs could make international trade an unattractive alternative to FDI, so also could internalization theory[61] which can render licensing an unattractive alternative to FDI.[62]

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[55] See, International Monetary Fund, *Balance of Payment Manual* BPM6 (IMF 6th edn, 2010) 87.
[56] Foreign Direct Investment (FDI) Net Inflows and Net Outflows as Share of GDP https://www.un.org/esa/sustdev/natlinfo/indicators/methodology_sheets/global_econ_partnership/fdi.pdf 345
[57] International Monetary Fund, *Balance of Payment Manual* BPM5 (IMF 5th edn, 1993); International Monetary Fund, *Balance of Payment Manual* BPM6 (IMF 6th edn, 2010) 86; UNCTAD, *World Investment Report: Transnational Corporation, Market Structure and Competition Policy* 1997, 295-302 shows how different countries measure FDI flows and stocks.
[58] See generally, International Monetary Fund, *Balance of Payment Manual* (IMF, 1948); International Monetary Fund, *Balance of Payment Manual* BPM2 (IMF 2nd edn, 1950); International Monetary Fund, *Balance of Payment Manual* BPM3 (IMF 3rd edn, 1961); International Monetary Fund, *Balance of Payment Manual* BPM4 (IMF 4th edn, 1977).
[59] International Trade.
[60] Licensing contracts.
[61] Internalisation theory is a branch of economic theory that explains why firms prefer FDI to licensing as follows: (i) licensing may result in firm giving away valuable technical capacity to a potential foreign competitor; (ii) licensing deprives the licensor firm close control over production, marketing and strategy in licensee firm, which may be required for maximum productivity; and (iii) licensing deprives the licensee firm of licensor's competitive advantage when it is not based on the licensed product but licensor's management, marketing and manufacturing capabilities. See: S. H. Hymer, *The International Operations of National Firms: A study of Direct Foreign Investments* (MIT Press, 1976); A Verbeke, 'The Evolutionary View of the MNE and the Future of Internalization Theory' (2003) 34 Journal of International Business Studies 498-501; A .H Kirca et al, 'An Empirical Analysis of Internalization Theory in Emerging Markets' (2016) 51 Journal of World Business 628-640.
[62] Charles W. L. Hill & G.Tomas M. Hult, *International Business* (n 41).

Various theories try to provide an account for FDI movement patterns. Accordingly, FDI may be influenced by strategic behavior,[63] internalisation theory[64] or the eclectic paradigm[65]. The strategic behavior theory argues that FDI is influenced by strategic rivalry and imitative behavior among firms. Here, FDI decisions are taken based on similar actions of another firm in a bid not to be disadvantaged within the home state, host state or global market. This approach has been criticized for not giving account of why the first firm undertook FDI.[66] On the other hand, the eclectic paradigm theory argues that location-specific advantages explain the reason for FDI movements. This theory is given the most credit for attempting to explain the drivers and patterns of FDI movements.[67] According to Dunning,[68] FDI movement takes place regarding the existence of ownership, location, and internalisation advantages. Ownership advantages refers to advantages derived from obtaining and retaining intellectual property, technology, and technical skills. Location advantages relates to advantages which accrue from exploiting resources or assets unique to a particular location which includes natural resources, labour, market size, government policy etc., all dependent on whether firm is resource seeking, market seeking, efficiency seeking or strategic asset seeking. [69] Internalisation refers to the advantages the firm derives from retaining technical and management capacities.[70] Dunning makes the point that opportunities in the host state for achieving competitive advantage over competitors explains why a firm will undertake FDI.[71] However, such competitive advantage has to be transferable across borders.[72]

(ii) Are there Merits to FDI Movement?

According to Nair-Reichart and Weinhold, a causal link exists between FDI and economic growth in developing countries.[73] As a result, FDI is viewed as having a positive impact on

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[63] F.T. Knickerbocker, *Oligopolistic Reaction and Multinational Enterprise* (Harvard Business School Press, 1973); K. Head, 'Revisiting Oligopolistic Reaction: Are Decisions on Foreign Direct Investment Strategic Complements?' (2002) 11 453-72.
[64] S. H. Hymer, *The International Operations of National Firms: A study of Direct Foreign Investments* (MIT Press, 1976)
[65] John H. Dunning, *Explaining International Production* (Unwin Hyman, 1988).
[66] Charles W.L Hill & G.Tomas M. Hult, *International Business* (n 41).
[67] Patricia L. Makoni, 'FDI and Foreign Portfolio Investment Determinants in Developing African Countries' (2017) 9(6) Journal of Economics and Behavioural Studies 253.
[68] John H. Dunning, *Explaining International Production* (n 65)
[69] Ibid.
[70] John H. Dunning, 'The Eclectic Paradigm as an Envelope for Economic and Business Theories of MNE Activity' (2000) 9(2) International Business Review 163.
[71] John H. Dunning & John R. Dilyard (n 32) 2.
[72] Ibid
[73] Usha Nair-Reichart & Diana Weinhold, 'Causality Tests for Cross-Country Panels: A New Look at FDI and Economic Growth in Developing Countries' (2001) 63(2) Oxford Bulletin of Economics and Statistics.

growth through capital accumulation within the host State and technology transfer and spillovers.[74] The unintentional spillover of technology to domestic firms improves productivity with minimal costs but immense benefits for economic growth. A study by Bosworth & Collins on the effect of capital movement on domestic investment in developing countries found that while FDI brings about a one-for-one increase in domestic investments, foreign portfolio investments (FPI) has little to no impact on domestic investments.[75] FDI is also an important source of external financing and a necessary driver for the implementation of the Sustainable Development Goals (SDG)s through enhancement of labour conditions, and improved corporate governance.[76]

Bende-Nabende and others, found that the wider the gap between the host State and the home State in terms of technological advancement the greater the significance of the impact of technology transfer on economic growth.[77] However, FDI flows does not automatically equate growth. Empirical studies show that economic growth arising from FDI movement is dependent on variables like level of education and financial development within the host State;[78] the absorptive capacity of the host State towards technology and human capacity;[79] and the economic stability of the host State.[80]

Additionally, FDI is less volatile compared to FPI.[81] According to Joseph Stiglitz, FDI brings into the host State, resources, technology transfer, access to markets, human capital

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[74] Xiaoying Li & Xiaming Lui, 'Foreign Direct Investment and Economic Growth: An Increasingly Endogenous Relationship' (2005) 33(3) World Development 394.

[75] Barry P. Bosworth and Susan M. Collins, 'Capital Flows to Developing Economies: Implications for Saving and Investment' (1999) Brookings Papers on Economic Activity 143.

[76] Foreign Direct Investment (FDI) Net Inflows and Net Outflows as Share of GDP https://www.un.org/esa/sustdev/natlinfo/indicators/methodology_sheets/global_econ_partnership/fdi.pdf 344.

[77] A Bende-Nabende et al., 'The interaction between FDI, Output and the Spillover Variables: Co-integration and VAR analyses for APEC 1965-1999' (2003) 10(3) Applied Economics Letters 165-167; F Sjoholm, 'Technology Gap, Competition and Spillovers from Direct Investment: Evidence from Establishment Data' (1999) 36(1) Journal of Development Studies 53.

[78] UNCTAD *World Investment Report: Foreign Direct Investment and the Challenge of Development* (New York and Geneva, 1999)

[79] E Borensztein et al., 'How Does Foreign Direct Investment affect Economic Growth' (1998) 45(1) Journal of International Economics 115.

[80] Marta Bengoa & Blanca Sanchez-Robles, 'Foreign Direct Investment, Economic Freedom and Growth: New Evidence from Latin America' (2003) 19(3) European Journal of Political Economy 529.

[81] FDI can also be volatile in terms of uncertainty of FDI inflows owing to political and economic conditions. See Robert Lensink and Oliver Morrssey, 'Foreign Direct Investment: Flows, Volatility and Growth in Developing Countries' (2022) 6909053.pdf (core.ac.uk) Accessed 10/10/2022.

development etc, yet it is not volatile or disruptive like foreign portfolio investment.[82] Historically, FDI movements to and from developing countries are usually stable or slightly affected by economic and financial crisis. During the Asian Financial Crisis, FDI movement was quite stable.[83] FDI displayed similar resilience during the Mexican crisis of 1994-95, and the Latin American debt crisis of the 1980's.[84] Comparatively, FDI improved against FPI during the Global Financial Crisis. At the early stages of the Global Financial Crisis, FDI movements to emerging markets surprisingly grew slightly, but greenfield FDIs eventually fell by 15% in 2009. It is noteworthy that during this period portfolio investments had dropped significantly.[85] This is because portfolio investments tend to experience huge reversals during times of crisis.[86]

Finally, Eichengreen and Mussa distances FDI volatility from FPI volatility. According to them, FDI volatility is not precarious for financial crisis like FPI which are prone to sudden surge of capital in and out of the host State. Thus, to reduce their systemic risk to the financial sector, the State must adopt sound macroeconomic policies such as exchange rate flexibility to moderate the volume of FPI particularly short-term debt.[87]

However, this should not be construed as the infallibility of FDI. According to Hausmann & Fernandez-Arias, large FDI flows may be indicative of institutional weakness within the host States because foreign investors may prefer to operate directly within the domestic market to avoid the regulatory and institutional inefficiencies within the financial market. Thus, States should focus on improving their overall investment environment.[88] Furthermore, Paul Krugman argues that the transfer of control occasioned by FDI is not always beneficial for the host State given the potential for fire sales of the domestic firm's assets during times of crisis.[89]

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[82] Joseph Stiglitz, 'Capital Market Liberalisation, Economic Growth and Instability' (2000) Columbia Business School https://www0.gsb.columbia.edu/mygsb/faculty/research/pubfiles/1479/Stiglitz_CapMktLiberaliz.pdf 2. Accessed 11/11/2022.

[83] Prakash Loungani & Assaf Razin, 'How Beneficial is Foreign Direct Investment for Developing Countries' (2001) https://www.elibrary.imf.org/view/journals/022/0038/002/article-A003-en.xml Accessed 10/10/2022

[84] Prakash Loungani & Assaf Razin, 'How Beneficial is Foreign Direct Investment fof Developing Countries' ()

[85] Lauge Skovgaard Poulsen and Gary Clyde Hufbauer, 'Foreign Direct Investment in times of Crisis' (2011) 20(1) Transnational Corporation 23. See also IMF, World Economic Outlook 2009: Sustaining the Recovery (Washington DC, 2009) Statistical Appendix Table A13.

[86] Robert E. Lipsey, 'Foreign Direct Investors in Three Financial Crises' (2001) NBER Working Paper No. 8084.

[87] Barry Eichengreen & Michael Mussa, 'Capital Account Liberalisation and the IMF' (1998) 35(4) *Finance & Development* December https://www.imf.org/external/pubs/ft/fandd/1998/12/eichen.htm Accessed 10/10/2022.

[88] Ricardo Hausmann and Eduardo Fernández-Arias, 'Foreign Direct Investment: Good Cholesterol?' (2000) Inter-American Development Bank Working Paper No. 417, 5.

[89] Paul Krugman, 'Firesale FDI' (1998) MIT Working Paper.

Finally, excessive leverage domestically can be a drawback of FDI. Here, most of the funds are sourced from the domestic credit market with little capital coming from outside, yet profits are repatriated. Consequently, the size of the gains from FDI is reduced.[90]

Part B

2.2 Foreign Portfolio Investment

Foreign portfolio investments are basically the outcome of individuals, firms and states decisions to move assets categorized as foreign portfolio investment wherever they are likely to be most profitable to make themselves better off.[91] Consequently, assets such as shares less than 10%, and fixed income assets are usually categorised as portfolio investments.[92] Also, investment fund shares or units evidenced by securities which are not reserve assets or direct investment may be included in portfolio investment provided the share holdings are less than the 10% threshold.[93]

However, there is no consensus on the definition of foreign portfolio investments as has been earlier stated in the introduction to this Thesis[94]. Nevertheless, for the purpose of this thesis, a foreign portfolio investment is **any financial investment in debt security entitlements (bonds), equity securities evidenced in shares/units less than 10%, and options, which the investor *intends to be a passive, short-term held investment for dividends, coupons/yields, capital gains through speculation, carry-trade, and foreign exchange arbitrage*.** Foreign portfolio investments such as bonds are held by investors who are usually anonymous and dispersed around the world.[95] Usually and contemporarily, the investor does not have experiential knowledge of the operations of the firm or government, rather reliance is had to financial statements, annual reports, investment reports, advice from financial intermediaries[96]

[90] Prakash Loungani & Assaf Razin, 'How Beneficial is Foreign Direct Investment fof Developing Countries' ()
[91] Chukwuemeka P. Ekeocha et al, 'Modelling the Long Run Determinants of Foreign portfolio investments in Nigeria (n 5) 194.
[92] Devashish Krishnan, 'A Notion of ICSID Investment' in TJ Grierson Weiler (ed) Investment Treaty Arbitration: A Debate and Discussion (Juris Publishing, 2008) 71; International Monetary Fund, *Balance of Payment Manual* BPM5 (IMF 5th edn, 1993).
[93] IMF, 'Functional Categories' in IMF *Balance of Payment and International Investment Manual* (Ch 6) https://www.imf.org/external/pubs/ft/bop/2007/pdf/chap6.pdf 12 Accessed 30/08/2020
[94] See Scope of Work in Introduction
[95] Misa Tanaka, 'Bank loans versus Bond Finance: Implications for Sovereign Debtors' (2005) Bank of England Working Paper No. 267 p. 11
[96] Ibid; Jun Wu et al, 'Foreign Direct Investment vs Foreign Portfolio Investment' (n 29) 645.

and herd behaviour for acquisition and sale. Also, the investment involves a largely anonymous relationship between the issuers and holders and possesses a degree of market liquidity.[97]

Equity portfolio investments by their nature are commonly long term, while debt investments of more than a year are considered as long term,[98] all others for about a year or less are short-term debt investments. Foreign portfolio investment capital flows into the host state are mostly through the capital markets and in the form of equity securities such as: shares/stocks, mutual funds, exchange traded funds (ETFs), global depository receipts, American depository receipts; debt securities such as: sovereign bonds and its entitlements, corporate bonds, and exchange traded funds (ETFs) evidenced in bonds; and options. It must be noted that though sovereign bond instruments fall within what constitutes foreign portfolio investment as defined within this thesis, for the purposes of this thesis, multilateral institution held debts like IMF loans to host States will not be included in this thesis because under the popular investor-state/state-state architecture of investment arbitration, multilateral institutions cannot institute and maintain investment arbitration claims. However, attention will be paid to private holders of sovereign bonds security entitlements (private creditors)[99], as well as other foreign portfolio investment financial assets investments like private sector stocks and corporate bonds, to determine if they are, or can be protected by international investment agreements, and the potential consequences thereof.

Finally, the stakeholders in foreign portfolio investment transactions are the investors who may be retail or institutional investors such as private individuals, insurance companies, hedge funds, sovereign wealth funds, pension funds, mutual funds, asset management companies, and endowment funds; the intermediaries which include stock exchanges, banks, investment fund companies etc; and the issuers who may be a private or public company, investment fund companies or States. Clearly, an investment fund company acts in different capacities as it could be an investor, an intermediary to a foreign portfolio investment transaction, and an

[97] Market liquidity is the extent to which an asset can be bought and sold quickly based on the number of buyers and sellers present in the market. See, IMF, 'Functional Categories' in IMF *Balance of Payment and International Investment Position Manual* (Chapter 6) https://www.imf.org/external/pubs/ft/bop/2007/pdf/chap6.pdf 12

[98] Generally, it is the instruments creating the financial obligations that describe if the investment is long-term or short-term. See, Mira Wilkins, 'Two Literatures' (n 40) 58.

[99] Substantial work has been done on such sovereign debt instruments in investment law and this work will build on them when discussing sovereign bonds portfolio investments as investments under international investment law. See particularly, Michael Waibel, 'Opening Pandora's Box: Sovereign Bonds in International Arbitration (2007) 101 American Journal of International Law.

issuer of foreign portfolio investment such as ETFs. In a world where foreign portfolio investment is protected by the international investment law regime, it would present a challenge identifying who the investor is when an investment fund company acts in multiple capacities.

2.2.1 Types of Foreign Portfolio Investment

As earlier discussed, foreign portfolio investments are either in the form of equity financial assets or debt financial assets. Equity foreign portfolio investment are financial assets acknowledging claims less than 10% of the residual value of a corporation or quasi-corporation, after the claims of all creditors have been met. It creates a liability on the firm and includes shares/stocks, depository receipts and shares in investment funds. The return on equity is largely dependent on the economic performance of the issuer.[100] Debt foreign portfolio investment are financial assets which creates an obligation to pay an amount of principal and/or interest usually according to a predefined formula, which usually means that the creditor has a more limited risk exposure. It gives the holders the unconditional right to fixed or contractually determined variable payments and it includes bonds. If the debtor is solvent, debt obligations are largely fixed or linked by a formula to some other variable, such as a market interest rate or the price of a selected item.[101] Below are some of the financial assets which can constitute foreign portfolio investments:

(a) Shares/Stocks

Shares/stocks represents a bundle of contractual rights conferred by the extant companies' statute within a state, and a company's constitution.[102] Shareholding implies the existence of a quantifiable financial stake in a company; company membership, with exercisable rights in the company to dividends, voting, etc; and proprietary rights over the shares which can be bought, sold and charged.[103] Instructively, proprietary rights are in respect to the shares themselves, it does not extend to company's assets.[104] Thus, shares represents the amount of money from the residual assets that shareholders are entitled to in the event of liquidation, after all of the company's debt have been paid are off. Usually, companies issue shares to raise capital to

[100] International Monetary Fund, *Balance of Payment and International Investment Position Manual* (IMF 6th edn, 2009) 83, 85
[101] Ibid, 85, 88.
[102] Alan Dignam & John Lowry, *Company Law* (OUP 6th ed, 2016) 163; *Borland's Trustees v Steel Bros & Co Ltd* (1901).
[103] Sealy & Worthington, *Sealy's Cases and Materials in Company Law* (OUP, 2013) Ch 11.
[104] Alan Dignam & John Lowry (n 102) 163; *Macaura v Northern Assurance Co. Ltd* (1925.

finance projects, and investors invest in shares of a company and become shareholders to own and control the company or parts thereof, or merely for profits (dividends and capital gains).[105] Generally, shareholder(s) with less than fifty (50) percent of shares are regarded as minority shareholders,[106] and depending on the Company Law of a State, class rights, and what is achievable by shareholders are dependent on the class of shares, and the percentage of the company's share owned by said shareholders. For instance, under the Nigerian Companies and Allied Matters Act, shareholders with more than 25% of shares can prevent a special resolution,[107] also shareholders with more than 10% of shares can demand a poll in a general meeting.[108] As earlier stated, shareholding less than 10% are considered as foreign portfolio investment.[109] Equity foreign portfolio investment are largely susceptible to foreign exchange risks, thus foreign exchange macroeconomic policies can affect foreign investor shareholding.

(b) Bonds

Firms typically raise funds by issuing debt (either through loans or bonds) or equity, by selling shares.[110] Bonds are a fixed income asset class that represents a loan made by a lender (investor) towards the borrower (company, host state, municipality). Bonds may be corporate or government bonds and are usually used to finance government projects or companies' asset acquisitions, research and development as well as future projects.[111] Bond assets are generally publicly traded but could be traded over the counter[112] or privately. Bond instruments contain the terms of the loan, the interest payments (coupon) and the maturity.[113] Bond investors are not obliged to hold bond till maturity, bonds can be sold in the open market where prices may fluctuate in response to changes in interest rates.[114] Though this may not be easily done owing to the liquidity risks[115] inherent in bonds.[116] Alongside interest rate and liquidity risks, bonds

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[105] Chris Murphy, 'Equity' Investopedia https://www.investopedia.com/terms/e/equity.asp
[106] Alan Dignam & John Lowry (n 102) 9.
[107] Companies and Allied Matters Act 2020 S. 258(2); See also S. 65(9) of the South African Companies Act 2008.
[108] Companies and Allied Matters Act 2020 S. 248(1)(d)
[109] See, International Monetary Fund, *Balance of Payment Manual* BPM6 (IMF 6th edn, 2010) 91.
[110] Chris Murphy, 'Equity' Investopedia https://www.investopedia.com/terms/e/equity.asp Accessed 30/09/2020
[111] James Gard, 'What is a Bond?' *MorningStar* https://www.morningstar.co.uk/uk/news/196707/what-is-a-bond.aspx. 30/09/2020
[112] Adam Hayes, 'Bonds' Investopedia https://www.investopedia.com/terms/b/bond.asp Accessed 30/09/2020
[113] Represents the time when the principal to the loan will be paid back to the investor.
[114] Adam Hayes, 'Bonds' (n 112).
[115] Risk of easy resale. Bonds are not as liquid as stocks/shares therefore it may be difficult selling bonds at a premium.
[116] Kimberly Amadeo, 'What Bonds Are, How They Work and What They Say About The Economy' https://www.thebalance.com/what-are-bonds-and-how-do-they-work-3306235 Accessed 30/09/2020.

are susceptible to credit risks and inflation risks.[117] Thus, host State monetary and fiscal policies can affect bonds.

(c) **Investment Funds**

Investment funds are a legal structure in the form of collective investment schemes wherein investors pool funds for investments in financial or non-financial assets or both. These funds issue shares or units depending on whether it operates as a corporation or trust. Investment fund shares or units refer to the shares issued by mutual funds and unit trusts, rather than the shares or bonds they may hold. Investment funds invest in a range of assets, such as debt securities like bonds, equity securities, commodity-linked investments, real estate, shares in other investment funds, and structured assets which they pool together and issue out to retail and institutional investors as shares or units.[118]

Investment funds could be active or passive. In an active fund, the fund manager selects the investments on behalf of the investor (retail or institutional) with the objective of outperforming the market through research and analysis, while in a passive fund the manager aims to match the performance of an index like the S & P 500 by investing in stocks of the companies listed in the index being tracked.[119] Types of investment funds includes mutual funds,[120] exchange-traded-funds,[121] and unit investment trusts[122] etc.

Investment funds presents an interesting dynamic because it throws up issues regarding who the investor under international investment law will be where initial debt, or equity investments are less than 10%? For instance, the fund companies acquire the initial debt or equity assets

[117] Ibid.

[118] International Monetary Fund, *Balance of Payment and International Investment Position Manual* (n) 85.

[119] 'Different Types of Funds' Hargreaves Lansdown https://www.hl.co.uk/beginners-guides/guide-to-funds/different-types-of-fund

[120] Mutual funds are mutual because profits are divided equally among all investors and not based on asset classes. They are either actively managed by a portfolio manager or are indexed. The shares are not traded in the stock market but can be acquired by investors directly from the fund company or through an intermediating broker. See generally, https://stockmarketmba.com/investmentfundtypes.php

[121] Exchange traded funds are mostly indexed, and they track an index rather than having a portfolio manager that makes investment decisions. ETFs are traded on the stock market and investors can buy and sell ETF shares amongst themselves.

[122] Unit investment trust funds are fixed portfolio investments in stocks and bonds offered to investors in redeemable units. Though they could be in stocks or bonds, they are typically in bonds because bonds offer predictable income and suffer less losses. They are mostly be bought and sold by the trust company, but may be bought from the stock market. See generally, James Chen, Unit Investment Trust Investopedia https://www.investopedia.com/terms/u/uit.asp

before they are packaged into units or security entitlements for their investor clients. Therefore, is it just the investment funds i.e. the fund company or holders/beneficiaries of the investment funds' security entitlements or units; or both, that will be contemplated as investors for the purposes of international investment agreements? Are the investment funds' shares or units to be considered as investments under international investment law requiring protection? The significance of these questions to this study will become clear in chapter four during the discussion of the meaning of 'investment' under the various investment treaties under review. However, it must be stated that a broad definition of investments in investment treaties will encompass both the shares/bonds and there units even if their acquisition or disposal is unconnected with the host State.

(d) **<u>Depository Receipts.</u>**

Depository receipts are negotiable securities certificates that represent ownership of shares in a foreign company listed and traded in the domestic market. Depository receipts listed on one exchange represent ownership of foreign shares listed on another exchange, and ownership of the depository receipts is treated as if it represents direct ownership of the underlying securities in the foreign country. Depository receipts facilitate transactions in securities in economies other than their home listing.[123] Depository receipts eschews the need for investors to trade directly from the domestic market of the foreign country, rather, the investor can trade with a financial institution, usually a bank in its home country who issues and acts as custodian for the foreign shares.[124] Consequently, an investor can indirectly access a foreign market through depository receipts, even if the market is restricted.[125] The implication of this with respect to foreign investment protection of foreign portfolio investment is whether an investor without investing directly in the host State financial market (foreign country) where the company is domiciled, but through depository receipts acquired in his home state, can take advantage of the host State's investment protection agreement from the relative comfort of its home country?

[123] International Monetary Fund, *Balance of Payment and International Investment Position Manual* (n) 84.

[124] Adam Hayes, 'Depository Receipts' *Investopedia* https://www.investopedia.com/terms/d/depositaryreceipt.asp

[125] Geert Bekaert et al, 'Dating the Integration of World Equity Markets' (2004) 65 Journal of Financial Economics 204.

Depository receipts could be American Depository Receipts (ADR)[126] or Global Depository Receipts (GDR).[127] Both are usually denominated in dollars and offers returns in the form of capital gains and dividends.

2.2.2 A Brief History of Portfolio Investment

Historically, cross-border capital movements were undertaken by traders establishing trading businesses in host states. A journey through historical records reveals that as far back as over 2000 years ago, the Assyrians and Phoenicians set up and were running the earliest type of transnational corporations.[128] Bearing this in mind, it could be concluded that FDI preceded foreign portfolio investment. Nevertheless, the earliest foreign portfolio investment were sovereign debts. As early as the middle ages, sovereigns were borrowing from foreigners, especially Florentine banks, and sometimes these loans were extended to the sovereigns to obtain trade concessions and advantages for the banks within the sovereign's territory.[129] According to Larry Neal,[130] the first financial revolution occurred when Charles V[131] imposed levies on the territories of the Hapsburg Empire in 1542 which led to the issuance of annuities and the creation of a market for these securities because they could be bought and sold by citizens and foreigners alike. These annuities were 'heritable', 'transferable' and 'suitable for resale.'[132] Interestingly, around this period, FDI in the form of cross-border trading establishments and foreign portfolio investment in the form of sovereign debts existed alongside one another. For instance, the Florentine banks with established branches abroad (FDI), lent out money to sovereigns (foreign portfolio investment).[133] This trend continued up until the eighteenth century as cross-border capital movements expanded through FDI business establishments, and foreign portfolio investment transactions in government and private securities. An example is the East India Company, which had cross-border affiliations and presence in colonies, and its securities were tradeable abroad.[134]

[126] American Depository Receipts are certificates of shares of a foreign company issued by US banks for foreign companies and traded on US stock markets.
[127] Global Depository Receipts are certificates of shares of a foreign company, held and issued and traded in multiple countries by branches of international banks.
[128] Karl Moore & David Lewis *Birth of the Multinational Corporation* (Copenhagen Business School Press, (1999)).
[129] Jonathan Baskin & Paul J. Miranti, *A History of Corporate Finance* (Cambridge University Press, 1997).
[130] Larry Neal, *The Rise of Financial Capital: International Capital Market in the Age of reason* (Cambridge University Press, 1990).
[131] Holy Roman Emperor and Archduke of Austria (1519-1556), King of Spain (1516-1556).
[132] Larry Neal, *The Rise of Financial Capital* (n 130) 5-6.
[133] Mira Wilkins, 'Two literatures and two storylines' (n 40) 63
[134] Ibid.

By the 19th century, FDI in plants, machinery and equipment dominated.[135] The United Kingdom was a major contributor of this, and the United States of America was a huge beneficiary of UK FDI with the railway sector being the largest recipient.[136] From the late 19th century to the early 20th century, cross border capital movements were in the form of:

i. Sovereign debts;

ii. Investments in large foreign enterprises where interest and dividends could be collected in the home state;

iii. Investments in smaller foreign businesses set up in a host state;

iv. Companies registered in home states to do business abroad; and

v. Companies whose principal business was at home but had expanded abroad.[137]

Owing to the erroneous assumption that categories i-iv were portfolio investments, it was concluded that majority of investments during this period where foreign portfolio investment.[138] It could be justified by the fact that at this time foreign portfolio investment was not seen as distinct from FDI.[139] However, those conclusions have been revised based on modern considerations of foreign portfolio investment and FDI. As a result, category i & ii are clearly forms of foreign portfolio investment, category iii may be foreign portfolio investment depending on the number of shares, and extent of control and influence the investor has over the business, while categories iv and v are forms of FDI.[140]

Both portfolio investors and direct investors designed measures of addressing different kinds of risks during this time. **Risks such as foreign exchange risks, commercial risks and political risks**. In relation to management of these risks, the merchant bankers which usually handled placements of bond issues for governments and companies, advised the issuing company of the securities, on how to price and market the securities.[141] In Britain, the

[135] Francis S. Pierce, 'International Payment and Exchange' https://www.britannica.com/topic/international-payment#ref265406

[136] *Ibid*.

[137] Mira Wilkins, 'Two literatures and two storylines' (n 40) 63-65; Mira Wilkins, 'Conduits for Long-Term Foreign Investment in the Gold Standard Era' In M. Flandreau, C. Holtfrerich, & H. James (eds), *International Financial History in the Twentieth Century: System and Anarchy* (Cambridge University Press, 2003) 55-58.

[138] Mira Wilkins, 'Two literatures and two storylines' (n 40) 63-65.

[139] Lukas Linsi, 'Fickle Formulas: Measuring Foreign Direct Investments' (n 51) 5.

[140] Mira Wilkins, 'Two literatures and two storylines' (n 41) 67; Mira Wilkins, 'Conduits for Long-Term Foreign Investment (n 137) 58; Geoffrey Jones, *The Evolution of International Business* (Routledge, 1996) 30.

[141] Mira Wilkins, 'Conduits for Long-Term Foreign Investment (n 137) 58.

Corporation of Foreign Bondholders,[142] took action to assist bondholders in dealing with these risks. The Corporation of Foreign Bondholders was established in 1868 by private British investors to coordinate their efforts in protecting their foreign investments in sovereign bonds.[143] Furthermore, bond underwriters, in collaboration with governments, designed bonds in a manner to reduce risks.[144]

It is noteworthy that equity portfolio investments were not as popular as bonds during this period,[145] however, both private equity and bond securities were traded in the well-developed London stock market which played a very critical role in cross-border capital movements during this period.[146] This is broadly reflected in the role the London Stock Exchange played in facilitating the co-existence of FDI and foreign portfolio investment. For instance, as previously mentioned, the US railway sector was a significant recipient of foreign capital from the UK during this period. European investors could purchase US railroad bonds traded in the London Stock Exchange (foreign portfolio investment), or purchase shares of UK companies registered in London but engaged in direct investments abroad.[147]

After the First World War, and during the interwar period, the US went from being a debtor nation to a creditor nation.[148] Hence, it started paying close attention to obtaining statistical information, as well as preparing and publishing balance of payment records. To this end, the US Department of Commerce started gathering data on inward and outward capital movements. Eventually, this led to the distinction between direct investments that involves control and influence on the one hand, and portfolio investments that consisted of traded securities for profit.[149]

Subsequently, around 1941, the US Treasury Department, after conducting a census of foreign owned assets in the US, concluded that control for the purposes of direct investment consists

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142 Organised in 1868 and incorporated in 1873.
143 Paolo Moura and Yishay Yefah, ‘The Corporation of Foreign Bondholders’ (2003) IMF Working Paper WP/03/107 2.
144 Mira Wilkins, ‘Conduits for Long-Term Foreign Investment (n 137) 58
145 Francis S. Pierce, ‘International Payment and Exchange’ (n 135).
146 Mira Wilkins, ‘Two Literatures’ (n 40) 70.
147 Ibid.
148 Francis S. Pierce, ‘International Payment and Exchange’ (n 135).
149 Mira Wilkins, ‘Two literatures and two storylines’ (n 40) 71; See also, Paul D. Dickens, ‘A New Estimate of American Investment Abroad’ (1931) United State Department of Commerce, Bureau of Foreign and Domestic Commerce 2-3 https://babel.hathitrust.org/cgi/pt?id=uiug.30112104075582&view=1up&seq=30 Accessed 30/09/2020.

of 25% or more ownership in stock. This parameter was similarly adopted by the US Department of Commerce, as well as the IMF subsequently in 1961.[150] However, the threshold was eventually reduced to 10% or more ownership of stock for US businesses abroad, and foreign businesses operating in the US around the 1970s.[151] Consequently, all shareholding less than 10% were considered as foreign portfolio investment going forward.

Part C

2.3 What are the Determinants of Foreign Portfolio Investment Movements, Sensitivity and Volatility?

Foreign portfolio investment movement is basically prompted by the search for higher return rates and higher profits adjusted for risks, in the form of dividends, coupons, yields and capital gains as against what is obtainable in the home state.[152] It is influenced by global liquidity fluctuations (push) as well as domestic **macroeconomic factors** (pull).[153] Investors' interests are mostly financial, except maybe certain State outward foreign portfolio investment, and they hardly plan on intervening.[154] Host state domestic macroeconomic conditions have been found to have an inflow effect on foreign portfolio investment movement.[155] Macroeconomic variables such as interest rates, foreign exchange rates, inflation rates, economic growth and financial market development in different studies have been shown to independently, and/or collectively have a significant inflow and outflow influence on foreign portfolio investment movement.[156] The ability of macroeconomic conditions to influence movement in foreign portfolio investment movements is possible through its interactions with the host State financial

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[150] International Monetary Fund, *Balance of Payment Manual* BPM3 (IMF 3rd edn, 1961); International Monetary Fund, *Balance of Payment Manual* BPM4 (IMF 4th edn, 1977).

[151] Mira Wilkins, 'Two Literatures' (n 40) 71. In 1993, the IMF revised its statistical rules and reduced the threshold to 10% or more of shares for both incorporated and unincorporated enterprises. See, International Monetary Fund, *Balance of Payment Manual* BPM5 (IMF 5th edn, 1993) 83.

[152] John H. Dunning & John R. Dilyard (n 32) 1

[153] Swarnali Ahmed Hanna, 'Revisiting the Determinants of Capital Flows to Emerging Markets—A Survey of the Evolving Literature' (2018) IMF Working Paper WP/18/214; UNCTAD, 'Foreign Portfolio Investment and Foreign Direct Investment: Characteristics, Similarities, Complementarities and Differences, Policy Implications and Development Impact' (1999) Trade and Development Board Commission on Investment, Technology and Related Financial Issues Expert Meeting on Portfolio Investment Flows and Foreign Direct Investment 2.

[154] Mira Wilkins, 'Two Literatures' (n 40) 89.

[155] Tng Boon Hwa et al, 'Macroeconomic Surveillance of Portfolio Flows and its Real Effects: Malaysia's Experience' A paper prepared for the 8th IFC Conference on "Statistical Implications of the new Financial Landscape" held at BIS Basel on 8-9 September 2016, 8 https://www.bis.org/ifc/events/ifc_8thconf/ifc_8thconf_4a4pap.pdf

[156] Patricia L. Makoni, 'Foreign portfolio investments, Exchange Rates and Capital Openness: A Panel Data Approach' (2020) 8(2) International Journal of Economics and Business Administration; Patricia L. Makoni, 'FDI and Foreign Portfolio Investment Determinants in Developing African Countries'; Chukwuemeka P. Ekeocha et al, 'Modelling the Long Run Determinants of Foreign portfolio investments in Nigeria (n 5).

markets.[157] What this means is that since foreign portfolio investment exists in a financial market, a foreign investor's decision to move into or out of a domestic financial market may be influenced by the effects of the host state's domestic macroeconomic conditions on the price/value of the foreign portfolio investment, which in turn can affect the return on the foreign portfolio investment. Consequently, the implications of the macroeconomic conditions such as exchange rate, interest rate etc., on the financial market with regards to price/value, and rate of return; can determine if foreign portfolio investment will move into or out of a domestic financial market.

The extent of price/value fluctuation of portfolio investment is known as its volatility.[158] Foreign portfolio investment tends to be more volatile compared to FDI[159], thus a highly volatile foreign portfolio investment is one that its price/value is prone to sudden and frequent fluctuations. The implication of foreign portfolio investment volatility is that future price/value of foreign portfolio investment becomes uncertain. Uncertainty in future price/value of foreign portfolio investment is the primary source of risk,[160] particularly systematic/market risk because it leaves return on investment to chance, which could result in foreign portfolio investment liquidation by investors where foreign portfolio investment price/value trend looks bleak; or falls.

Foreign portfolio investment price/value susceptibility to fluctuations depends on its sensitivity to the changes in its determinants, which is often domestic macroeconomic conditions.[161] This is because foreign portfolio investment are constantly influenced directly and/or indirectly by factors idiosyncratic and specific to the firm or systematic to the market or economy. Macroeconomic policies are systematic to the economy, thus are considered as one of such

[157] G. K. Gumus, A. Duru & B. Gungor, 'The Relationship between Foreign portfolio investments and Macroeconomic Variables' (2013) 9(34) European Scientific Journal.
[158] Volatility is the extent to which the value/price of a security varies/changes/moves from time to time. High volatility security is a security susceptible to large, sudden and frequent price fluctuations. Security prone to large sudden, and frequent fluctuation is considered highly volatile and risky. Volatility of securities can be measured using beta co-efficient to indicate how a security responds to movements in the market. Beta is used in the Capital Asset Pricing Model (CAPM) when determining expected return in the face of systematic/market risk. For instance, if a share rises or falls above or below the market average will determine if it has a high beta co-efficient (highly volatile compared to the market) or low beta co-efficient (low volatility compared to the market). Also, the Chicago Board Option Exchange (cboe) Volatility Index (VIX) aka 'fear gauge' which is a real time market index is also used by investors to measure the market expectation of future volatility.
[159] Trevor Alleyne, Mauro Mecagni et al, *Managing Volatile Capital Flows* (n 21) 1.
[160] William Sharpe, 'Risk, Market Sensitivity and Diversification' (1972) 28(1) Financial Analyst Journal 74.
[161] Chukwuemeka P. Ekeocha et al, 'Modelling the Long Run Determinants of Foreign portfolio investments in Nigeria (n 5) 195; William Sharpe, 'Risk, Market Sensitivity and Diversification' (n 160) 74.

influential factors on price/value volatility of foreign portfolio investment,[162] and thus, affecting foreign portfolio investment movement and volatility (fluctuations in foreign portfolio investment price/value).

It is noteworthy that macroeconomic factors are location specific, and are most times within the control of the host governments and relevant policy making authorities.[163] However, they could be swayed by foreign portfolio investment movements itself; global fundamentals such as tightening of global finance,[164] multilateral institution obligations; other macroeconomic objectives such as the need for economic stability, controlling inflation, dealing with unemployment etc., and social forces such as, host State economic ideology etc.[165] Nevertheless, considering that economists in their characteristic nature are unable to find consensus on anything including the macroeconomic drivers of foreign portfolio investment movements,[166]the thesis will discuss *ceteris paribus* some of the conditions that have been found to have some influence on foreign portfolio investment movement decisions and volatility.

(a) <u>Foreign Exchange Rate:</u>

Foreign portfolio investment inflow usually takes into consideration host state's currency exchange rates and high interest rates. Host state devaluation of currency has been found to incentivize international portfolio investment inflows because of its potential for return on investments.[167] On the contrary, in another study, currency devaluation was a deterrence to foreign portfolio investment inward movement.[168] However, it is important to point out that context matters. An existing foreign portfolio investment investor sees devaluation of currency

[162] Adam Hayes, 'Sensitivity' *Investopedia* 10 June, 2020 https://www.investopedia.com/terms/s/sensitivity.asp
[163] Patricia L. Makoni, 'FDI and Foreign Portfolio Investment Determinants in Developing African Countries' (n 156) 254.
[164] International Monetary Fund, *Global Financial Stability Report:* April 2022
[165] Christina Romer & David Romer, 'The Determinants of Macroeconomic Policy' University of California, Berkley Economics 210c/236a Lecture 12 November 30, 2016.
[166] Chukwuemeka P. Ekeocha et al, 'Modelling the Long Run Determinants of Foreign portfolio investments in Nigeria (n 5).
[167] M. Bleaney & D. Greenaway, 'The Impact of Terms of Trade and Real Exchange Rate Volatility on Investment and Growth in Sub-Saharan Africa' (2001) 65 Journal of Development Economics.
[168] R. Aggarwal, 'Foreign portfolio investments in Some Developing Countries: A Study of Determinants and Macroeconomic Impacts' (1997) 32 Indian Economic Review; V. Kumar, 'Dynamics of Private Capital Flows to India: A Structural VAR Approach (2018) 52(4) The Journal of Developing Areas 129.

negatively because fluctuations in real exchange rate[169] increases foreign portfolio investment volatility.[170] Investors are averse to holding assets denominated in currencies whose value is prone to falling. If they happen to do, they liquidate same quickly. [171] Meanwhile a potential equity foreign portfolio investment investor may view currency devaluation positively, where the currency possesses the potential for appreciation. As a result, foreign portfolio investors are constantly monitoring exchange rates[172] owing to their inverse relationship.[173] What this means is that host state's policy of currency devaluation attracts new foreign portfolio investment in assets at a low price. Subsequent fluctuations in the exchange rate will result in foreign portfolio investment volatility i.e., large, and sudden fluctuation in foreign portfolio investment asset prices; potentially resulting in sale of foreign portfolio investment assets.

To avoid this, foreign investors prefer the domestic currency to be pegged to a foreign currency preferably the dollar to avoid currency risks. However, such pegging could lead to the local currency being overvalued as well as a current account deficit, and potential Balance of Payment crisis. Consequently, the host state will be constrained to abandon the peg and devalue which will be detrimental to foreign portfolio investments.

(b) Interest Rate[174]:

Interest rates.[175] Interest rates can exert push-pull influence on foreign portfolio investment, especially on fixed-income asset (debt assets) foreign portfolio investment such as bonds. Interest rates are either short-term interest rates, or long-term interest rates.[176] Central banks or monetary authorities within a state usually set the nominal short term interest rates,[177] while the long-term interest rates are based on the short-term rates and determined by the forces of

[169] Real Exchange rate of foreign exchange that has been adjusted for inflation. It has been argued to be a better indicator of Foreign Portfolio Investment volatility. See, F. Carrieri et al, 'Does Emerging Market Exchange Risk Affect Global Equity Prices?' (2006) 41 Journal of Financial and Quantitative Analysis.
[170] Yahya Waqas et al, 'Macroeconomic Factors and Foreign Portfolio Investment Volatility: A Case of South Asian Countries (2015) 1 Future Business Journal 66
[171] Odongo Kodongo & Kalu Ojah, 'Real Exchange Rates, Trade Balance and Capital Flows in Africa' (2013) 66 Journal of Economics and Business 43.
[172] J. Darby et al, 'The Impact of |Exchange Rate Uncertainty on the Level of Investment' (1999) The Economic Journal.
[173] C. S Eun & B. G. Resnick, 'Exchange Rate Uncertainty, Forward Contracts and International Portfolio Selection' (1988) 43 Journal of Finance 197.
[174] All You Need To Know About Interest Rates & Exchange Rates | Instarem Insightsss
[175] https://www.oecd-ilibrary.org/finance-and-investment/short-term-interest-rates/indicator/english_2cc37d77-en
[176] Ibid.
[177] Nominal interest rates are interest rates fixed and advertised for a fixed-income asset which does not take cognizance of inflation rate.

demand and supply (market forces). High interest rates have a positive influence on new debt foreign portfolio investment movements because it demands that the borrower compensate the lender higher rates of return for the investment, but negative effect on the value of older long-term debt investments with lower interest rates. To this end, debt foreign portfolio investment investors rely on real interest rates when making their push or pull decision on a foreign portfolio investment owing to real interest rates being adjusted for inflation and reflecting the real economic value of the investment.[178]

(c) Inflation Rate:

Inflation, including the expectation of future inflation are a consequence of the activities between short-term interest rates and long-term interest rates.[179] Interest rates are one of the tools utilized by Central Banks and monetary authorities to control inflation. Central Banks set and adjusts short-term interest rates to expand or tighten money supply, and influence the rate of inflation in a country.[180] Variations in money supply sometimes is related to variations in prices (rise and fall in inflation) according to the quantity theory of money.[181] Increase in money supply may result in low interest rates which in the short run may have 'liquidity effect', but if the money supply continues to increase, may eventually result in an 'expected inflation effect'[182]. In this regard, low interest rate encourages more borrowing, stimulates money supply, and increases consumer spending - resulting in economic growth and probably in the long run high inflation. Conversely, rising interest rates discourages borrowing, encourages savings, constrains money supply, and reduces spending-resulting in economic slowdown and decreasing inflation.[183] What this then means is that inflation rates are a function of interest

[178] Will Kenton, 'Nominal Interest Rates' https://www.investopedia.com/terms/n/nominalinterestrate.asp

[179] Barry Nielsen, 'Understanding Interest Rates, Inflation and Bonds' Investopedia https://www.investopedia.com/articles/bonds/09/bond-market-interest-rates.asp Accessed 21/08/2020.

[180] Jean Folger, 'What is the Relationship Between Interest Rates and Inflation' Investopedia https://www.investopedia.com/ask/answers/12/inflation-interest-rate-relationship.asp 24 August, 2020

[181] James Chen, 'Quantity Theory of Money' Investopedia https://www.investopedia.com/terms/q/quantity_theory_of_money.asp 12 November, 2019. The quantity theory of money assumes that increase in money supply relates to increase in inflation. Essentially if the Central Bank increases the quantity of money in circulation, prices will go up, thus inflation rises, and vice versa. Fisherian Theory, advanced by Irvine Fisher within quantity theory of money assumes a fixed proportional relationship between increased money supply and increased inflation. However, Knut Wicksell argued that an artificial stimulation of money supply by central banks would result in uneven price distortions (a situation where prices are not determined by market forces, but by other forces like monetary policies such as interest rates), and may cause business cycles.

[182] The Liquidity Effect, http://users.ox.ac.uk/~exet2581/msc/ec924liquid.pdf An increase in the money supply can have two effects: (i) it can reduce the real interest rate (this is called the "liquidity effect", more money, i.e. more liquidity, tends to lower the price of money which is equivalent to lowering the interest rate) (ii) it forecasts higher future inflation (called the expected inflation or Fisher effect).

[183] Jean Folger, 'What is the Relationship between Interest Rates and Inflation' (n 180).

rates and vice versa. Furthermore, home state's low interest rates and high inflation may motivate portfolio investors to seek higher interest rates in countries with lower inflation but higher return [184] since increase in home state inflation is correlated to foreign portfolio investment outflows.[185]

(d) **Capital Liquidity, Economic Development & Financial Market Development**

Rising market index is an indication of positive macroeconomic conditions, economic growth, and high return on investment. [186] High returns on investment is reflected in the rise in market index which affects increase in stock prices, thus foreign portfolio investment flow will be attracted by the rise in stock market index [187] thereby increasing domestic stock market liquidity[188]. This is because current and previous positive returns have been found to influence foreign portfolio investment inflow.[189] What it means is that an increase in stock market returns encourages investors to continue investing which will in turn increase stock market liquidity.[190] However, this positive correlation between stock market returns owing to rising index, and foreign portfolio investment flows is dependent on the extent of financial market development within the host state as reflected in the stock market.[191] The significance of financial market development and economic growth on influencing foreign portfolio investment flows remains uncertain,[192] nevertheless, it has been contended that economic developments in terms of GDP might influence foreign portfolio investment flows. [193] Also, stock market development reflected in its capacity to effectively intermediate the acquisition and disposal of shares might

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[184] R. Aggarwal, 'Foreign portfolio investments in Some Developing Countries' (n 167).
[185] A. Mody *et al*, 'Modelling Fundamentals for Forecasting Capital flows to Emerging Markets' (2001) 6 International Journal of Finance and Economics.
[186] A. Çulha, 'A Structural VAR Analysis of the Determinants of Capital Flows into Turkey' (2006) 2 Central Bank Review 11.
[187] R. Chakrabarti, 'FII Flows to India: Nature and Causes' (2001) 2 Money Finance 61.
[188] R. Levine, 'Financial Development and Economic Growth: Views and Agenda' (1997) 35 Journal of Economic Literature 688.
[189] J. Gordon & P. Gupta, 'Portfolio Flows into India: Do Domestic Fundamentals Matters?' (2003) IMF Working Paper 1.
[190] R. Levine, 'Financial Development and Economic Growth' (n 188).
[191] C. K. Choong et al, 'Private Capital Flows, Stock Market and Economic Growth in Developed and Developing Countries: A Comparative Analysis' (2010) 22 Japan and the World Economy 107.
[192] R. A. Santis & M. Luhrmann, 'On the Determinants of Net International Portfolio Flows: A Global Perspective' (2009) 28 Journal of International Money and Finance, found that economic growth and financial development with improved macroeconomic conditions seemingly attracts more Foreign Portfolio Investment flows. However, Yahya Waqas et al (n 170) argued that insignificant results were found on this correlation at 67.
[193] Economic development from the perspective of GDP as an influence on Foreign Portfolio Investment movement was also re-echoed in A. Levchenko & P. Mauro, 'Do Some Forms of Financial Flows Help Protect against "Sudden Stops"?' (2007) 21 The World Bank Economic Review 389; and C. Thapa & S. S. Poshakwale, 'International Equity Portfolio Allocations and Transaction Costs' (2010) 28 Journal of Banking Finance 2627.

influence foreign portfolio investment movement;[194] so might a developed credit market reflected in retail banking influence Foreign Portfolio Investment movement through intermediation for debt finance.[195]

From all indications, changes in domestic macroeconomic conditions have an effect either positively or negatively on foreign portfolio investment movement and volatility. The changes are usually in response to other macroeconomic factors, global fundamentals, or in line with international commitments. For instance, interest rates which have a push or pull effect on debt foreign portfolio investment investments, are influenced by inflation rate, real GDP, and market forces. Inflation rate which also has a push or pull effect on foreign portfolio investment investments is influenced by money supply, which is influenced by interest rates. Each macroeconomic factor may be a function of the variations in other macroeconomic factors. Constant variations in macroeconomic conditions could result in macroeconomic uncertainty and instability, leading to a risky perception of a host state domestic market by foreign investors.[196] Ideally, foreign portfolio investment investors require maintenance of certain macroeconomic conditions such as pegging exchange rate for foreign portfolio investments or maintaining interest rates for debt asset foreign portfolio investors to ensure consistent foreign portfolio investment investor returns in host state domestic markets.[197] However, history shows us that this is unsustainable.

2.4 What are the Benefits and Risks of Foreign Portfolio Investment?

(a) Benefits of Foreign Portfolio Investment Movement to Host State:

The benefits of FPI are mostly seen through their efficiency effects.[198] Benefits from foreign portfolio investment include benefits from: international portfolio diversification; market segmentation; hedging; and participation in growth of foreign markets through expansion and diversification of foreign investor base.[199] Foreign portfolio investment can facilitate increased

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[194] B. Hearn et al, 'Market Liquidity and Stock Size Premia in Emerging Financial Markets: The Implications for Foreign Investment' (2010) 19(5) International Business Review 489.
[195] E. K. Agbloyor et al, 'Financial Markets and Cross Border Mergers and Acquisitions in Africa' (2011) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1914478
[196] Odongo Kodongo & Kalu Ojah, 'Real Exchange Rates, Trade Balance and Capital Flows in Africa' (n 171) 23
[197] Patricia L. Makoni, 'Foreign portfolio investments, Exchange Rates and Capital Openness' (n 156).
[198] Joseph Stiglitz, Capital Market Liberalisation, Economic Growth and Instability (2000).
[199] Swarnali Hannan, 'Revisiting the Determinants of Capital Flows in Emerging Markets: A survey of Evolving Literature (2018) IMF Working Paper18/214.

efficiency of domestic capital markets by deepening these markets and raising their disclosure standards.[200] Debt foreign portfolio investment such as infrastructure sovereign bonds may engender real economic growth, potential social and economic development in the sense of job creation, reduced cost of capital for domestic firms[201] if they are utilised for the actual purpose. Equity foreign portfolio investment could also supplement domestic savings and investment and help reduce investor risks by increasing stock market liquidity, improve compliance, transparency, and corporate governance, and facilitate capital market integration.[202] Purchase and sale of foreign portfolio investment assets by foreign investors can bring stability to the secondary market and help to 'offset cyclical behavior[203] of domestic investors' within the secondary market.[204] However, the short-term benefits of FPI capital flows are offset by the costs in terms of economic distress and potentially crisis, caused by its sudden stop, and exit given its reversibility.[205]

(b) Risks Associated with Foreign Portfolio Investment Movements

(i) Risks to Host States

Hausmann & Fernandez-Arias view portfolio investments, particularly debt portfolio investments as "bad cholesterol". To them, portfolio investments are motivated by speculative search for favourable macroeconomic conditions like interest rates, and exchange rates, and are usually the first to move at the earliest sign of trouble. As a result, they are usually responsible for boom-bust cycles.[206] Similarly, Rawi Abdelal in highlighting the rationale for capital controls, pointed out that they are meant to apply to and regulate unrestricted mobility of short-term speculative capital (FPI) owing to their volatility, capacity to be disequilibrating, and potential to cause crisis.[207] This was to reverberate the opinion of John Maynard Keynes

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200 UNCTAD, 'Foreign Portfolio Investment and Foreign Direct Investment: Characteristics, Similarities, Complementarities and Differences, Policy Implications and Development Impact' (1999) Trade and Development Board Commission on Investment, Technology and Related Financial Issues Expert Meeting on Portfolio Investment Flows and Foreign Direct Investment 2.
201 N. N. Sawalha et al, 'Foreign Capital Inflows and Economic Growth in Developed and Emerging Economies: A Comparative Analysis' (2016) 50(1) The Journal of Developing Areas 237.
202 Patricia L. Makoni, 'Foreign portfolio investments, Exchange Rates and Capital Openness' (n 156).
203 Investment behaviour that follows the cycles of an economy. It can be procyclical or counter-cyclical.
204 World Bank, 'Direct and Portfolio Investment' World Bank Open Knowledge https://openknowledge.worldbank.org/bitstream/handle/10986/5968/9780195204827_ch09.pdf?sequence=11&isAllowed=y
205 Yilmaz Akyuz, 'Capital Flows to Developing Countries in a Historical Perspective: Will the Current Boom end with a Bust?' (2011) South Centre Research Paper 37 p 11
206 Ricardo Hausmann & Eduardo Fernandez Arias, 'Foreign Direct Investment: Good Cholesterol?' (2000) Inter-American Development Bank Research Department Working Paper No. 417 p 3.
207 Rawi Abdelal, *Capital Rules* (Harvard University Press, 2007) 45-46.

on FPI. Arthur Bloomfield also reiterated the necessity for controlling unrestricted movement of ‘hot money’.[208] He said:

> It is now highly respectable doctrine, in academic and banking circles alike, that a substantial measure of direct control over private capital movements, especially of the so called ‘hot money’ varieties, will be desirable for most countries not only in the years immediately ahead but also in the long run as well…Unfettered freedom of individuals to transfer funds across national boundaries…has long been a hallowed dogma of traditional economic thought…This doctrinal *volte face* represents a widespread disillusionment resulting from the destructive behaviour of these movements in the interwar years.[209]

However, Eichengreen & Mussa recognizes the complexity of financial crisis which makes it difficult to pinpoint with exactitude the cause. However, they contend that there are a good number of crisis which unrestricted FPI movement played a significant part in causing. For instance, the Asian Financial Crisis of 1997.[210]

The Asian Financial Crisis best illustrates the disequilibrating capacity of FPI, and its potential for causing or exacerbating financial and economic crisis. The macroeconomic policy change by major East Asian countries of adopting a pegged exchange rate, and capital account liberalisation were instrumental to causing the crisis. The objective for liberalisation was to attract capital for growth. Such assurance of stability in foreign exchange incetivised foreign portfolio investors to believe that currency risks had been eliminated, leading to large capital movement into these markets.[211] The increase in quantity of investments and not quality, increased the exposure of these Asian economies to volatile investments, capable of leaving at the first sign of trouble. The massive movement of FPI fueled inflation in these East Asian economies.

For instance, Thailand refused to introduce capital controls and adopt a flexible exchange rate out of fear of slowing growth. Eventually, it was when their foreign exchange reserve was at

[208] *Ibid*.
[209] Arthur I Bloomfeld, ‘Post-war Control of International Capital Movement’ (1946) 36(2) American Economic Review p 687.
[210]Barry Eichengreen & Michael Mussa, ‘Capital Account Liberalisation and the IMF’ *Finance & Development* December 1998 35(4) https://www.imf.org/external/pubs/ft/fandd/1998/12/eichen.htm.
[211] Barry Eichengreen, *Globalisng Capital* (n 24) 193.

the verge of being completely wiped out, that they decided to devalue the Thai Baht, and float it. Indonesia on the other hand, did not. They held on to their liberalisation policy and fixed exchange rate. Rather than more investments coming in, they saw massive capital movements out of Indonesia which affected their currency value and led to a run on the domestic banks. Citizens moved from deposits to cash with the Central Bank unable to meet the cash demands of the citizens. The entire banking system had to be shutdown to avoid contagion, but with implications for production, leading to a recession.

Furthermore, the massive inflow of portfolio investments post the lobal financial crisis resulted in a number of concerns not limited to volatility. For instance, these inflows had the potential to 'overwhelm the intermediation capacity of domestic financial systems' with the effect of excessive credit creation and asset price bubbles which created risks of financial instability.[212] Furthermore, the inflows also created complications in terms of inflation and what macroeconomic policies to adopt to manage the excessive inflows while managing inflation. Interest rate increases may deal with inflation but may spur more inflows, while slowing tightening may have inflationary consequences.[213] However, recent research has demonstrated that benefits may accrue to volatile portfolio investments. For instance, increased equity FPI flow has been associated with increment in funding for investments.[214] Furthermore debt FPIs have been correlated to boosting investments,[215] increased productivity[216] and growth.[217]

Nonetheless, as can be seen, unrestricted capital mobility of FPI exposes host States to the risk of sudden capital outflows by investors whenever their perception of the risks within the market changes, rather than facilitating the intended productive capital inflows[218]. For instance, the depletion of reserves suggests to foreign investors that the host state will be unable to finance payments towards foreign denominated short-term obligations, the outcome will be a sudden

[212] Shaghil Ahmed & Andrei Zlate, 'Capital flows to emerging market economies: A brave new world?' [2014] 48 Journal of International Money and Finance 222.
[213] Ibid.
[214] C Calomiris, M Larrain and S Schmukler, 'Capital inflows, equity issuance activity, and corporate investment' (2019) Journal of Financial Intermediation. M Kacperczyk, S Sundaresan, and T Wang 'Do foreign institutional investors improve price efficiency' (2021) 34(3) The Review of Financial Studies 1317.
[215] T Williams, 'Capital inflows, sovereign debt and bank lending: micro-evidence from an emerging market' (2018) 31(12) The Review of Financial Studies 4958.
[216] M Larrain and S Stumpner, 'Capital account liberalization and aggregate productivity: the role of firm capital allocation (2017) 72(4) The Journal of Finance 1825.
[217] D Igan, A M Kutan, and A Mirzaei, 'The real effects of capital inflows in emerging markets' [2020] 119 Journal of Banking & Finance.
[218] Joseph Stiglitz, 'Capital Market Liberalisation, Economic Growth and Instability' (n 82) 6-7

reversal of capital out of the host States. The reversal of FPI flows out of host State can bring about instability. There will therefore be a need for State intervention to manage the instability. Intervention will inevitably be through macroeconomic and prudential policies. Such interventions will be challenged in investment arbitration where FPI are protected. The Asian Financial crisis exposes the necessity for host states to have macroeconomic flexibility. It also unearths the challenges of using macroeconomic policies to attract all kinds of investments rather than qualitative investments. Evident in the case of Indonesia. The longer Indonesia failed to change policy course, the worse the situation became.

Recognition of the need for macroeconomic flexibility is underscored by the fact that previous governments may have adopted the economic policies responsible for the economic downturn just like in the Asian Financial Crisis, Argentinian Economic Crisis, and the current Sri Lankan crises. Thus, it remains imperative that succeeding governments can adjust without consequences in the interest of the economic and social wellbeing of the citizens. Interestingly, it has been argued that all things being considered, particularly real-world scenarios, the costs and other constraints of foreign portfolio investment at best limits their potential advantages, at worst undermines their benefits.[219]

(ii) <u>Risks to Foreign Portfolio Investments</u>

The main risk to foreign portfolio investment is essentially risk to investment return. Foreign portfolio investment exposure to risk include debtor default; management inefficiency; and host state's macroeconomic measures in the form of foreign exchange controls, inflation, interest rates, taxation (withholding tax, taxation of income, double taxation) and capital market regulations. According to William Sharpe, investment return on stock is dependent on systematic non-diversifiable market risks and idiosyncratic diversifiable non-market risks.[220] Thus, foreign portfolio investment risks are either idiosyncratic (on-market) risks or systematic (market) risks

(A) Idiosyncratic (Non-Market) Risks

[219] Bartram M Sohnke & Gunter Dufey, 'International Portfolio Investment: Theory, Evidence and Institutional Framework' (n 12) 2.
[220] William Sharpe, 'Capital Asset Prices: A Theory of Market Equilibrium under Conditions of Risk' (1964) 19(3) Journal of Finance 441.

Risks associated with uncertainty of price/value of security dependent partly on the fortune of the issuer and independent of the market or overall economy. It is risk indigenous to individual assets such as company shares, bonds etc., or group of assets of a particular sector. Idiosyncratic risks make up most of the risks and uncertainties surrounding individual stock price/value over time. It could be risks to foreign portfolio investment value/price emanating from company investment strategies, management decisions, corporate culture, and even strikes within a particular sector.[221] Diversification is a common means of mitigating the non-market risks of foreign portfolio investment movements.[222] Diversification involves mixing of diverse assets and investments in a portfolio to limit exposure to risk.[223] How this works is that the greater the number of different assets within a portfolio, the higher the chance of good fortune, equalizing the potential bad fortunes.

(B) Systematic (Market) Risks

Risk associated with the sensitivity of the security/portfolio to market swings. It is common to all financial assets including foreign portfolio investment within the financial market.[224] It is correlated to macroeconomics variables[225] because changes in the latter, such as in exchange rates, interest rates or restructuring creates a risk of volatility (fluctuation in foreign portfolio investment prices across the financial market) potentially resulting in price/value uncertainty and loss. It also arises owing to economic and political uncertainties.[226] Systematic risks cannot be diversified, though, some of these risks may be mitigated through hedging and discount brokerages.[227]

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[221] https://www.investopedia.com/terms/i/idiosyncraticrisk.asp
[222] William Sharpe, 'Risk, Market Sensitivity and Diversification' (n 160) 74.
[223] https://www.investopedia.com/terms/d/diversification.asp
[224] Hayette Gatfaoui, 'Idiosyncratic Risk, Systematic Risk and Stochastic Volatility: An Implementation of Merton's Credit Risk Valuation' in G. N. Gregoriou, *Advances in Risk Management* (Palgrave Macmillan, 2007) Ch 6, 107-108.
[225] Ibid.
[226] Market Risk https://www.wallstreetmojo.com/market-risk/
[227] Bartram M Sohnke & Gunter Dufey, 'International Portfolio Investment: Theory, Evidence and Institutional Framework' (n 12) 4.

Systematic risk exists in interest rate risks,[228] currency exchange risks,[229] equity risks,[230] inflation risks and political/country risks[231] etc. As their names implies, these risks are associated with changes in macroeconomic fundamentals. Thus, the changes may be the function of state action through monetary and fiscal authorities to achieve monetary and financial stability; or that of market forces in reaction to demand and supply.

2.5 What are the Consequences of the International Investment Regime's Protection of Portfolio Investments?

Given the complexity of the dynamics involved in macroeconomic policy making as demonstrated and their economy wide implications, the relevant questions remain:

(i) whether the international investment law regime can and should be deployed to protect foreign portfolio investments to ensure macroeconomic stability favourable to such investments? Also,

(ii) what are the consequences of using the international investment law regime framework to protect foreign portfolio investment investors within emerging and frontier economies especially in the face of existing or impending crisis?

The feasibility and sustainability of resorting to international investment law regime to protect foreign portfolio investments is within the remit of this thesis. The above questions will be dealt with in the succeeding chapters to this thesis.

Ideally, investors would rather not have market swings with implications for their investments, especially state induced fluctuations, given the belief that stable market conditions incentivizes foreign portfolio investment.[232] Therefore, considering, the efficacy of the international

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[228] Interest rate risk is the risk resulting from fluctuations in interest rates owing to monetary policy measures. Debt assets like bonds are most susceptible to exposure to this risk.
[229] Currency risk represents the risk of a possible decline in value of an asset, or return accruable to an investor over an asset held by the investor owing to a depreciation in the value of the currency in which the asset is being held.
[230] Equity risks represents the risk of sudden fluctuation in the prices of shares in the stock market arising from its sensitivity to changes within the domestic or global economy.
[231] Country risks are risks which are outside the control of the financial markets but has an impact therein such as political instability, ease of doing business, economic mismanagement through regulatory and policy measures etc.
[232] Patricia L. Makoni, 'Foreign portfolio investments, Exchange Rates and Capital Openness' (n 156).

investment law regime in stabilizing state policy measures,[233] it is no surprise that it has been argued peripherally by Julian Mortenson[234] and quite strenuously by Michail Dekastros[235] that the international investment protection framework ought to be extended to foreign portfolio investments, since foreign portfolio investments are investments within the scope of international investment agreements. Thus, it deserves protection against state measures that threatens their value and profit.

Customarily, the international investment regime is designed to cater for FDI, against state action, because FDI are mostly capital intensive, long-term and involve fixed assets i.e. assets that have a useful life of more than one year which includes property, plants and equipment. Flowing from this, FDIs are at greater risk and stands to lose more from exposure to risks emanating from changes in state policies in the form of expropriation and discrimination. To reassure potential investors regarding their investments, states conclude international investment agreements (IIAs) such as Bilateral Investment Treaties (BITs) and treaties with investment protection chapters which offer investment protection standards, enforceable by Investment Treaty Arbitration (ITA) that guarantees *ex post* and *ex ante* investment protection[236] and compensation against state driven expropriatory, discriminatory and unjust measures.[237] This essentially, is the objective and aim of BITs/Investment Chapters.[238] Fundamentally, international investment agreements functions to reduce the effect of state induced risks on FDI.[239] The effect of the investment protection capacity of BITs, has witnessed a significant rise in BITs and arbitration disputes.[240]Consequently, about 2901 BITs

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[233] Christoph Schreur "Do We Need Investment Arbitration?" in Jean E. Kalicki and Anna Joubin-Bret "Reshaping the Investor-State Dispute Settlement System: Journeys for the 21st Century" (Brill Nihoff NV, Leiden, 2015) 879 at 879

[234] Julian Mortenson, 'The Meaning of "Investment": ICSID's Travaux and the Domain of International Investment Law [2010] 51 Harvard International Law Journal 270.

[235] Michail Dekastros, 'Portfolio Investment: Reconceptualising the Notion of Investment under the ICSID Convention' (2013) The Journal of World Investment and Trade; *Enron v Argentina* 14 January 2004, 11 ICSID Report 273; *CMS v Argentina* 17 July 2003, 7 ICSID Reports 494; *Abaclat v Argentina* 4 August 2011.

[236] Jeswald W Salacuse & Nicholas P. Sullivan, 'Do BITs Really Work?: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain' (2005) 46(1) Harvard International Law Journal 75

[237] World Bank, 'Direct and Portfolio Investment' World Bank Open Knowledge https://openknowledge.worldbank.org/bitstream/handle/10986/5968/9780195204827_ch09.pdf?sequence=11&isAllowed=y

[238] Peter Muchlinski, 'The Framework of Investment Protection: The Content of BITs' in K. P Suavant & Lisa E. Sachs (eds) *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (OUP, 2009) 39.

[239] See, Zachary Douglas *The International Law of Investment Claims* (Cambridge University Press, 2012) at 1.

[240] J Linarelli, M E Salomon, and M Sornarajah, *The Misery of International Law: Confrontations with Injustice in the Global Economy* (OUP 2018). 102.

and 391 preferential trade agreements with investment protection chapters have been negotiated and signed to date.[241]

In opposition to foreign investment protection coverage for foreign portfolio investments, this thesis argues that the consequence of an extension of the international investment law protection to foreign portfolio investment will result in absurdity in the first instance because of the nature, complexity[242] and consideration of what constitutes foreign portfolio investment and its drivers. Secondly, such extension will work to constrain the macroeconomic capacity of host states. In the face of economic/financial crisis, such constriction may result in severe economic and social welfare costs. Protecting less qualitative investments with BITs will only magnify the risks of FPI to host States since it will reinforce FPIs unrestricted capital movement, even when States would rather have capital restrictions.

Furthermore, extending protection to FPI would ensure that host state interventions can then be challenged before investment arbitration where FPIs are considered as investments and protected. Arbitration tribunals will therefore have to contend with balancing the need for social returns to citizens by the host State, and the need for private returns to investors. It is submitted that the social and economic costs of tilting the scale in favour of private returns will outweigh whatever benefits. Granting access to investment arbitration to FPI will essentially be investors trying to force a policy decision on host states. Stiglitz has demonstrated that forcing policies on developing countries will serve to make matters worse.[243]

Finally, international investment law protection is an inefficient risk management framework, when compared to existing financial engineering and technological tools to deal with systematic risks.[244] The costs (economic and social) of protection outweighs the benefits as has been illustrated. A positive and normative review of BIT/Investment Chapter protection of Foreign Portfolio Investments in subsequent Chapters[245]will demonstrate that it can fall short of providing effective and efficient protection to FPI.

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[241] United Nations Conference on Trade and Development Investment Policy Hub https://investmentpolicy.unctad.org/international-investment-agreements

[242] For a detailed discussion on this please see part C above of this Chapter.

[243] Joseph Stiglitz, 'Principles of Financial Regulation: A dynamic portfolio approach' (2000); See also Joseph Stiglitz, 'Capital Market Liberalisation' (n 82) 8.

[244] For a detailed discussion on this, please see Chapter Seven of this Thesis.

[245] For detailed discussion of these please see Chapters Four, Five and Six of this Thesis.

2.6 Conclusion

Globalisation and improvements in information technology ushered in massive movements of foreign investments globally including FDI and foreign portfolio investment. While FDI involves the ownership of assets by foreign investors for the purposes of controlling and influencing the use of those assets; Foreign portfolio investments are essentially the results of investor decisions to move foreign portfolio investment assets wherever they are likely to be most productive to make themselves better off. Host state macroeconomic factors play a pivotal role in those foreign portfolio investment movements' decisions, as well as foreign portfolio investment volatility and foreign portfolio investment exposure to systematic risks. Historically, these risks were managed by merchant banks and even the now defunct corporation of foreign bondholders, and not through customary international law or international investment law. However, it has been suggested that the international investment law regime can accommodate foreign portfolio investment. It is this, narrative that this thesis seeks to critically evaluate. Going forward, only financial claims in relation to emerging and frontier markets' portfolio investments such as shares and debt securities bought directly in foreign or domestic markets are relevant to the discussions in this thesis. The reason being that these foreign securities offer more attractive investments options following from their potential for higher risks (more risks and volatility) and higher rewards and the extent of financial market development in those economies.

Chapter Three

Capital Account Liberalisation and International Investment Law' Protection of Foreign Portfolio Investment

3.0 Introduction

This chapter traces the alternating evolution of the norms and rules in international capital movements from regulated to liberalised to regulated. It examines the arguments against capital liberalisation owing to its destabilising effect during the inter-war period, and why liberalisation was adopted and promoted by the developed countries through organisations like the EU, OECD, and the IMF, and how it subsequently became absorbed within the international investment regime of developed and emerging and frontier markets reflected in their Bilateral Investment Treaty (BIT) practice.

Neoliberalism, as well as dissatisfaction with the distributional effects of capital control policies accounted for the adoption of capital liberalisation in developed countries despite its capacity for disequilibria and crisis.[1] While factors such as hegemonic socialisation of the elites,[2] neoliberal professional training of economic policymakers,[3] and IMF's positive disposition towards capital liberalisation accounts for the adoption of capital liberalisation in emerging/frontier economies. Emerging/frontier economies needed capital for growth an believed that liberalised capital is fundamental to growth[4] despite the mixed and uncertain results of this claim.[5] The outcome is more than 2000 executed Bilateral Investment Treaties (BITs).

Within these executed BITs capital liberalisation was expressed in broad definitions of investment which allows short term and speculative FPIs to be considered as covered investments, as well as in unrestricted movement of funds clauses with no State policy space safeguards in the event of crisis. It is noteworthy that less than 15% of BITs contain policy space safeguards. The consequence of such blanket recognition of investments without

[1] Rawi Abdelal, *Capital Rules* (Harvard University Press, 2007)
[2] G John Ikenberry & Charles Kupchan, 'Socialisation & Hegemonic Power' (1990) 44(3) International Organisation 283.
[3] Jeffrey Chwieroth, 'Neoliberal Economists and Capital Account Liberalisation in Emerging Economies' (2007) 61(2) International Organisation 450
[4] Robert Solow, 'A Contribution to the Theory of Economic Growth' (1956) 70(1) Quarterly Journal of Economics 65,
[5] Obstfeld & Taylor, *Global Capital Markets: Integration, Crisis and Growth* (Cambridge University Press, 2004) 297

restrictions has resulted in the establishment of FPI rights to challenge host State macroeconomic measures which affect FPIs, with economic and social implications for emerging and frontier economies.

Consequently, it is contended that such blanket adoption of capital liberalisation is flawed because of the implications for emerging and frontier economies wherein the recognition and protection of all capital movements as investments by default will include short-term, volatile FPIs in search of high interests even though such types of capital may potentially be detrimental to the economy.[6]

The effect of the financial crisis of the 1990s, the Global Financial Crisis of 2007-2008 and the economic and financial effect of the Covid-19 pandemic cumulatively led to the recognition of the volatile effects of unrestricted capital liberalisation of foreign portfolio investments. As a result, the IMF has steadily moved away from promoting unrestricted capital liberalisation policies to advocating for a slower and cautious adoption of capital liberalisation in emerging and frontier economies, as well as adoption of pre-emptive capital flow regulations such Capital Flow Management measures (CFM) where foreign currency denominated external debts are accumulating without sufficient reserves to offset such debts.[7]

Even emerging and frontier states are moving away from capital liberalisation in investment treaties, with emerging and frontier States now excluding foreign portfolio investments from their definition of investments[8] and including safeguards to preserve their regulatory autonomy. However, majority of extant BITs/IIAs still contain capital liberalising enforceable provisions. It is these BITs which will be the focus of the subsequent chapters to this thesis.

This Chapter is divided into 5 parts. Part A explores the trend of capital liberalisation after the second world war. It identifies the drivers of this global movement in developed and developing countries. Part B examines the evolution of the international investment regime and how modern BIT provisions were influenced by capital liberalisation ideologies of developed

[6] Jagdish Bhagwati, 'Capital Myths: The Difference between Trade in Widgets and Dollars' (1998) 77(3) *Foreign Affairs*
[7] International Monetary Fund, 'Review of the Institutional View on the Liberalisation and Management of Capital Flow' (2022).
[8] There are about 31 BITs out of over 2000 that exclude FPI. See, Mapping of IIA Content | International Investment Agreements Navigator | UNCTAD Investment Policy Hub

countries, and the necessity for capital in emerging economies which resulted in them not taking cognizance of the destabilizing effect of liberalised FPI movements. Part C considers the effect of entrenching capital liberalisation in emerging and frontier economies through BITs. Part D explores the current global attitude towards capital account liberalisation after the various crises. Despite the current global movement towards more State autonomy, majority of the extant BITs contain enforceable capital liberalising provisions. Part E concludes.

Part A

3.1 Examining the Evolving Trend in Capital Account Liberalisation

The financial crisis and volatile exchange rate fluctuations during the interwar period tested developed economies policymakers' faith in liberalised, unregulated financial markets. It led to the necessity for the development of new sets of rules and systems to avert or mitigate such crisis. At the forefront of developing new set of rules and systems was John Maynard Keynes and Harry Dexter White. They came up with the Bretton Woods system and advocated for capital regulations by governments for economic autonomy and stability. In essence, they argued for the autonomy of governments to freely pursue expansionary macroeconomic policies for economic stability. They saw controls as an important aspect of the international financial system.[9]According to Keynes in his statement to the House of Lords, he stated that:

> In my own judgment, countries which avail themselves of the right may find it necessary to scrutinize all transactions, as to prevent the evasion of capital regulations. Provided innocent current transactions are let through, there is nothing in the plan to prevent this. In fact, it is encouraged. It follows that our right to control the domestic capital market is secured on firmer foundation than ever before and is formally accepted as a proper part of agreed international arrangements.[10]

Echoing similar thoughts was Arthur Bloomfield on the imperative of government regulation, especially of short-term speculative capital flows (FPI) said:

[9] Kevin P. Gallagher, 'Regaining Control? Capital Control and Global Financial Crisis' in Wyn Grant & Graham K Wilson eds, *The Consequences of the Global Financial Crisis: The Rhetoric of Reform and Regulation* (OUP, 2012) p 109.
[10] See John Maynard Keynes's 'Speech to the House of Lords, May 23 1944' in Donald Moggridge (ed) The Collected Writings of John Maynard Keynes (Cambridge University Press, 1944).

> It is now highly respectable doctrine, in academic and banking circles alike, that a substantial measure of direct control over private capital movements, especially of the so called 'hot money' varieties, will be desirable for most countries not only in the years immediately ahead but also in the long run as well…Unfettered freedom of individuals to transfer funds across national boundaries…has long been a hallowed dogma of traditional economic thought…This doctrinal *volte face* represents a widespread disillusionment resulting from the destructive behaviour of these movements in the interwar years.[11]

Richard Cooper also remarked that freedom of capital movement was unnecessary for high income and efficient growth but were also harmful and disruptive to growth and employment objectives.[12]

As a result, with the leading thinkers on the side of capital regulations, there seemed to be consensus on the adoption of capital regulations from the mid-1940s onwards to regulate short-term, speculative capital (FPI) because they were considered as restrictive of government autonomy,[13] harmful and disruptive to growth. Owing to the experience during the interwar financial crisis, the movement of short-term speculative capital (FPI) were viewed as being capable of bringing about disequilibria,[14] and financial crisis where no crisis exists; or worsening same where they do. As opposed to more 'productive capital flows' according to Henry Dexter White, which were less likely to lead to crisis.

The consensus on the undesirability of unrestricted movement of short-term speculative capital flows[15] (FPI) were captured in the earlier IMF rules, as well as in the EC (Rome) Treaty (1957) and the Organisation for Economic Cooperation and Development (OECD) Code of Liberalisation of Capital Movement (1961).[16] Implicit in these frameworks was the right of host States to regulate capital flows. Within the Rome Treaty, trade was clearly intended to freely move across borders, while capital could only freely move to the extent 'necessary to

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[11] Arthur I Bloomfeld, 'Post-war Control of International Capital Movement' (1946) 36(2) American Economic Review p 687.
[12] Richard Cooper, *The Economics of Interdependence* (1968) p 27.
[13] Rawi Abdelal, *Capital Rules* (n 1) 6.
[14] League of Nations, *International Currency Experience: Lessons of the Inter-War Period* (1944) 16.
[15] Original IMF Articles of Agreement only prohibited restrictions on current account transactions. Capital account liberalisation was not part of the goals of the IMF. See Jagdish Bhagwatti, 'Capital Myths: The Difference between Trade in Widgets and Dollars' (n 6) 7.
[16] Rawi Abdelal, *Capital Rules* (n 1) 7.

ensure the functioning of the common market.'[17] The inclusion of the condition for capital to move freely according to Rawi Abdelal, was to reflect the consensus that capital flows ought to be regulated to prevent financial crisis. It also captured the bargaining dynamics which existed within Europe at that time because aside Germany, most of Europe, particularly France, were in favour of capital regulation. Interestingly, the Dutch government argued for the exclusion of short-term capital flows (FPI) from the Rome Treaty, arguing that FPI was just money.[18]

However, from the 1970s, there arose a move away from capital flows regulation to a more liberalised vision for capital flows. The move started with the recognition of the liberalisation of FDI capital among developed economies while excluding short-term speculative flows. However, by 1988, both the OECD and the EC removed all restrictions and regulations on all capital movements (productive and speculative) which then included short-term speculative foreign portfolio investments.[19]

The ideology behind capital liberalisation in the US and UK was neoliberalism[20] championed by the Right. However, in Europe, capital liberalisation was promoted by the Left, particularly in France.[21] According to Rawi Abdelal, the main *dramatis personae* in promoting capital liberalisation in France, and eventually in Europe, the OECD and the IMF were Jacque Delors, Henri Chavranski & Michel Camdessus who were on the French left. Rawi Abdelal credits them for being the most responsible for the globalisation of capital liberalisation.[22] According to Rawi Abdelal,Delors, Chavranski & Camdessus, saw capital liberalisation as a means of addressing the distributional effects of capital controls which negatively affected the middle and working class, but left the rich largely unaffected. This situation was owing to the ability of the rich to find alternative means of moving funds out of France despite extant capital

[17] European Union, Treaty Establishing the European Community (Consolidated Version), Rome Treaty, 25 March 1957 (Rome Treaty 1957) Article 67; Age F.P Bakker, *The Liberalisation of Capital Movement in Europe: The Monetary Committee and Financial Integration, 1958-1994* (Springer, 2012) 42-43.
[18] Age F.P Bakker, *The Liberalisation of Capital Movement in Europe: The Monetary Committee and Financial Integration, 1958-1994* (n 17) 85. It is noteworthy that it was only when France changed its view to a more favourable outlook on capital liberalisation in 1984 that Europe adopted liberal rules on finance.
[19] Rawi Abdelal, *Capital Rules* (n 1) 11.
[20] Peter Hall, 'The Movement from Keynesianism to monetarism: Institutional analysis and British economic policy in the 1970s' in S. Steinmo, K. Thelen, & F. Longstreth (eds) Structuring Politics: Historical Institutionalism in Comparative Analysis (Cambridge University Press, 1992) 90; Eric Helleiner, States and the Reemergence of Global Finance: From Bretton Woods to the 1990 (Cornell University Press, 1994) 15-16.
[21] Philip G Cerny, 'The 'Little Big Bang' in Paris: financial market deregulation in a dirigiste system' (1989) 17(2) European Journal of Political Research 169.
[22] Rawi Abdelal, *Capital Rules* (n 1) 26-27.

controls. Ordinarily, capital controls are meant to be for the benefit of the middle and working class, yet it seemed to have had the opposite effect of imprisoning the funds of the middle and working class.[23]

While in government in France in the 1980s Delors, Chavranski & Camdessus proposed capital liberalisation within France. Subsequently, after they had gotten into international organisations like the EC and OECD, they introduced capital liberalisation and crystalised them into rules which empowered these organisations with jurisdiction over member states capital account policies.[24] Meanwhile, the IMF had started promoting capital account liberalisation among its members in the 1980s such that between the late 1980s, and 1990s a sizable number of IMF member States including emerging and frontier economies abandoned capital controls for unrestricted capital movements to compete for, and benefit from international capital movements. The removal of controls led to the global expansion of international capital movements.[25]

Finally, the IMF at the annual World Bank/IMF Meeting in 1997, attempted to expand its mandate to include capital account convertibility i.e., capital account liberalisation which eventually failed. In reaction to the IMFs action of attempting to include capital account liberalisation as part of its mandate,[26] Joseph Stiglitz viewed such decision as unjustifiable, arguing that capital account liberalisation no basis in theoretical analysis, historical experience, or econometric studies.[27]

Part B

3.2 Capital Account Liberalisation in International Investment Law

Prior to investment protection under Bilateral Investment Treaties,[28] proto-investment treaties existed. These were treaties on Friendship, Commerce and Navigation between the United States and its allies during the 18th and 19th century. The aim of the treaties was to establish trade and commercial relations between the US and its allies. They ordinarily did not cover foreign investments protection. They were mostly restricted to trading in goods by merchants

[23] Rawi Abdelal, *Capital Rules* (n 1) 29.
[24] Ibid.
[25]Barry Eichengreen & Michael Mussa, 'Capital Account Liberalisation and the IMF' Finance & Development December 1998 35(4) https://www.imf.org/external/pubs/ft/fandd/1998/12/eichen.htm
[26] World Bank Group-IMF Annual Meeting in Hong Kong 1997.
[27] Joseph Stiglitz, 'Capital Market Liberalisation, Economic Growth and Instability' (2000) Columbia Business School https://www0.gsb.columbia.edu/mygsb/faculty/research/pubfiles/1479/Stiglitz_CapMktLiberaliz.pdf 2. Accessed 10/10/2022.
[28] The first ever BIT was the Germany-Pakistan BIT of 1959.

and were extended to military activities like access to ports and navigation through internal waters,[29] and in some rare cases, investment protection was covered.[30] The treaties had provisions guaranteeing special protection and full and perfect protection to the property of the citizens of one party in the territory of the other. The treaties offered quite limited protections for currency transfers.[31]

However, the source of the principles for protection of the property of foreigners was customary international law which developed to obligate host States to protect foreigners and aliens, and to treat them in accordance with minimum standards of treatment.[32] Minimum standard of treatment initially did not relate to the obligation to protect the property of foreigners[33] however, it subsequently became applied in regard to protection of foreign investments and properties in accordance with customary international law.[34] However, the investment protection offered under customary international law was considered inadequate.[35]

Latin American independent countries objected to being under any obligation to extend minimum standards of treatment under Customary International Law.[36] Instead, they chose to adhere to the Calvo Doctrine.[37] The Calvo doctrine became relevant following the resort to gun-boat diplomacy tactics adopted by imperialist governments for protection of their citizens' property.[38] Furthermore, the concept and content of minimum standards of protection was vague, and relaxed, though it included the requirement for prompt, adequate and effective compensation in the event of expropriation of foreign property. This requirement was expressed in 1938 by the US Secretary of State Cordell Hull. Finally, enforcement of breach of the minimum standards of protection of foreign property under customary international law was espousal. Espousal allowed proprietary claims to be made by a home State either with force or diplomacy, on behalf of its overseas entities and citizens against the host State for

[29] M. Sornarajah, *The International Law on Foreign Investment* (Cambridge University Press, 2010) 180.
[30] Andreas Paulus, 'Treaties of Friendship, Commerce and Navigation' (2011) Max Planck Encyclopaedia of Public International Law
[31] Kenneth J Vandevelde, 'Investment Liberalisation and Economic development: The Role of Investment Treaties' (1998) Columbia Journal of Transnational Law 503.
[32] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (2nd edn, OUP, 2012) 3
[33] *Neer v Mexico* Opinion, 15 October 1926, IV RIAA 60.
[34] Ian Brownlie, *Principles of Public International Law* (5th ed 1998)
[35] Vandevelde, 'Brief History of International Investment Agreements' (2005) 12 U.C-Davis Journal of International Law & Policy 159.
[36] Ibid.
[37] Calvo Doctrine holds that foreign investors are not entitled to any special protection; they are only entitled to the same protection host States offer to their own domestic investors.
[38] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (OUP 2nd edn, 2012) 2

injury caused. Diplomacy was used by the United States in the 19th century to convince Latin American countries to submit claims to arbitrations. Foreigners and their properties were given diplomatic protection which was recognised by the Permanent Court of International Justice (PCIJ).[39] However, before the home state presents a claim under diplomatic protection, it must have decided to present the claim, and the citizen or entity must have exhausted local remedies within the host State.[40]

The trend of reliance on customary international law minimum standards for the protection of foreign assets continued until after the Second World War. After the Second World War, foreign investment protection evolved, and was shaped by changing events. The conclusion of the General Agreement on Tariffs and Trade (GATT) in 1947[41] which created a global multilateral trade regime with the objective of trade liberalization had a profound effect in foreign investment protection because it separated the trade regime from the investment regime[42]. The outcome was the United States signing new series of Treaties on Friendship Commerce and Navigation (FCN) that liberalised capital investments and had investment protection provisions extended to corporate entities (FDI). These FCN treaties guaranteed equitable treatment, Most Favoured Nation (MFN) and National Treatment (NT) rights to business activities, as well as expropriation without just compensation (FDI protection). The new FCNs also included dispute resolution provisions where both parties consented to the jurisdiction of the International Court of Justice over disputes on the interpretation and application of the agreements.

Nevertheless, under the new FCN, foreign investors were still expected to exhaust local remedies before being able to activate the jurisdiction of the international court of justice and institute claims.[43] Furthermore, the emergence of the socialist bloc under the Soviet Union, and newly independent States in Africa and Asia, also had an impact on shaping foreign investment protection and international investment agreements. The newly independent states that makthe e up majority of the emerging and frontier countries presently, were very suspicious of foreign investors from developed, capital-exporting countries which they viewed as exploitative, and

[39] *Mavrommatis Palestine Concession (1924) PCIJ SerA, No.2 at 12.*
[40] Andrew Newcombe & Lluis Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Walter Kluwer 2009) 6.
[41] General Agreement on Tariffs and Trade 1947 (Adopted in 1947, came into force in1948, amended in 1986 and incorporated into General Agreements on Tariffs and Trade 1994) 55 UNTS 194
[42] Vandevelde, 'Brief History of International Investment Agreement '(n 35) 167.
[43] *Ibid.*

their investments as a form of economic dependence. They were of the view that political independence was meaningless without capacity to control the economy.[44] With this in mind, most of the newly independent developing countries resorted to expropriation of existing foreign investments assets most notable of which were the expropriation of petroleum assets by Iran and then Libya in 1951 and 1955 respectively.[45] Justification was found in notions of economic justice and economic self-determination. The realities of the threat of uncompensated expropriations by developing newly independent countries led to the development and creation of modern foreign investment protection under BITs as we know them today.

The first ever Bilateral Investment Treaty (BIT) signed was the Germany-Pakistan BIT in 1959.[46]

Article 8 of the German-Pakistan BIT[47] defines ‘investment’ in very broad terms without expressly excluding foreign portfolio investment investments. It provides that:

> (a) The term "investment" shall comprise capital brought into the territory of the other Party for investment in various forms in the shape of assets such as foreign exchange, goods, property rights, patents and technical knowledge. The term "investment" shall also include the returns derived from and ploughed back into such "investment".
>
> (b) (b) Any partnerships, companies, or assets of similar kind, created by the utilisation of the above-mentioned assets shall be regarded as "investment".

It is submitted that the first ever BIT was influenced by capital liberalisation and laid the template for subsequent broad definitions of investments, thereby opening the possibility for construction to cover foreign portfolio investments going forward. This is unsurprising because at that time, Germany had a favourable disposition towards liberal capital movement and had

[44] J Linarelli, M E Salomon, and M Sornarajah, *The Misery of International Law: Confrontations with Injustice in the Global Economy* (OUP, 2018) 91
[45] Vandevelde, ‘Brief History of International Investment Agreement’ (n) 167
[46] Howard Mann, ‘Reconceptualizing International Investment Law: Its Role In Sustainable Development’ [2013] 17(2) Lewis and Clark Law Review 522; M. Sornarajah, *The International Law On Foreign Investment* (3d Ed. CUP 2010)
[47] German-Pakistan BIT 1959.

notably advocated for same[48], as opposed to other developed countries who were historically opposed to liberalised capital movement, favouring capital controls to prevent the inflow of short-term, speculative investments (Hot money). However, this did not stop developed countries from adopting similarly broad definitions of investment in their subsequent investment treaty law and policy.

It is instructive to note that by the 1960's and 1970's, most countries, particularly emerging and frontier countries that emerged from colonialism were reluctant to sign these new BITs. Emerging from their independence, they rejected foreign capital through BITs in a bid to protect their independence and sovereignty.[49] There was massive agitation for permanent sovereignty over natural resources[50] which led to the United Nations General Assembly Resolutions on New International Economic Order (NIEO)[51] and the Charter of Economic Rights and Duties[52] (CERD). The CERD asserted concrete economic rights like sovereignty over property rights and the right to expropriation with compensation to be based on domestic law.[53] New international economic order (NIEO) on the other hand recognised and reaffirmed the right to permanent sovereignty over natural resources.[54]

However, the NIEO and CERD were criticised for being mere United Nations General Assembly resolutions, as a result were *lex fereda:* mere aspirational and not binding instruments. Furthermore, the doctrine of permanent sovereignty over natural resources was viewed as conflicting with already established rules of foreign investment contracts like concessions, which were internationalised and were on the same level as treaties because of their inclusion of dispute resolution mechanism under foreign arbitration.[55] This attitude of mistrust and suspicion of BITs that characterised the post-colonial era which led to movements

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[48] Age F.P Bakker, *The Liberalisation of Capital Movement in Europe: The Monetary Committee and Financial Integration, 1958-1994* (n 17) 34. According to Rawi, by 1957, Germany had eliminated all restrictions on capital outflows and almost all on, capital inflows. See Rawi Abdelal, *Capital Rules* (n 1) 48.

[49] Kenneth J Vandevelde, 'A Brief History of International Investment Agreements http://jilp.law.ucdavis.edu/issues/volume-12-1/van5.pdf>

[50] General Assembly Resolution 1803 XVII on Permanent Sovereignty Over Natural Resources

[51] General Assembly Resolution 3201 Declaration on the Establishment of a New International Economic Order.

[52] General Assembly Resolution 3281 Charter of Economic Rights and Duties.

[53] Asha Kaushal, 'Revisiting History; How the Past Matters for the Present Backlash Against the foreign Investment Regime [2009] 50(2) Harvard International Law Journal 501.

[54] Vandevelde Brief History of International Investment Agreement (n 50).

[55] M. Sornarajah, *The International Law On Foreign Investment* (n) 289 – 305.

like NIEO and the United Nations Code on Transnational Corporations significantly changed in the 1980s.[56]

The eventual decline of access to capital owing to reduction in international private lending arising from the Latin American sovereign debt crises[57] and limited development assistance to developing countries in the 1980s, resulted in the increase in demand for BITs despite their broad definitions of investment, and lack of policy space safeguards.[58] Consequently, developing countries had to abandon notions like NIEO and Calvo doctrine[59] in favour of international substantive standards for protection of investments as contained in BITs for economic development.[60]

The motivation for developing countries particularly emerging/frontier countries in signing BITs was to attract more foreign capital to accelerate development by offering foreign investment protection,[61] while for the developed countries it was for unrestricted capital movement for returns[62] with robust investment protection.[63] Essentially, BITs were considered as offering a 'Grand Bargain' where for a promise of protection of investment; there is a corresponding promise of increased inflow of all kinds of foreign investment for economic development[64] based on the belief that increased capital flow correlates with economic development. The outcome saw an explosion of BITs based on the implied understanding of capital inflow in exchange for development whereby host states altered or removed domestic restrictive measures to allow capital liberalisation, while also adopting investment protection measures by negotiating and signing BITs to protect foreign investments.[65]

The adoption of capital liberalisation within BITs by emerging and frontier economies without questioning their contents or implications may have arisen out of the power dynamics between

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[56] Kenneth J Vandevelde, 'Investment Liberalisation and Economic development' (n 31).
[57] Andreas F Lowenfeld, 'The International Monetary System: A Look Back Over Seven Decades (2010) 13(3) Journal of International Economic Law 575.
[58] Asha Kaushal (n) 502.
[59] Patrick Julliard, Calvo Doctrine/Calvo Clause http://opil.ouplaw.com/view/10.1093/law:epil/9780199231690/law-9780199231690-e689>
[60] Vandevelde 'Brief History of International Investment Agreement' (n 35) 179
[61] Anthony Anghie, *Imperialism, Sovereignty and the Making of International Law* (CUP, 2004) 224.
[62] Jeswald Salacuse, *The Law of Investment Treaties* (OUP, 2015) 76
[63] Vandevelde, 'Brief History of International Investment Agreement' (n 35) 170.
[64] Ibid.
[65] Olivia Chung, 'The Lopsided International Investment Law Regime and Its Effect on the Future of Investor-State Arbitration' [2007] 47(4) Virginia Journal of International Law 957

developed and developing countries back then.[66] Ikenberry & Kupchan, contend that the dynamic was a function of the socialisation of the elites in the developing countries by the developed countries usually after colonisation or war. Through socialisation, norms of the developed country such as capital liberalisation in this instance were readily adopted.[67] Jeffrey Chwieroth, reaching similar conclusions posits that there exists ambiguous empirical basis for capital account liberalisation in emerging markets.[68] However, he states that emerging and frontier economies adopted capital account liberalisation policies because of engagement of neoliberal economists promoting capital account liberalisation who were socialised in pro-capital liberalisation institutions in developed countries, and were appointed by emerging economies as a signal to creditors and investors of credit worthiness, or credibility and commitment to capital openness.[69] To Simmons & Elkin, policy contagion accounts for why emerging and frontier host States adopted such policy. They contend that States tend to liberalise capital movements when their peers have done so either by emulation or signalling.[70] In response, Eichengreen argues that it may not be about peers influencing policy contagion, but more of host State policymakers having similar responses to common economic and political situations.[71] Whatever the case, the 1990s and early 2000s witnessed a massive move towards BITs with immense liberalising effects.

Finally, the advancement and proliferation of ICT in finance has obscured the clarity and effectiveness of capital controls thereby enabling the adoption of liberalised capital movement policies. The advancement in ICT especially within finance also contributed to the growth of capital movement and adoption of unrestricted capital mobility owing to the ineffectiveness of controls in the light of these technologies. Currently, FPI investors can access and assess asset prices, acquire, and dispose financial assets with minimal control from States.[72]

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[66] G John Ikenberry & Charles Kupchan, 'Socialisation & Hegemonic Power' (n 2) 283; Barry Eichengreen, 'Capital Account Liberalisation: What Do Cross Country Studies Tell Us?' (2001) 15(3) The World Bank Economic Review 350.
[67] G John Ikenberry & Charles Kupchan, 'Socialisation & Hegemonic Power' (n 2) 284
[68] Jeffrey Chwieroth, 'Neoliberal Economists and Capital Account Liberalisation in Emerging Economies' (n 2) 450.
[69] Ibid.
[70] Beth Simmons & Zachary Elkins, 'The globalization of liberalization: policy diffusion in the international political economy' (2004) 98(1) American Political Science Review 171-189; Barry Eichengreen, 'Capital Account Liberalisation: What Do Cross Country Studies Tell Us?' (2001) 15(3) The World Bank Economic Review 350.
[71] Barry Eichengreen, 'Capital Account Liberalisation: What Do Cross Country Studies Tell Us?' (n 71)) 350.
[72] Barry Eichengreen & Michael Mussa, 'Capital Account Liberalisation and the IMF' (n 25).

Capital liberalisation has its benefits and risks.[73] Capital account liberalisation has been said to be relevant for attracting capital for economic growth. Roger C. Altman, a famous investment banker once stated in the *New York Times* that 'the worldwide elimination of barriers to trade and capital... have created the global financial marketplace, which informed observers hailed for bringing private capital to the developing world, encouraging economic growth and democracy'.[74]

However, a far more compelling case against unrestricted capital mobility exists.[75] According to Joseph Stiglitz, unrestricted movement of FPI capital does not engender economic growth because they cannot support productive long-term projects and investments. Rather than having a positive effect, they tend to have a destabilizing effect.[76] Rawi Abdelal, argues that the subsequent consensus on capital liberalisation of the 1980s was not based on scientific reasoning.[77] Similarly, Jagdish Bhagwatti contends that claims of the benefits of capital account liberalisation are not persuasive, they tended to be 'asserted rather than demonstrated'. Instead, benefits are more attributable to FDI.[78] According to Jagdish Bhagwatti, proponents of unrestricted capital mobility are engaging in 'banner waving' since they merely assert its alleged benefits without also acknowledging its crisis inclinations. China for instance, recorded considerable growth without liberalising capital movement. Similarly, most of Europe experienced economic growth and development before adopting liberalised capital movement in the late 80s and early 90s.[79]

The question then is, does liberalised capital movement engender growth and development? Rodrik does not think so. Rodri relying on data from 100 countries comprising of developed and developing countries between 1975-1989, analysed the growth of their GDP per capita during times of capital liberalisation (i.e., unrestricted movement of FDI and FPI) to see if there was economic growth reflected in indicators like income per capita, secondary school enrolment etc. He found no correlation between capital liberalisation and growth.[80]

[73] See Rawi Abdelal, *Capital Rules* (n 1)) 32-33.
[74] Roger C. Altman, "The Nuke of the 90's," *The New York Times Magazine*, March 1,1998, p. 34.
[75] Joseph Stiglitz, 'Capital Market Liberalisation, Economic Growth and Instability' (n 27).
[76] Ibid 6.
[77] Rawi Abdelal, *Capital Rules* (n 1) 33.
[78] Jagdish Bhagwati, 'Capital Myths: The Difference between Trade in Widgets and Dollars' (n 6) 7.
[79] Ibid 9-10.
[80] Dani Rodrik, 'Who Needs Capital-Account Convertibility?' In Peter Kenen (ed) *Should the IMF Pursue Capital Account Convertibility? Essays in International Finance no. 207* (Princeton University Press 1997).

Interestingly, in a study under Political Science conducted by Quinn (1997),[81] a positive correlation was found between unrestricted capital movement and growth. The study covered the period from 1960-1989 and it focused on 66 countries. Eichengreen posited that the differences between the Quinn study from the Rodrik one was that Quinn had a longer timeline since it started earlier, which made it study FDI flows more which has positive effects on growth, before capital liberalisation of FPI began taking effect, and had less time to study FPI resulting in mixed effects.[82] A study conducted on the impact of capital liberalisation on economic growth in seventeen (17) emerging economies in 2017 found that only FDI had a significant positive impact on economic growth, while other aspects of capital liberalisation including FPI had statistically insignificant impacts on economic growth. The paper went on to recommend that emerging economies avoid hasty financial liberalisation where their financial system is fragile.[83] Pending the development of the financial system, emerging economies need to preserve their regulatory space to exercise some control over capital flows.[84]

According to Peter Blair Henry, capital liberalisation brings about short-medium-term increases in the growth rate of poorer countries. He contends that this is hardly acknowledged because of the reliance on cross-sectional method which lump developed countries with developing countries in the studies.[85] A number of recent studies demonstrate that liberalising equity FPI markets fosters growth,[86] increases investments,[87] boosts exports[88] and wages.[89] Debt FPIs, though they are generally considered as being less beneficial as demonstrated ad nauseam, it has been contended that removal of the restrictions on foreign borrowing by firms

[81] Dennis P. Quinn, 'The Correlates of Changes in International Financial Regulation' (1997) 91(3) American Political Science Review 531-51.
[82] Barry Eichengreen, 'Capital Account Liberalisation: What Do Cross Country Studies Tell Us?' 351-352.
[83] Muhammad Atiq ur Rehman and Muhammad Azmat Hayat, 'Capital Account Liberalisation and Economic Growth' (2017) 55(1) Pakistan Economic and Social Review 299-313. S Kalemli–Özcan, B Sorensen and V Volosovych, 'Deep financial integration and macroeconomic volatility' (2014) 12 (6) Journal of European Economic Association 1585.
[84] Ibid.
[85] Peter Blair Henry, 'Capital Account Liberalisation: Theory, Evidence and Speculation' (2007) 45(4) Journal of Economic Literature 888 & 900.
[86] N Gupta and K Yuan, 'On the growth effect of stock market liberalizations' (2009) 22(11) The Review of FinancialStudies 4715.
[87] L Alfaro and E Hammel, 'Capital flows and capital goods' (2007) 72(1) Journal of International Economics 150.
[88] K Manova, 'Credit constraints, equity market liberalizations and international trade' (2008) 76(1) Journal of International Economics 33.
[89] A Chari, A, P Henry, and D Sasson, 'Capital market integration and wages' (2012) 4(2) American Economic Journal:
Macroeconomics 102.

has a positive effect on investment and productivity[90] with the imposition of controls negatively affecting investment and productivity.

Finally, in the study conducted by Obstfeld and Taylor[91] they find that no definitive conclusion can be reached on the benefits of capital liberalisation. While some countries have benefitted from capital liberalisation, others have suffered disasters as a result thereof.[92] Most studies are unable to find robust empirical evidence demonstrating a significant quantitative causal relationship between capital liberalisation and growth.[93] However, it can generate 'collateral benefits' such as development of financial service sector and bring about macroeconomic policy discipline.[94] Nevertheless, capital liberalisation, particularly debt FPI has been shown to pose risks of capital misallocation where capital goes to where it is least productive, sudden stops in capital inflows during banking or financial crisis which exacerbates the situation[95]; and financial stability.

Among the emerging and frontier economies that embraced BITs for development in exchange for investment protection were the following countries: Nigeria, Egypt, Morocco, Kenya and South Africa who represents the largest economies in Africa, and biggest recipients of foreign capital.[96]

Part C

3.3 Entrenching Capital Account Liberalisation with the International Investment Law Regime in Emerging and Frontier Economies.

The preceding sections has demonstrated that there was little basis for promoting unrestricted capital account liberalisation owing to the majority view of the volatility and capacity for disequilibria of FPIs. They also showed that emerging and frontier markets were opposed to BITs which are vehicles for capital account liberalization but were essentially socialised into

[90] L Varela, 'Reallocation, competition, and productivity: evidence from a financial liberalization episode' (2017) 85(2) The Review of Economic Studies 1279.
[91] Obstfeld & Taylor, *Global Capital Markets: Integration, Crisis and Growth* (Cambridge University Press, 2004) 297
[92] See Barry Eichengreen, Capital Account Liberalisation: What Do Cross Country Studies Tell Us?' (n 71) 360.
[93] Eswar S. Prasad, Kenneth Rogoff, Shang-Jin Wei, and M. Ayan Kose, 'Effects of Financial Globalization on Developing Countries: Some Empirical Evidence' (2003) IMF Occasional Paper No 220 ix.
[94] M. Ayhan Kose, et al, 'Financial Globalization: A Reappraisal' (2006) IMF Working Paper WP/06/189 p 8.
[95] J Joyce and M Nabar, 'Sudden stops, banking crises and investment collapses in emerging markets' (2009) Journal of Development Economics 314; M Hutchison and I Noy, 'Sudden stops and the Mexican wave: currency crises, capital flow reversals and output loss in emerging markets' (2006) 79(1) Journal of Development Economics 225.
[96] Rand Merchant Bank, 'Where to Invest in Africa Report' 2020 7-18.

signing them in exchange for growth providing capital, even though uncertainty exists regarding their growth potential. It then begs the question why an argument could be made favouring FPI protection using the international investment law regime, since there is no dispute on FPI volatility, and it is largely agreed that the international investment regime acts to freeze policies? It is therefore submitted that preserving capital liberalising policies favourable to the unrestricted entry and exit of volatile investments can only spell doom for the emerging economy. It will only serve to prioritise less qualitative investments over State macroeconomic policy independence to the detriment of the economy, and welfare of the citizens in terms of growth and sustainable development.

Additionally, the move to interpret BITs and Investment Chapters broadly, as well as apply unrestricted transfer of funds clauses broadly without exceptions is consistent with capital account liberalisation objectives. Instructively, none of the proponents of a broad definition of investments or unrestricted capital movement, took into consideration the caveats for developing countries, raised at the 1997 IMF Annual Meeting in Hong Kong. There, it was suggested that before capital liberalisation is promoted in developing countries, they must have the relevant institutional and regulatory architecture, as well as safety nets to support the effects of capital account liberalisation.[97] This is very poignant since most emerging, and particularly frontier markets do not have the institutional and regulatory structures necessary to support capital liberalisation as identified by IMF and also pointed out by Eichengreen and Mussa[98], nor do they have the adequate safety nets for supporting their citizens should crisis ensue. Instead, they argue for the indiscriminate promotion and protection of capital account liberalisation without considering host State capacity to deal with it, and its consequences.

A broad definition of investment with guarantee of unrestricted transfer of funds without any safeguards but with investment arbitration protection is the most radical and farthest reaching international economic framework for entrenching capital liberalisation on emerging and frontier economies. Such that, any form of macroeconomic interference/regulation will be the subject of investment arbitration, even if such interference is meant to mitigate or avert crisis. Furthermore, it is an imposition of capital liberalisation upon emerging and frontier markets even in circumstance where they may not be in favour of it or are ill-prepared for it. For

[97] World bank group - IMF Meeting in Hong Kong 1997
[98] Barry Eichengreen & Michael Mussa, ‘Capital Account Liberalisation and the IMF’(n 25).

instance, BITs and IIAs are now currently being executed with express exclusion of foreign portfolio investments. Investment arbitration ought not and should not be used to impose such policies.

Additionally, if the proponents of foreign portfolio investment law protection should be minded, erratic investment flows emanating from home states of signatories to BITs/Investment Chapters with emerging and frontier economies would be protected. Also, given the frontier and emerging state of most of these economies, it is only fair that macroeconomic flexibility will be necessary and present to respond to unexpected developments such as the existence or threat of economic or financial crisis.[99] Moreso, in the event that foreign portfolio investments are protected, any inevitable exercise in macroeconomic flexibility to deal with such unexpected crisis situation, which occasions loss of value/price in the foreign portfolio investment can be the grounds for claims in investment arbitration by foreign portfolio investment investors. Finally, such claims or potential claims, whether successful or not could have major economic and social impacts on the emerging and frontier economies. Highlighting the legal and potential economic and social consequences of foreign portfolio investment law protection is within the remit of this thesis and will be discussed in the subsequent chapters.

Part D

3.4 Global Move Towards Control

The crisis of the mid-late 1990s[100] which saw the massive outflow of capital from the emerging economies (that experienced that crisis) back to developed economies catalysed the crisis of faith in capital account liberalisation policy.[101] Interestingly, these economies were previously hailed for their adoption of an open capital movement policies, nevertheless the common denominator in all the countries that experience crisis, was their openness to capital movement.

Worst affected by the crisis of faith in capital liberalisation was the IMF. In the 1970s, the IMF began to promote capital account liberalisation, which culminated in the attempt at the IMF Annual Meeting in 1997 to amend its mandate to include capital account liberalisation. However, the impacts of the financial crises of the 1990s undermined IMF's effort at expanding

[99] Ashoka Mody, 'What is an Emerging Market' (2014) International Monetary Fund Working Paper WP04/177, 4.
[100] See for instance the Asian Financial Crisis, Brazilian Crisis and the Russian Crisis.
[101] Rawi Abdelal, *Capital Rules* (n 1) 198.

its mandate into capital liberalization, resulting in the abandonment of the proposal. In the 1999 executive board meeting, several directors pointed to the necessity for state regulations, and the need for assessing the benefits and risks of adopting such control measures.[102]

Consequently, IMF moved to a more cautious approach in terms of capital liberalisation for emerging and frontier economies. What this entailed was IMF recommending slow and reluctant transition to unrestricted capital liberalisation to avoid the risks and financial crisis experienced in countries which the IMF had previously promoted liberalization.[103] As a result, host state policymakers were enjoined to weigh the risks and benefits of capital liberalisation, as well as develop their financial institutions and frameworks before adoption.[104] IMF additionally highlighted the challenges that could arise with unrestricted capital mobility in emerging and frontier economies.[105]

In December 2012, IMF adopted an 'Institutional View on the Liberalisation and Management of Capital Flow'. The aim of the Institutional View (IV) was to enable countries benefit from capital flows, while managing the risks therefrom and preserving economic stability, and avoiding negative spillovers. According to the IV the IMF recognised that capital flows are accompanied by risks, and capital liberalisation exacerbates those risks in emerging and frontier countries. Thus, under certain circumstances, and to avert the worst effects of unrestricted capital movements, capital flows should be regulated with capital flow management mechanisms or counter-cyclical macroeconomic policies where relevant.[106]

In further recognition of the necessity for state regulation of capital flows and following the effect of the Covid Pandemic on Capital flows, the IV was reviewed and updated in 2022. At the start of the Covid pandemic, there was massive outflows of capital from emerging economies back to developed economies. This served as a reminder of the volatility of FPI capital flows. Additionally, Covid-19 pandemic recovery expenditure in most countries including emerging and frontier economies were financed by external debt, sometimes without

[102] Summing Up by the Acting Chairman of Countries 'Experiences with the Use of Controls on Capital Movements and Issues in Their Orderly Liberalization' 6 April 1999, BUFF/99/45 (IMF Archives) 2. See Rawi Abdelal, *Capital Rules* (n 1) 198.
[103] Mexico, South Korea, Thailand etc.
[104] Rawi Abdelal, *Capital Rules* (n 1) 198-199.
[105] IEO, 'International Monetary Fund's Approach to Capital Account Liberalisation' 8, 9, 36-37, 57-58.
[106] International Monetary Fund, 'Institutional View on the Liberalisation and Management of Capital Flow' (2012).

hedges, or enough reserves to offset these debts. As a result, the financial vulnerabilities of these economies are currently heightened given the propensity for short term investors to suddenly find their debt assets in emerging economies as unattractive leading to a pull out which can cause distress and crisis.[107]

In view of these threats, the reviewed IV in 2022, supports pre-emptive adoption of regulatory policy in the form of capital flows management measures and macro-prudential measures (CFMs/MPMs) to restrict capital flows and manage the risks of external debts. The pre-emptive policy is applicable even without a surge in capital inflows given the risk to financial stability that gradual buildup of external debts denominated in foreign currency can have on emerging economies.[108] Furthermore, the Bank of International Settlement, at the G20 Conference in Bali, expressed its support for more proactive measures to deal with the challenges of volatile capital flows.[109]

Despite the global recognition of the merits of host states in undertaking some form of capital flow regulation, majority of the international investment law frameworks still entrench the ideology of unrestricted liberalised capital flows through the inclusion of broad definitions of the meaning of investment to accommodate FPI, and the absence of safeguards permitting host state restriction of FPI capital, in BITs/IIAs. Furthermore, IMF's advice of caution to host state policy makers when rushing to adopt capital liberalisation policies is not reflected in the zeal with which emerging, and frontier economies execute BITs/IIAs containing the afore-mentioned capital liberalising features. However, it is important to state that few emerging economies' BITs now excludes foreign portfolio investments from their definition of investment and provides safeguards for transfer restrictions.[110]

Nevertheless, it is in recognition of the fact most BITs/IIAs with emerging and frontier economies as signatories contain wide capital liberalising features with no host state right of

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[107] Why the IMF is updating its View on Capital flows https://www.imf.org/en/Blogs/Articles/2022/03/30/blog033122-why-the-imf-is-updating-its-view-on-capital-flows. 11/11/2022.

[108] International Monetary Fund, 'Review of the Institutional View on the Liberalisation and Management of Capital Flow' (2022).

[109] Stephen Grenville, 'Capital flows to emerging economies' https://www.lowyinstitute.org/the-interpreter/capital-flows-emerging-economies

[110] There are about 31 BITs out of over 2000 that exclude FPI. See, Mapping of IIA Content | International Investment Agreements Navigator | UNCTAD Investment Policy Hub

control despite the current recognition for capital regulation, that subsequent Chapters of this thesis will identify and demonstrate the existence of jurisdictional and substantive issues that emerging, and frontier host states can rely on in preventing the investment regime's entrenchment of unrestricted FPI capital movements.

3.5 Conclusion

This chapter explores the alternating evolution of the norms and rules in international capital movements from regulated to liberalised to regulated. It examines the arguments against capital liberalisation owing to its destabilising effect during the inter-war period, why liberalisation was adopted and promoted by the developed countries through organisations like the EU, OECD, and the IMF, and how it subsequently became absorbed within the international investment regime of developed and emerging and frontier markets. It considers the drivers towards capital account liberalisation in developed countries such as dissatisfaction with the distributional effect of capital regulation despite the destabilising effect of capital liberalisation. It also points out the influences of capital liberalisation in emerging economies, including reasons why BITs were adopted. It contends that the effect of adopting BITs was the entrenchment of capital liberalisation on emerging economies, even though currently there is a recognition of the destabilising effect of capital liberalisation and move towards control. Though this is mildly seen in international investment law treaty framework, the challenge remains with already executed treaties with enforceable capital liberalising provisions.

To mitigate the effect of a blanket adoption of capital liberalisation within the extant IIR, this thesis will subsequently rely on jurisdictional and substantive doctrinal analysis which may be adopted to exclude extant IIAs with such broad and blanket adoption of capital to prevent or mitigate potentially catastrophic economic effects of such adoption on emerging and frontier economies at the brink of, or amidst economic and financial crisis.

Chapter Four

Jurisdiction ratione materiae within the ICSID Convention and Contracting Parties Investment Treaties for Foreign Portfolio Investment Protection.

> *It has been pointed out already that both on the judicial and the academic levels, there is much controversy on the meaning to be given to the term "investment" in Art. 25 of the ICSID Convention and on whether to construe it broadly or restrictively.*[1]

> *the term 'investment'...is a term of art: its ordinary meaning cannot be extended to bring any rights having an economic value within its scope, for otherwise violence would be done to that ordinary meaning in contradiction to Article 31 of the Vienna Convention on the Law of Treaties.*[2]

> *…there is a limit to the freedom with which the parties may define an investment if they wish to engage the jurisdiction of ICSID tribunals.*[3]

> *Moreover, mere portfolio investments made by the Claimants in the Italian retail market do not amount, as it will be shown below, to the kind of transactions falling under the jurisdiction of the ICSID Convention either.*[4]

4.0 Introduction

Adopting capital account liberalisation in Bilateral Investment Treaties (BITs) and Investment Chapters of preferential trade agreements (Investment Chapters) means that all kinds of capital, including foreign portfolio investments (FPI) enjoy unrestricted mobility. Unrestricted capital mobility within BITs/Investment Chapters is fully expressed in broad definitions of 'investments' in interpretation clauses and in guarantees of free transfer of funds clauses. While Chapter Six will deal with guarantees of unrestricted fund movement, this Chapter will focus on unrestricted capital liberalising definitions of investment in investment treaties that are broadly drafted to include all kinds of assets especially short-term, volatile FPIs.

Foreign portfolio investments[5] *prima facie* can be considered as investment from a purely financial sense. However, they ought not to be recognised as investments under International Investment Law generally, and the Convention for the Settlement of Investment Dispute

[1] *Ambiente Ufficio SPA & Ors v. Argentina* (ICSID Case No. ARB/08/9) Decision on Jurisdiction and Admissibility of 8 February 2013 para 466.
[2] Zachary Douglas, *The International Law of Investment Claims*, (Graduate Institute of International Studies, Geneva, 2009) para. 342 p 164-165.
[3] *Joy Mining Machinery Limited v. Arab Republic of Egypt* (ICSID Case No. ARB/03/11) Award of 6 August 2004 para 49.
[4] *Ambiente Ufficio SPA & Ors v. Argentina* (ICSID Case No. ARB/08/9) Decision on Jurisdiction and Admissibility (Dissenting Opinion of Santiago Torres Bernardez) of 8 February 2013 para 159.
[5] For the purpose of this thesis, a foreign portfolio investment (portfolio investment) are any speculative financial investment in debt securities (bonds); and equity securities evidenced in shares less than 10%, or investment funds, unconnected with any specific project or productive activity in the host State, but intended to be for dividends, coupons/interest and capital gains.

(ICSID convention)[6] framework specifically, because they are short-term, speculative, and volatile financial assets, usually unconnected to any specific project or economic operation within the host state. FPIs fall outside the consent and inherent meaning of 'investments' within international investment law when considered under Article 25 of the ICSID convention, and its preamble. A combined construction of Article 25 of the ICSID convention and its preamble requires protected investments to play a role in the host state's economic development. However, as demonstrated in Chapters 2 and 3, the growth effect of FPIs is mostly uncertain,[7] but its crisis potential enjoys some acknowledgement[8] even by the IMF.[9] Furthermore, owing to its sensitivity to macroeconomic policies, jurisdictional access can be used to challenge unfavourable host state macroeconomic policies. Therefore, there exists high likelihood for protected foreign portfolio investments to undermine economic growth and development given their potentially disequilibrating nature, and their threat to host State macroeconomic policy[10] autonomy. Thus, they ought not to be considered as investments within the contemplation of the convention.

An FPI ICSID claim will challenge and try to frustrate host State macroeconomic policies such as foreign exchange policies, sovereign debt default and restructuring policies, bailouts etc., undertaken by the host State. Regardless of whether such policies are in its economic interest and are intended to contain or avert economic and financial crisis. For instance, a range of host state economic policies undertaken in response to the Asian Financial Crisis,[11] Argentinian

[6] Convention on the Settlement of Investment Disputes between States and Nationals of other States 1965 established the International Centre for the Settlement of Investment Disputes (Centre). ICSID is a forum and framework for the settlement of disputes between host states and economically productive international private investments. ICSID is the largest forum for international investment dispute resolution. It has 155 member states and 8 signatory states. About 70% of all investor-state investment disputes are settled by ICSID. ICSID has its own enforcement mechanism whereby awards are enforceable as final judgments in all member states. See https://icsid.worldbank.org/About/ICSID; https://icsid.worldbank.org/sites/default/files/publications/ICSID_Benefits_English.23.2020.pdf

[7] Eswar S. Prasad, Kenneth Rogoff, Shang-Jin Wei, and M. Ayan Kose, 'Effects of Financial Globalization on Developing Countries: Some Empirical Evidence' (2003) IMF Occasional Paper No 220 ix.

[8] Yilmaz Akyuz, 'Capital Flows to Developing Countries in a Historical Perspective: Will the Current Boom end with a Bust?' (2011) South Centre Research Paper 37 p 11; Ricardo Hausmann & Eduardo Fernandez Arias, 'Foreign Direct Investment: Good Cholesterol?' (2000) Inter-American Development Bank Research Department Working Paper No. 417 p 3.

[9] Akira Ariyoshi et al., 'Capital Controls: Country Experiences with Their Use and Liberalization' (2000) IMF Occasional Paper 190, 3.

[10] The role of private investment in host state's economic development also means that private investment should not undermine economic development. Consequently, the potential of portfolio investment to undermine economic development suffices as a reason to exclude it.

[11] Currency devaluation and capital controls.

Economic Crisis,[12] and European debt crisis (with respect to Greece)[13] which affected portfolio investments' value in those countries were the subject of investment arbitration disputes before the International Centre for the Settlement of Investment Disputes (ICSID). In *Gruslin v Malaysia,*[14] the State decision to devaluate and float currency in the face of the Asian Financial Crisis was challenged in investment arbitration by an Exchange Traded Funds (ETF) investor. In *Abaclat v Argentine Republic*[15] and *Uficio v Argentina Republic*[16] sovereign bond default and repayment restructuring in the face of the Argentinian economic crisis was challenged by sovereign bond security entitlement holders. Similarly, in *Postova v Greece*[17] the repayment restructuring decision was challenged by financial institutions holding Greek sovereign bonds.

Consequently, where macroeconomic policies such as those recently undertaken by emerging/frontier economies to stem the outflows of FPIs arising from the effects of Covid-19 are open to challenge through investor-state arbitration, it can only result in incalculably dire economic conditions. Primarily given the capacity for the international investment regime to constrain host state macroeconomic policy making capacities[18] at a time where flexibility is imperative. Therefore, foreign portfolio investments should be denied access to challenging macroeconomic policies deployed to contain or avert existing or impending crisis. This can be done by correctly placing them outside the consent and jurisdictional boundaries of the ICSID convention through the interpretation of the meaning of 'investment'.

Multiple tests are usually applied in determining the meaning of the notion of investment when jurisdiction of an investment arbitration tribunal is called in question. While some tribunals favour a restrictive approach of interpretation others favour a broader approach that facilitates investors' rights. In uncovering the meaning of 'investment,' recourse has been had to just the

[12] Currency devaluation, debt default and restructuring.
[13] Debt default and restructuring.
[14] *Gruslin v. Malaysia* ICSID Case No. ARB/99/3 Award (27 November 2000)
[15] *Abaclat & Others v. Argentine Republic* ICSID Case No. ARB/07/5 Decision on Jurisdiction and Admissibility (4 August 2011).
[16] *Ambiente Ufficio SPA & Ors v. Argentina* (ICSID Case No. ARB/08/9) Decision on Jurisdiction.
[17] *Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic*, ICSID Case No. ARB/13/8 Award (15 April 2015).
[18] See papers on restrictive effects of the IIR on regulatory autonomy.

specific definitions contained in Bilateral and Multilateral investment treaties,[19] or the ordinary objective meaning of the word from usage.[20]

Where macroeconomic policies are challenged before ICSID, this chapter argues that whatever approach that is adopted must be within the framework of the ICSID convention. This will require examining the meaning of the word, 'investment' within the context of the convention to determine what parties consented to, i.e., by examining the object and purpose of the convention.[21] To put it in perspective, for an investment to be recognised for protection, the requirements in the convention, must be met. It is a threshold issue. Thus:

> '…the existence of an "investment" within the meaning of Art. 25 ICSID Convention is a mandatory requirement for the jurisdiction of the Centre, with a request for arbitration transcending these limits leading to the dismissal of the case.'[22]

The tribunal must be satisfied that under the ICSID convention, the 'investment' is one that is consented to within the convention. Article 25(1) of the ICSID convention remains the jurisdictional portal into ICSID's arbitration orbit, such that, satisfying the 'investment' hurdle is fundamental to gaining access into the centre.[23]

Nevertheless, some scholars and tribunals contend that party autonomy/consent resting in the BIT definitions ought to be given deference.[24] It is this narrative of BIT deference that has led to the expansion of the meaning of investment to encompass foreign portfolio investments in the form of sovereign bond entitlements,[25] speculative corporate bonds,[26] and investment

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[19] *Lanco Int'l Inc v. Argentina* (ICSID Case No. ARB/97/6) Decision on Jurisdiction and Admissibility of 8 December 1998 para 48; *Gruslin v. Malaysia* ICSID Case No. ARB/99/3 Award (27 November 2000) para13.5-13.6.
[20] *Fedax N.V v. The Republic of Venezuela* (ICSID Case No. ARB/96/3) Decision of the Tribunal on the Objection to Jurisdiction of 11 July 1997 para 43; *Salini Costruttori S.p.A v. Kingdom of Morrocco* ICSID Case No. ARB/00/4 Decision on Jurisdiction 23 July 2000.
[21] Rudolf Dolzer & Christoph Schreuer, *Principles of International Investment Law* (OUP 2nd edn, 2012) p. 61.
[22] *Ambiente Ufficio SPA & Ors v. Argentina* para 439, p 153.
[23] *Patrick Mitchell v. Democratic Republic of the Congo* ICSID Case No. ARB/99/7 Decision on the Application for annulment of 1 November 2006, para. 31
[24] This opinion stems from the fact that Article 25 does not provide for a definition of investment. Rather than conjecture what an investment could mean, the Tribunals hold that the definition agreed by the parties, captured in the investment treaties should be given primacy. See: *Alpha Projektholding GMBH v. Ukraine* ICSID Case No. ARB/07/16 Award (8 November 2010); *Inmaris Perestroika v. Ukraine* ICSID Case No. ARB/08/8) Decision on Jurisdicti on (8 March 2010); *Pantechikni v. Albani* ICSID Case No. ARB/07/21 Award (30 July 2009).
[25] *Abaclat & Others v. Argentine Republic* ICSID Case No. ARB/07/5 Decision on Jurisdiction and Admissibility (4 August 2011); *Ambiente Ufficio SPA & Ors v. Argentina*.
[26] *Olguin v. Republic of Paraguay* ICSID Case No. ARB/98/5 Decision on Jurisdiction (8 August 2000).

funds.[27] This chapter in rejecting that narrative, supports a definition of investment under Article 25(1) of the ICSID convention consistent with the object and purpose of ICSID which remains international cooperation for economic development. Extending ICSID coverage to volatile foreign portfolio investments with arguable economic growth credentials, and sensitive to macroeconomic conditions will go outside what contracting parties consented to. It can expose the host State to challenges of its macroeconomic policies which can only result in undermining host State economic development. Therefore, it is contended that owing to the volatility of portfolio investments, and the direct impact FPI claims can have on a host State's macroeconomic policymaking amidst crisis, it ought not to be conceived of as an investment for protection because of the undermining effect on economic growth and development.

This Chapter is divided into 6 parts. Part A considers the different approaches to defining investment under ICSID. It argues against a BIT/Investment Chapter party autonomy approach by pointing out that it will permit all kinds of transactions as investments including crypto assets. Interestingly, some pro-BIT party autonomy tribunals recognise the need for jurisdictional limitation. However, prioritising Article 25 of the ICSID convention, read in conjunction with the convention's preamble is the correct and most objective way of defining an investment. Part B reviews decided case law and academic arguments relating to FPI as investments. It points out issues arising from the analysis supporting FPI as investments in cases like *Olguin v Paraguay; Abaclat v Argentine Republic etc.*, while arguing against the inclusion of FPI as an investment. Part C proffers a teleological approach to defining an investment under the ICSID convention to the exclusion of FPI. It argues that FPI is outside the limits of what ICSID members consented to since disputes that ICSID has jurisdiction over are disputes arising from private international investment activities that play a role in economic development. Thus, there is a need for a consideration of the effect FPI challenge may have on economic development when determining whether FPIs are covered investments. Since FPIs are volatile, short-term, and prone to systemic risk, and since when protected they have the effect of freezing macroeconomic conditions with economic consequence, they ought not be accorded recognition. Part D considers the definition of investment in relation to FPI contained in BITs/Investment Chapters without ICSID access. It considers interpretative options such as reliance on the objective characteristics of investment, or 'subsequent state practice'. It, however, concludes that, where ICSID is unavailable, States can try to offer substantive

[27] *Gruslin v. Malaysia*.

defence to FPI claims. Part E identifies the global effect of extending protection to FPI and critically analyses the international investment policy options that may be available to host states to exclude FPI protection. Part F, concludes.

Part A

4.1 Defining 'Investment'.

The controversy over the nature of what constitutes an investment is as old as the ICSID convention. At the initial drafting stage, opinions regarding the direction to take in relation to defining investment was divided. Capital exporting countries (developed) favoured a broad and open-ended approach in line with their capital liberalisation ideology, while capital importing countries (emerging/frontier) favoured a narrower and restrictive approach. To break the deadlock, the UK representatives suggested leaving it open, but including the provisions of Article 25(4) of the ICSID Convention which was incorporated to allow parties submit notices of types of investments which they intend to exclude from arbitration.[28] It is noteworthy that capital importing States (emerging/frontier economies) were and continue to be mostly opposed to a broad, open-ended conception of investment. Some recent BITs executed by emerging/frontier economies amongst themselves that expressly excludes foreign portfolio investments[29] attest to this fact. However, it does not mean that there are not fairly recent intra-emerging/frontier economies BITs which can recognise FPIs as investments. For instance, the India-Bangladesh BIT (2009) in Article 1(b) broadly defines an investment.

To determine whether an investment falls within the remit of the ICSID tribunal, the purported investment activity must meet the definitional requirements under the ICSID convention before a consideration of the requirements under the relevant investment treaties.[30] Regarding the necessity of satisfying the jurisdictional requirement under ICSID, recourse must be had to Article 25 of the ICSID Convention, which is not without its own challenges. Demonstrable in the fact that the meaning of the notion of investment under the ICSID convention is far from being clear. The absence of clarity can be traced to the undefined provision of the notion of

[28] Julian Davies Mortenson, 'The Meaning of "Investment": ICSID's Travaux and the Domain of International Investment Law [2010] 51 Harvard International Law Journal 281.

[29] There are about 31 BITs out of over 2000 that excludes FPI. See Mapping of IIA Content | International Investment Agreements Navigator | UNCTAD Investment Policy Hub.

[30] *Noble Energy Inc v. The Republic of Ecuador and Anor* ICSID Case No. ARB/05/12 Decision on Jurisdiction (5 March 2008) para 125 – 142.

investment under Article. 25(1) of ICSID convention. Article 25(1) of the ICSID convention provides that:

> '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.'

Article 25(1) did not define what an investment is. Rather, it offered a circular definition of an investment, wherein it used the word 'investment' in defining an investment. It was the absence of a definition, and the need for clarity on the notion of investment within the ICSID convention, that led the tribunal in *Fedax v. Venezuela,* [31] to set out five (5) typical characteristics of an investment for the purposes of determining if the promissory notes in issue constituted an investment. According to the tribunal, investments had the following characteristics to wit: substantial commitment; certain duration; assumption of risk; significance to host state development; and regularity of profit and returns. The requirements were formulated based on an understanding of the meaning of investments within economics.[32] Consequently, some tribunals began to follow this description prescriptively when construing Article 25 of the ICSID convention, beginning with the decision in *Salini .v. Morocco,*[33] where the tribunal adopted the elements of an investment as highlighted in *Fedax* except the requirement of the regularity of profits and returns.[34] This approach became known as the *'Salini Test'* and seemingly acquired the status of mandatory jurisdictional requirements in respect to ICSID, and has been variously relied on.[35]

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[31] *Fedax N.V v. The Republic of Venezuela* para 21 - 33

[32] Rudolf Dolzer & Christoph Schreuer, *Principles of International Investment Law* (OUP 2nd end, 2012) 66.

[33] *Salini Costruttori S.p.A v. Kingdom of Morrocco* para 56.

[34] *Salini Costruttori S.p.A v. Kingdom of Morrocco,* adopted only four of the features of investment as set out in *Fedax v. Venezuela,* as follows: certain duration; assumption of risk; substantial contribution; and host state development.

[35] See, *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan* ICSID Case No. ARB/01/13 Decision on Jurisdiction (6 August 2003) para 113; *AES Corporation v. The Argentine Republic,* ICSID Case No. ARB/02/17 Decision on Jurisdiction (26 April 2005) para 88; *Bayindir .v. Pakistan* ICSID Case No. ARB/03/29 Decision on Jurisdiction (14 November 2005) para 130-138; *Saipem S.p.A. v. The People's Republic of Bangladesh* ICSID Case No. ARB/05/07 Decision on Jurisdiction (12 March 2007) para 99-106; *RSM Production Corporation v. Grenada*, ICSID Case No. ARB/05/14 Award (13 March 2009); *Phoenix Action, Ltd. v. The Czech Republic* ICSID Case No. ARB/06/5 Award (15 April 2009).

However, given the doctrine of judicial precedent is considered alien to the international investment law jurisprudence,[36] the *Salini criteria* has been diverged from with criticisms since it has no binding force on subsequent tribunals. For instance, in *Biwater Gauff v. Tanzania,*[37] the tribunal refused to follow *Salini* on the basis that Article 25 ICSID Convention contained no requirements and the negotiating history suggested that the parties intended the definition to be open. The *Biwater* tribunal supported a BIT party autonomy approach in defining an investment. That is, definition based on what parties intended as contained in BIT/Investment Chapter. However, the tribunal went on to accept that the definitional requirements may exclude certain projects from protection, especially where such definitions reflect the trend of having a broad scope.[38] Meaning that a limit can be placed on what should be construed as investments despite BIT provision, where BIT definition is open-ended.

In further support of a BIT party autonomy approach advocated in the *Biwater decision*, the Annulment decision in *Malaysian Historical Salvors v. Malaysia*,[39] held that the term investment is undefined under Article 25 of the ICSID convention. From the *travaux* of the convention, only sales and transient commercial transactions were excluded from the scope of ICSID. Thus, any other dispute within the confines of transactions consented to by the parties were permitted under ICSID.[40] That, reference to *Salini* would restrict the transactions upon which parties can present claims before the tribunal, which can result in a 'crippling of the institution'.[41] The tribunal further held that *Salini* erroneously elevated the typical characteristics to mandatory jurisdictional requirements. In line with other criticisms that the *Salini test* was merely 'prescriptive criteria for investments' not mandatory standards.[42] Christoph Schreuer, credited with the initial development of the tests, also viewed them as typical characteristics of investments and not jurisdictional requirements.[43] He found the adoption of the typical characteristics as mandatory jurisdictional requirements, as

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[36] *Daimler Financial Services v. Argentine Republic* ICSID Case No. ARB/05/1 Award (22 August 2012).
[37] *Biwater Gauff v. United Republic of Tanzania* ICSID CASE NO. ARB/05/22 Award (24 July 2008) para 313.
[38] *Biwater Gauff v. United Republic of Tanzania* para 313-315.
[39] *Malaysian Historical Salvors, SDN, BHD v. The Government of Malaysia* ICSID Case No. ARB/05/10 Decision on Annulment 16 April 2009; *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB/01/12 Decision on Jurisdiction (8 December 2003) para 59-65; *AES Corporation v. The Argentine Republic* para 58-61.
[40] *Malaysian Historical Salvors, SDN, BHD v. The Government of Malaysia* Decision on Annulment para 72
[41] *Malaysian Historical Salvors, SDN, BHD v. The Government of Malaysia* Decision on Annulment para 73.
[42] *M.C.I. Power Group L.C. and New Turbine, Inc. v. Republic of Ecuador*, ICSID Case No. ARB/03/6 para 165; Christoph Schreuer, *The ICSID Convention: A Commentary on the Convention on the Settlement of Investment Disputes between States and Nations of Other States* (2001) 159; Michail Dekastros, 'Portfolio Investment: Reconceptualising the Notion of Investment under the ICSID Convention' [2013] 14 The Journal of World Investment & Trade 293.
[43] Christoph Schreuer, *The ICSID Convention: A Commentary* (2001) 122.

unfortunate.[44] Regardless, it is fair to say that the existence or absence of a thing will be determined by its typical characteristics therefore it is understandable that tribunals in trying to determine if an investment exists, will rely on objective features or characteristics, rather than subjective lists or descriptions.

Following the *Biwater* and the *Malaysian Historical Salvors (*annulment decision), tribunals are split on whether to adopt a party autonomy approach or a modified *Salini* approach. In *Alpha v Ukraine,*[45] the tribunal held that the BIT definitions ought to be accorded great deference but that does not mean any definition of an investment by parties in their BITs should constitute an investment. It is however, contended that where a BIT definition of investment includes short term, volatile investments which enables a challenge of a host State's macroeconomic policy autonomy, such definition should constitute persuasive reasons not to accord deference to the BIT definition because of the effect such challenge portends for the host state economy. Interestingly, in *Inmaris v Ukraine,*[46] it was the host state's contention that the contract for financing repairs and operations for a training vessel did not constitute an investment, owing to its lack of contribution to the development of Ukraine. This argument was roundly rejected by the tribunal on the basis that the ICSID convention contained no definition of investment in terms of a requirement for a contribution; therefore, it was not obliged to do so where the parties to the convention chose not to do so. Consequently, deference must be had to the state parties' definition of an investment contained in their BIT, because it is not for BIT parties to confine the multilateral ICSID convention.[47] However, the tribunal stated that the *Salini test* could be relied on to discern whether an investment exists in circumstances where the BIT defines the term so broadly that it becomes unreasonable.[48] It is submitted that if the same tribunal is consulted, it will probably say that broad definition to include volatile, short-term speculative assets will constitute transactions 'that would not normally be characterized as an investment under any reasonable definition'[49].

[44] Christoph Schreuer et al, *The ICSID Convention: A Commentary on the Convention on the Settlement of Investment Disputes between States and Nations of Other States* (Cambridge University Press, 2nd ed., 2009) 171-174.
[45] *Alpha Projektholding GMBH v. Ukraine* para 308 - 314
[46] *Inmaris Perestroika v. Ukraine* para 129-131.
[47] Devashish Krishan, 'A Notion of ICSID Investment in TJ Grierson Weiler (ed), *Investment Treaty Arbitration: A Debate and Discussion* (Juris Publishing, New York 2008) 71; Michail Dekastros, 'Portfolio Investment: Reconceptualising the Notion of Investment under the ICSID Convention' (n 42) 65.
[48] *Inmaris Perestroika v. Ukraine* para 131.
[49] *Inmaris Perestroika v. Ukraine* para 131.

Critically, even in a party autonomy approach there is recognition of boundaries such that ambit is given to tribunals to confine the meaning of an investment where it will be unreasonable to uphold a broad definition by parties or based on highly persuasive reasons. The *Biwater Gauff*[50] recognised the necessity for having limits despite what is contained in the definition, especially where such definition is too broad. Thus, a broad definition of investment where volatile foreign portfolio investments can be considered as covered investments is clearly an unreasonable extension of the meaning of an investment. Why cover an investment that is: crisis prone, exposes host state macroeconomic policy to external review, and is akin to a commercial transaction? Ignoring these questions will see investors claiming anything as covered investment to obtain ICSID protection. Policy wise, in view of the asymmetrical dynamics of investment treaty negotiation and execution between developed economies and emerging/frontier economies,[51] can it really be said that party autonomy exists? Emerging and frontier economies signed BITs for capital and growth, without being availed of adequate information on the effect of these agreements; or were influenced by neoliberal economists[52] and multilateral institutions. Historical records and current practice show that emerging and frontier economies were not in favour of this liberal view of investments. As earlier stated, following the realisation of the destabilising effects of FPI, emerging/frontier economies are now beginning to expressly exclude foreign portfolio investments from their investment treaties in line with their current views on capital controls.

Confirming the above analysis on the absurdity of strict reliance on BIT party autonomy, in *Joy Mining v Egypt*,[53] the tribunal held that if parties were allowed to determine the notion of investment in their BITs, Article 25 of the ICSD convention will be meaningless. It will render the role of Article 25 otiose. In *Phoenix v Czech Republic*, the tribunal held that:

> 'There is nothing like a total discretion, even if the definition developed by the ICSID case law is quite broad and encompassing. There are indeed some basic criteria and parties are not free to decide in BITs that anything [...] is an investment'[54]

[50] *Biwater Gauff v. United Republic of Tanzania* para 313-315.
[51] Arcuri, Alessandra, 'The Great Asymmetry, and the Rule of Law in International Investment Arbitration' in Lisa Sachs, Lise Johnson and Jesse Coleman, eds., *Yearbook on International Investment Law and Policy* (OUP, 2019).
[52] Jeffrey Chwieroth, 'Neoliberal Economists and Capital Account Liberalisation in Emerging Economies' (2007) 61(2) International Organisation 450.
[53] *Joy Mining Machinery Limited v. Arab Republic of Egypt* para 501.
[54] *Phoenix Action, Ltd. v. The Czech Republic*, para 82; *Patrick Mitchell v. Democratic Republic of the Congo* (n) para. 31

In *Malaysia Historical Salvors v Malaysia*,[55] the tribunal held that Article 25 of the ICSID convention had to be satisfied first. *Abaclat v Argentina,* interestingly held that an investment ought to have the economic characteristics of an investment under ICSID but be consistent with the legal form parties agreed to in the BIT.[56] The issue then is what the effect will be where the investment satisfies one of the two jurisdictional thresholds?[57] Zachary Douglas opined that where a conflict emerges between an ICSID definition and the BIT definition, the tribunal ought to decline jurisdiction where the BIT definition 'transcended the frontier of the ordinary meaning of the term, investment'.[58]

In *PSEG V Turkey,* the tribunal held that despite how broad the definition of an investment is in the BIT, 'there is a limit to what can reasonably encompass as an investment';[59] and, in *Enron v Argentina,* it was held that assets in the BITs will not qualify as investments under Article 25 ICSID Convention where it will be absurd and incompatible with the object and purpose of the convention.[60]

In the Report of the Executive Directors of the ICSID Convention, it was stated that:

> '…consent alone will not suffice to bring a dispute within (the jurisdiction of the Centre). 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'[61].

Furthermore, the jurisdiction of tribunals established under multilateral instruments are not expected to be determined as a question *inter-partes*.[62]

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[55] *Malaysian Historical Salvors, SDN, BHD v. The Government of Malaysia* ICSID Case No. ARB/05/10 Decision on Jurisdiction para 55.
[56] *Abaclat & Others v. Argentine Republic* (n) para 349.
[57] *Malicorp Limited v. The Arab Republic of Egypt* ICSID Case No. ARB/08/18 Award (7 February 2011) para 110.
[58] Zachary Douglas, *The International Law of Investment Claims* (n 2) para 344, p 164-165; Ceskoslovenska Obchodni Banka, A.S. v. The Slovak Republic, ICSID Case No. ARB/97/4 Decision on Jurisdiction (1 December 2000) para 65; *Patrick Mitchell v. Democratic Republic of the Congo* para. 31
[59] *PSEG v. Republic of Turkey* ICSID Case No. ARB/02/5 Decision on Jurisdiction (4 June 2004) para 184.
[60] *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic* ICSID Case No. ARB/01/3 Decision on Jurisdiction (14 January 2004) para 42.
[61] International Bank for Reconstruction and Development, Report of Executive Directors of the ICSID Convention, 18 March 1965 para 25; *Saba Fakes v. Republic of Republic of Turkey*, ICSID Case No. ARB/07/20 award of 14 July 2010 para 441; Christoph Schreuer et al, *The ICSID Convention: A Commentary* (2009) (n 44) p. 117
[62] *Anglo-Iranian Oil Co v Iran* (1952) ICJ Rep 93, 116; Article 34-38 ICJ Statute.

This thesis finds kinship in these reasonings. On the strength of the above legal reasonings, it confidently argues for an exclusion of portfolio investments from access to ICSID for falling outside its jurisdictional remit. This is because BIT consent alone, is not enough to bring a dispute within ICSID jurisdiction.[63] A BIT party autonomy approach to determining ICSID jurisdiction, will not produce an objective determination of the meaning of investment, rather it will result in subjective and arbitrary conceptions of the notion of investment leading to an extension of ICSID jurisdiction to any kind of transaction including at best speculative and volatile financial assets, and at worst, crypto assets which are outside the remit of ICSID.

Therefore, it is submitted that BIT consent must be consistent with the object and purpose of the ICSID convention.[64] It is critical that the investment in question falls within the meaning of investment as contemplated by ICSID, and since it only provided a circular definition, the type of investments for its jurisdiction must not be those inconsistent with its object and purpose i.e., volatile short-term speculative investments that puts economic development at risk.

Part B

4.2 A Review of Caselaw and Scholarship on Foreign Portfolio Investments' Jurisdiction

4.2.1 *Fedax v Venezuela*

This arbitration claim is the earliest ICSID claim where the notion of investment under Article 25 ICSID convention was analysed. Here, the jurisdiction of the centre was objected to by the respondent on the basis that the promissory note transaction under review did not meet the conditions to be considered as an 'investment.'[65] The claim concerned six (6) promissory notes issued by the respondent to a company called Industrias Metalurgicas Van Dam C.A. The company then endorsed the promissory notes to the claimant, a Dutch company. After the notes became due, the claimant brought ICSID arbitration against the respondent based on the

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[63] Aron Broches contended that the fact that parties recognise a dispute as an investment dispute in their investment agreement will be accorded great weight in determining jurisdiction, but it will not be the controlling factor. See: Aron Broches, Convention on the Settlement of Investment Disputes: Some Observations on Jurisdiction (1966) 268.

[64] *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic* ICSID Case No. ARB/01/3 Decision on Jurisdiction (14 January 2004) para 42

[65] Prior to this, ICSID tribunals have on their own volition, considered the existence of an investment. See, *Kaiser Bauxite Company v. Jamaic*a ICSID Case No. ARB/74/3; *Alcoa Minerals of Jamaica Inc. v. Jamaica* ICSID Case No. ARB/74/2.

Netherland-Venezuela BIT[66] for default in payment of principal, though some interest had been paid. The respondent objected to the jurisdiction of ICSID to entertain the claim contending that the promissory notes do not constitute an investment.

In determining jurisdiction, the tribunal identified the basic features of an investment as follows: certain duration; regularity of profits and return; assumption of risk; and substantial commitment to host state development; and held that the promissory notes satisfied all these features. The tribunal also held that jurisdiction extended to indirect investments provided the parties dispute arise from the indirect investment transactions which must not be a commercial transaction. As a result, loans and bonds qualify as investments. Thus:

> …jurisdiction can exist even in respect of investments that are not direct, so long as the dispute arises directly from such transaction. This interpretation is also consistent with the broad reach that the term "investment" must be given in light of the negotiating history of the Convention[67]… However, under both ICSID and the Additional Facility Rules, the investment in question, even if indirect, should be distinguishable from an ordinary commercial transaction[68]…ICSID may cover investments which may not be direct if the circumstances so warrant.[69] Loans qualify as an investment within ICSID's jurisdiction as does, in given circumstances, the purchase of bonds.[70]

Surprisingly, the tribunal which emphasised a broad interpretation of investment, inferred that volatile capital foreign investments (FPI) ought to be excluded from ICSID jurisdiction. It held that:

> **'The status of the promissory notes under the Law of Public Credit is also important as evidence that the type of investment involved is not merely a short-term, occasional financial arrangement, such as could happen with investments that come in for quick gains and leave immediately thereafter - i.e. ''volatile capital**."[71] Emphasis supplied.

[66] Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Republic of Venezuela 1991.
[67] *Fedax v. Venezuela*, para 24, p 1383.
[68] *Fedax v. Venezuela*, para 28, p 1384
[69] *Fedax v. Venezuela*, para 27, p. 1384.
[70] *Fedax v. Venezuela*, para 29, p 1384
[71] *Fedax v. Venezuela*, para 43, p 1387.

Clearly from the foregoing, short term, occasional financial arrangements that comes in for quick gains and leave immediately (FPI) ought not to be considered as investments. It is interesting to note that the Tribunal recognised that short-term, volatile profit seeking investments ought not to be considered as investments, yet, with respect, it erroneously included bonds as investments. This is quite important because most foreign portfolio investments are either expressly short-term, or have the propensity to be short-term, profit seeking financial instruments such as shares, global depository receipts, investment funds and security entitlements arising from sovereign bonds, acquired for quick profits etc. The acquisition of bonds could constitute short-term profit seeking investment capable of leaving immediately because of its negotiability and the extent of market liquidity.

Also, the tribunal excluded volatile capital. How do you distinguish between volatile-capital portfolio investments and non-volatile-capital portfolio investments, given the predisposition of portfolio investments to move about freely? The broad definition of investments in the Netherlands-Venezuela BIT does not distinguish these types of investments but grants all kinds of assets access to ICSID. Article 1 of the Netherland-Venezuela BIT defines an investment as

> For the purposes of this Agreement:
> (a) the term 'investments' shall comprise every kind of asset and more particularly though not exclusively:
> i. movable and immovable property, as well as any other rights in rem in respect of every kind of asset;
> ii. rights derived from shares, bonds, and other kinds of interests in companies and joint-ventures;
> iii. title to money, to other assets or to any performance having an economic value;
> iv. rights in the field of intellectual property, technical processes, goodwill and know-how;
> v. rights granted under public law, including rights to prospect, explore, extract, and win natural resources.

A broad BIT consensual approach will see all FPI investments as investments since there is no express exclusions within the BIT, of investments that come in for quick gains and leave immediately thereafter i.e speculative, volatile investments, neither is there a requirement for the investments to be connected to a productive activity within the state, or the tribunal to inquire into the intention of the investors. The recognition of a broad interpretation will result in a situation contradictory to the tribunal's position, since 'every kind of assets' include speculative and volatile investments which will be allowed access, as there is no requirement to inquire into investors' intention, or nature and characteristics of the investments.

It is noteworthy that the tribunal also excluded commercial claims. In excluding commercial claims, the tribunal did not elaborate on what constitutes a commercial claim. It is submitted that since the claim was a claim for default in repayment on the promissory note, the claim could be considered a commercial claim, and ought to be denied jurisdiction. The risk of default or non-performance is a credit/commercial risk, which emanates purely from the promissory note between the host state and the holder of the endorsed promissory note. Nothing has been placed to show that the risk of default in payment of the promissory note is not a mere commercial risk.

It is trite that ICSID has no jurisdiction over commercial claims.[72]Default in payment is merely a breach of contract which should be determined by the domestic court, and not ICSID since promissory notes do not usually provide for the method of recourse where there is a breach such as ICSID arbitration, and promissory notes usually indicate the consequences of non-payment or late payments, which may be payment of default fees.[73] The fact that the host State issued the promissory note should not automatically confer ICSID with jurisdiction. If that is the case, in commercial transactions involving States or agents of States, every breach of contract claim against the State will fall within the remit of investment arbitration.

4.2.2 *Olguin v Paraguay*

Here, in 1993 the claimant a Peruvian-American was contacted by an official of the respondent's Central Bank and informed him of the interest rates that he could obtain if he deposited money with a financial company in Paraguay. The claimant then deposited money with the financial company, and in exchange he was issued corporate investment bonds which bore the seal of the clerk of the Central Bank. The funds were used to incorporate a food supply company. In 1994 the Peruvian and Paraguayan bilateral investment treaty[74] came into force. A couple of months later, Paraguay went into an economic crisis, which led to the insolvency

[72] *Malaysian Historical Salvors, SDN, BHD v. The Government of Malaysia* para 112.
[73] Adam Barone, 'Promissory Note' https://www.investopedia.com/terms/p/promissorynote.asp#:~:text=A%20promissory%20note%20is%20a,at%20a%20specified%20future%20date. Accessed 30/09/2020.
[74] Convention between the Republic of Peru and the Republic of Paraguay on the Reciprocal Promotion and Protection of Investments 1994.

of the food supply company. As a result of the economic crisis and bankruptcy of the food supply company, the finance company was unable to continue making coupon payments on the bonds. Incidental to the crisis, the Paraguayan Central Bank passed a law agreeing to guarantee bank deposits of up to a certain amount in financial institutions.

While pursuing an insolvency suit against the Finance Company in Paraguay, the claimant instituted this claim before ICSID claiming that the Paraguayan government as guarantor to the investment bonds, are liable for the finance company's default in coupon payments on the bond. The respondent (Paraguay) opposed the claim. The respondent filed an objection contending that the claimant's bonds were not investments as contemplated under the Peru-Paraguay BIT 1994, on the basis that they were speculative financial instruments in search of high interest rates, and speculative financial investments were not covered under the BIT. The claimant argued that his deposit was an investment as contemplated under the BIT.[75]

After considering the provision of Article 1 of the Peru-Paraguay BIT, and adopting a party autonomy approach, the tribunal held that the definition of an investment contained in the BIT covered the claimant's investment. The tribunal held as follows:

> This Tribunal has no doubt that the investments made by Mr Olguin in the Republic of Paraguay are included in those enumerated in Article 1 of the CPI. Moreover, there exists no rule in the CPI which requires investments made by a national of another Contracting State to be accepted or recognized by the State in which they are made.[76]

Nowhere in the decision on jurisdiction did the tribunal attempt to distinguish the claimant's investment from a speculative investment, i.e an investment that is high risk with an expectation of significant gain owing to market value changes.[77] As far as the tribunal was concerned, provided the transaction can be subsumed within the list of investment under the BIT, it ought to be protected. It is immaterial whether such kind of investments are accepted or recognised by the host state, or the nature of such investment is volatile, or the macroeconomic consequence of such investment is distress. The implication of this is that any

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[75] *Olguin v. Republic of Paraguay,* para 20-23

[76] *Olguin v. Republic of Paraguay,* para 28. [Source: Translated from the Spanish text at http://www.woridbank.org/icsid/cases/paraguay-decision.pdf by Mr Jonathan Goldberg.]

[77] Alan Farley, 'Speculation' Speculation Definition & Explanation (investopedia.com)

transaction, including speculative, volatile, short-term, high-risk investments can enjoy ICSID access provided the investment falls within a broad BIT definition.

As previously stated, foreign portfolio investments have high propensity to be speculative especially when done for coupons or yields. foreign portfolio investments have been known to have catalysed financial crisis and may make no contribution to the productive economy.[78] Bearing this in mind, why then should portfolio investments be protected? How does the tribunal justify its decision? Granting portfolio investments access to ICSID will further encourage speculation because of the improved chances of recovering returns where speculative assets are affected by host state policy, and investment arbitration jurisdictional access is guaranteed just like in the above case.

4.2.3 *Abaclat v Argentina*.

In this case, sovereign bond financial interests were held to be investments under ICSID.[79] This case arose because of Argentina's sovereign debt default of 2001 arising from its economic crisis. Around the late 1990s, Argentina was in the middle of an economic crisis[80] which led to the default of its sovereign debt obligations. Following the default, Argentina restructured its debt profile. However, some bondholders held back, refusing to accept Argentina's exchange offer.[81] To lessen its debt liabilities to the holdouts, Argentina passed a law in 2005[82] banning the executive arm from engaging in any judicial, or out of court settlement with the holdouts. The result was some holdouts instituting civil claims before courts in New York, Germany, and Italy.[83] Some other holdouts like including Italian banks which served as intermediaries, refused the restructured offer, organised themselves as 'Task Force Argentina', and brought the instant ICSID arbitration claim against Argentina for breach of the Argentina-Italy BIT 1990. They then recruited Italian retail investors, holding security entitlements in the bonds acquired from the secondary market, to join this ICSID claim.[84] However, in 2010 Argentina

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78 Financial Speculation: The Good, the Bad and the Parasitic Financial speculation: the good, the bad and the parasitic (theconversation.com)

79 *Abaclat & Others v. Argentine Republic* para 356-367

80 For more details of the crisis, see Chapter One of this Thesis.

81 An Exchange Offer involves the host State, amidst a default in sovereign debt obligation, develops and issues new bonds which are within its ability to pay and acceptable to most bondholders, with the intention of exchanging the new bonds for the old bonds to secure the acceptance of the majority of bondholders.

82 Ley 26.017 of 9 February 2005, Boletín Oficial de la República Argentina, Núm. 30.590, 11 February 2005 (hereinafter "Law No. 26.017").

83 Michael Waibel, 'Opening Pandora's Box: Sovereign Bonds in International Arbitration' (2007) 101 Am. J. Int'l L. 711, 714; *Abaclat & Others v. Argentine Republic* para 82.

84 *Abaclat & Others v. Argentine Republic,* para 65-67, 84-91.

conducted another round of restructuring, and some of the claimants accepted the new exchange offers and withdrew from this claim.[85] The number of claimants was then reduced from 180,000 to 60,000.

Argentina raised jurisdictional objection to the arbitration claim, strongly contending that the bonds and security entitlements were not investments within the contemplation of Article 25 ICSID convention;[86] and that the claim was inadmissible for being a mass claim which Argentina did not consent to in its BIT, and which is alien to the ICSID framework.[87]

The majority tribunal held that Argentina's default and subsequent act of debt restructuring amounted to a breach of treaty obligations protected under the Argentina-Italy BIT, which gave rise to investment claims before ICSID.[88] The tribunal found that bonds were meant to be sub-divided into smaller negotiable economic values, i.e., securities entitlements[89] for resale; and the bond underwriters[90] would not have subscribed to the bonds unless they were re-sellable to intermediaries and retail investors. The Tribunal further found that the bonds and security entitlements are part of the same economic operation, therefore it was irrelevant that the purchase price for the security entitlements were not made available to Argentina since the initial lump sum for the bonds were paid to Argentina by the underwriters which was the basis for the sub-division and resale to intermediaries and retail investors.

The tribunal in analysing the concept of investment identified two (2) aspects necessary for defining investments which are:

(i) the contribution that constitutes the investment; and
(ii) the rights and values that are generated or derivable from the contribution.

According to the tribunal, the BIT focuses on the rights and values that are generated from the contributions which can be endangered by the host state's activities, while ICSID convention focuses on the nature of the contributions that makes up the investment. Reference was made

[85] *Abaclat & Others v. Argentine Republic* para 97.
[86] *Abaclat & Others v. Argentine Republic* para 234 (iv-vi)
[87] *Abaclat & Others v. Argentine Republic* para 504-551.
[88] *Abaclat & Others v. Argentine Republic* para 320-326
[89] The security entitlements are the result of the division and sub-division of the bonds into multitude of smaller securities each representing a fraction of the value of the bond, and which are easily acquired and disposed of electronically without a physical transfer of any title, but allows rights to pass to the acquirers of the securities upon payment of the price. *Abaclat & Others v. Argentine Republic,* para 364.
[90] *Abaclat & Others v. Argentine Republic, para* 358

to the *Salini* features in determining the nature of contributions.[91] The BIT protects the value or rights generated by the investment, and ICSID protects the contributions. According to the majority tribunal, the contribution will only be protected if it creates a right or value enumerated in the BIT that can be undermined by host state action, likewise a right or value enumerated in the BIT can only be protected if it is generated by a contribution. The only requirement is that the contribution be 'apt' to create the value or right that is enumerated for protection under the BIT.[92] The majority tribunal held as follows:

> 'In this respect, there is no doubt that Claimants made a contribution: They purchased security entitlements in the bonds and thus, paid a certain amount of money in exchange of the security entitlements. The value generated by this contribution is the right attached to the security entitlements to claim reimbursement from Argentina of the principal amount and the interests accrued.'[93]

On the inadmissibility of the claim for being a mass claim, the majority tribunal held that ICSID could entertain mass claims pursuant to Article 44 ICSID convention, and Article 19 ICSID Arbitration rules. Article 44 ICSID convention allows tribunals the authority to determine procedural issues which are not covered by the arbitration rules or parties' agreements,[94] while Article 19 ICSID Arbitration Rules empowers tribunals to make procedural orders.[95] According to the majority tribunal, these provisions serve as gap-fillers where there exists a procedural gap in the rules and party's agreements, thus they could be used to empower the tribunal to determine mass claims.[96]

In dissenting, Professor Abi Saab points out that the majority award dispensed with the requirement under Article 25, but jumps to the conclusion that the bonds/security entitlements constitute a contribution which qualifies it as an investment.[97] He contends amongst other things that the security entitlements could not be protected investments because of their legal remoteness from Argentina, and the majority tribunal holding that the bonds and security

[91] *Abaclat & Others v. Argentine Republic*, para 346-347.
[92] *Abaclat & Others v. Argentine Republic*, para 365.
[93] *Abaclat & Others v. Argentine Republic*, para 366.
[94] Convention on the Settlement of Investment Disputes between States and Nationals of other States 1965, Article 44.
[95] ICSID Arbitration Rules, Article 19.
[96] *Abaclat & Others v. Argentine Republic* para 521-528.
[97] *Abaclat & Others v. Argentine Republic* Dissenting Opinion para 66

entitlements are one single economic operation amounts to simplification of the reality.[98] This is because the award did not distinguish between the primary market for bonds in which the issuing state and the underwriters are the main parties, and the secondary market where the security entitlements are traded among investors, in the absence of the state.[99] In further illustration, Professor Abi Saab stated that it is the underwriters that bear the risk of demand in the securities, which is why they are entitled to underwriters spread.[100] Also, Argentina only receives the proceeds of the issue at the primary market, every other funds generated at the secondary markets are between the buyers and sellers of the security entitlement.[101] Consequently, the award ought to have considered the traceability as well as the legal and economic nexus between Argentina and the security entitlements before concluding it was a covered investment.

Aside the *Abaclat* dissenting opinion, which is the correct view, the reasoning behind *Abaclat* majority award's recognition of the security entitlements as investment under ICSID raises some other concerns. Firstly, in determining the nature of the contributions, the majority tribunal referred to the *Salini* features[102] it however cautioned against the use of the *Salini* features to limit jurisdiction since neither ICSID nor the BIT provided for it.[103] Clearly, from the majority tribunal's point of view, *Salini* if to be considered at all, is only applicable for the purposes of expanding the jurisdictional boundaries of ICSID, and not limit it. Also, the contribution and value/right creation approach proffered by the majority tribunal would mean that any transaction which contributes through payment, and the contribution creates rights or values that can be subsumed within a BIT, and capable of being negatively affected by host state action, ought to be recognised as an investment. Essentially, the effect of the decision is that provided the purchase price is paid in exchange for the security entitlement which has value and confers rights of payment to the holder and creates obligation on the host state, suffices as an investment under ICSID. Respectfully, this will tear down the walls of ICSID and at best: open her to every kind of transaction including speculative financial investments

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[98] *Abaclat & Others v. Argentine Republic* Dissenting Opinion para 69.
[99] *Abaclat & Others v. Argentine Republic* Dissenting Opinion para 70.
[100] Underwriters spread is the difference between what an underwriter pays to an issuer and the total amount gained from the issue. It is the gross profit margin from which other costs and fees are deducted. The value of the spread is determined by the risk and volatility of the securities. See, James Chen, Underwriting Spread Underwriting Spread Defined (investopedia.com)
[101] Michael Waibel, 'Opening Pandora's Box: Sovereign Bonds in International Arbitration' (n 83) 727; *Abaclat & Others v. Argentine Republic* Dissenting Opinion para 71.
[102] *Abaclat & Others v. Argentine Republic* para 346.
[103] *Abaclat & Others v. Argentine Republic* para 364.

and even mere commercial transactions, and at worse: allow the protection of decentralised financial assets like cryptocurrency provided the BIT definition is drafted wide enough.

Consequently, volatile assets unconnected with the host state, acquired through online brokerage platforms will be guaranteed investment protection despite their propensity for crisis. Host State macroeconomic public expenditure policy freedom will be constrained with detrimental consequences for social wellbeing and welfare of citizens because there will be an increased pressure to place investor's rights over citizen welfare.

It is relevant to state that even though the sovereign bond contract made provisions for legal protection in the event of default, the tribunal held the default and restructuring gave rise to ICSID arbitration because they were done in the exercise of sovereign power.[104] Thus, by their analysis, every commercial transaction undertaken by the State that goes wrong is subject to ICSID arbitration. Clearly, the emphasis was on the fact that the default and restructuring were carried out by Argentina. Yet, consideration was not paid to the fact that the default and eventual restructuring were inevitable consequences of a deteriorating economic situation which would have resulted in a 'run on' Argentina, akin to a 'Bank run' thereby spelling doom for the Argentine economy. Nor was it considered that speculative assets like the ones sought to be protected contributed to the crisis as well.

Finally, the decision by the *Abaclat* tribunal finding jurisdiction to entertain the claims of the sixty thousand (60, 000) bondholders can only be characterised as 'regulatory arbitration'[105] since prior to this decision, mass claims were phenomena alien to the ICSID framework and jurisprudence. The tribunal in an act of judicial procedural law making,[106] made the commencement of mass claims conceivable within ICSID, and technically opened 'pandora's box'[107] for mass claims in investment arbitration.

4.2.4 *Ufficio v Argentina*.

This claim is identical to the *Abaclat* claim. It arose from similar facts in terms of Argentina's sovereign debt default and Exchange offers of 2005, and adoption of Law 26.017 on 9 February

[104] *Abaclat & Others v. Argentine Republic* para 323-326.
[105] S. I Strong, 'Mass Procedures as a form of Regulatory Arbitration' (2013) Corp. L 263-265.
[106] Gus Van Harten & Martin Loughlin, 'Investment Treaty Arbitration as a Species of Global Administrative Law' (2006) 123. Here ISDS was viewed as a 'comprehensive form of global administrative law'
[107] Michael Waibel, 'Opening Pandora's Box: Sovereign Bonds in International Arbitration (n 83).

2005. In view of this, the majority strangely adopted the facts of *Abaclat* as the facts of this case. [108]It was commenced by 119 claimants. Jurisdictional and admissibility issues affecting individual claimants were not dealt with in the decision but were postponed for further examination during the determination of the claim on the merits. During the hearing on jurisdiction, 29 claimants accepted the Respondent's exchange offer of 2010, while 90 claimants remained. However, owing to the discontinuation of the claims in May 2015, we are not afforded the opportunity of the tribunal's reasoning on the outcome of the remaining claimant's substantive claim. Nevertheless, the tribunal in this decision set out its general criteria for determining jurisdiction and admissibility.[109] The majority tribunal reasoned that given the significant similarities between this claim and the *Abaclat* claim, especially the fact that similar arguments were proffered by the respondent in both cases, and for continuity, it would be 'artificial' for the tribunal to disregard the decision taken in *Abaclat.*[110]

The majority tribunal held that in determining jurisdiction *ratione materiae* of the Centre and competence of the tribunal to dispose of claims, the claims must be based on Art. 25(1) of the ICSID Convention and Art. 1(1) of the Argentina-Italy BIT.[111] Thus, in interpreting the notion of investment under Article 25, the term should be given a broad meaning, only to be restricted to transactions outside the outer margins of economic activities. They go ahead to state that provided the parties have agreed to include 'any plausible economic activity or asset' in their BIT, it is not for the tribunal to decide the question of whether to include such assets of activities under the umbrella of Article 25. Therefore, regardless of the peculiarities of sovereign bonds and security entitlements and given the broad reach to be accorded to Article 25, there is no doubt that sovereign bonds and security entitlements should be considered as investments under Article 25. The majority tribunal then held:

> Accordingly, the Tribunal can see no reason why sovereign bonds/security entitlements should be excluded from the jurisdiction of the Centre and, for that matter, from the competence of this Tribunal, *if and to the extent* that there is evidence that the States parties, i.e. Argentina and Italy, considered those to be investments to be protected, in view of which they both gave their 'advance and irrevocable consent

[108] *Ambiente Ufficio SpA & Ors v. Argentine Republic* para 60-62.
[109] *Ambiente Ufficio SpA & Ors v. Argentine Republic* para 6, p 2.
[110] *Ambiente Ufficio SpA & Ors v. Argentine Republic* para 10, p 3. Despite the absence of the doctrine of precedent in the IIR, the tribunal had no issues following the decisions of previous tribunals. Granted, this may be ideal for developing a more consistent and coherent IIR, but the danger remains that it could set up a trend of incorrectly decided decisions permitting protection for offshore Portfolio Investments.
[111]*Ambiente Ufficio SpA & Ors v. Argentine Republic* para 415, p. 135.

> that any dispute (on this basis) may be submitted to arbitration' (Art. 8(3) of the Argentina-Italy BIT. Hence, sovereign bonds/security entitlements are covered by the term 'investment' in Art. 25(1) of the ICSID Convention.[112]

In a rather tenuous attempt to respond to the dissenting opinion of Professor Abi Saab in *Abaclat,* on the issue of whether the security entitlements arose directly out of the investment, the majority tribunal held that the funds provided in exchange for the bond instrument were used to finance the respondent's budgetary needs, and a distinction between the economic operations giving rise to the sovereign bond acquisition, and that giving rise to security entitlements acquisition disregards the realities of the sovereign bond process. To buttress this point, the majority tribunal pointed out that the issuing State counts on the fact that investors would purchase the bonds (security entitlements) at the secondary market for the bond issuance to be successful. That is, the host State relies on the transferability and liquidity of the bonds to ensure the subscription.[113] Therefore, the majority tribunal concluded that:

> In the light of this jurisprudence and applying it to the facts of the present case, the Tribunal is convinced that the process of issuing bonds and their circulation on the secondary, i.e. financial, markets in the form of security entitlements are to be considered an economic unity and must be dealt with as such a unity for the purpose of deciding whether disputes relating to financial instruments of this kind "aris[e] directly out of an investment" and are therefore covered by Art. 25 of the ICSID Convention and Art. 1 of the Argentina-Italy BIT. Being part of a single economic operation, the purchase of security entitlements by Claimants on the secondary market is to be considered part and parcel of a single investment.[114]

In the dissenting opinion, Santiago Torres Bernardez rejected the reasoning of continuity proffered by the majority award as the basis of following the *Abaclat* award stating that it was alien to ICSID rules and practice, since ICSID arbitral tribunals are not permanent tribunals,

[112] *Ambiente Ufficio SpA & Ors v. Argentine Republic* para 471-472

[113] *Ambiente Ufficio SPA & Ors v. Argentine Republic* para 425, p 139. Essentially, the liquidity of the bonds was intended by the state to ensure its success. Consequently, does it mean that the state intended the protection of liquid and very volatile assets, just because by their very nature, they are intended to be liquid?

[114] *Ambiente Ufficio SpA & Ors v. Argentine Republic* para 434. Reliance was placed on *CSOB v Slovakia* were the tribunal held that '…a dispute that is brought before the Centre must be deemed to arise directly out of an investment even when it is based on a transaction which, standing alone, would not qualify as an investment under the Convention, provided that the particular transaction forms an integral part of an overall operation that qualifies as an investment.' *See also Enron Corporation v. Argentina* para 70; Christoph Schreuer & U. Kriebaum, 'At What time must legitimate expectations exist?' in Jacques Werner & Arif Hyder Ali (eds.), *A Liber Amicorum: Thomas Wälde. Law Beyond Conventional Thought* (2010) 272.

and do not have any appeals jurisdiction.[115] He furthered stated that it was disingenuous of the majority award to selectively pick the *Abaclat* award to follow on the basis of continuity, but ignored the prior decision in *Impreglio*[116] on the interpretation of Article 8(3) of the Argentina-Italy BIT (where ICSID jurisdiction was refused for failure to first proceed to domestic courts before ICSID jurisdiction can inure in accordance with Article 8(3) of the Argentina-Italy BIT) which was also a live issue in the *Ufficio* claim.

On the issue of the purported economic unity within sovereign bond issuance and sale of security entitlements, Santiago Torres correctly held that the majority tribunal in reaching that conclusion, neglected the factual distinctions between sovereign bonds and security entitlements as well as the difference between a primary market and a secondary market.[117] He also held that the security entitlements acquired at the Italian secondary market were too remote from the initial bond issuance by Argentina, and that the claimants failed to prove that at the time of their acquisition of the security entitlements, they perceived them as part of the same economic operation with the issuance of the of the sovereign bonds at the primary market. This is because the security entitlement transactions took place in different places, at different times, and for different purposes. [118] Also, the majority tribunal did not reference or evaluate expert evidence presented by the respondent on the process of issuance and circulation of bonds, and the legal implications of each stage of the transactions.[119] Furthermore, to claim economic unity, at least one of the transactions had to be an investment recognised under ICSID, however, none of the transactions qualified, and the claimants were unable to prove that the purchase of the bonds by the underwriters qualified as an investment under ICSID, because by their own admission the underwriters only held the bonds for mere seconds before they were sold off, defeating the duration feature of the ordinary meaning of an investment.[120]

On whether the security entitlements were investments, Santiago Torres held that the majority tribunal had a subjectivist view of investment under ICSID which was why they subsumed it under BIT consent. He rejected this subjectivist view, holding that applying it to the *Ufficio* claim was its ‘most extreme manifestation’. Parties are allowed their own meaning of

[115] *Ambiente Ufficio SpA & Ors v. Argentine Republic* Dissenting Opinion para 38-39, 45-48.
[116] *Impregilo S.p.A. v. Argentine Republic* ICSID Case No. ARB/07/17 Award (21 June 2011) is based on similar circumstances and the Argentina-Italy BIT 1990.
[117] *Ambiente Ufficio SpA & Ors v. Argentine Republic* Dissenting Opinion para 151.
[118] *Ambiente Ufficio SpA & Ors v. Argentine Republic* Dissenting Opinion para 152-153
[119] *Ambiente Ufficio SpA & Ors v. Argentine Republic* Dissenting Opinion para 154
[120] *Ambiente Ufficio SpA & Ors v. Argentine Republic* Dissenting Opinion para 157-159.

investment provided it falls within the perimeter of the ordinary meaning of investment under Article 25 in the context of the ICSID convention and in the light of its objects and purpose.[121]

Santiago Torres further stated that the majority also wrongly viewed the initial bond acquisition by the underwriters as covered investment, just to hinge the security entitlements thereon. This is because the initial sovereign bond placement did not satisfy the contribution,[122] duration[123] and risk[124] objective requirements for defining investments under ICSID. Therefore, it was not an investment but a mere commercial transaction. The underwriters[125] were not acting as investors investing in a host state, Argentina was also not hosting any investment rather they were selling a product in the international financial market, like they would sell any product. Therefore, the claimants could not have acquired any 'investment right' when you can't give what you don't have.[126]

Unsurprisingly, tribunals have excluded, and correctly so Foreign Portfolio Investment assets from ICSID jurisdiction.

4.2.5 *Postova v Greece*[127]

Between 2007- 2010, Greece issued sovereign bonds to fund its indebtedness. However, owing to the effects of the global financial crisis of 2007-2008, Greece experienced economic distress. Following its growing debt burden and rising fiscal deficit, rating agencies in 2009 downgraded Greek government bonds (GGBs). The GGBs were issued to 'participants' who delivered the bonds to 'primary dealers' who acquire the bonds in exchange of funds. The primary dealers then sell the GGBs on the secondary markets. The GGBs are dematerialised, thus they are sold

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[121] *Ambiente Ufficio SpA & Ors v. Argentine Republic* para 195

[122] The underwriters may have paid money to Argentina, the underwriters did not put the money in any economic activities or ventures and/or *for* the particular purpose of the economic development of Argentina. The claimants also did not pay any money to Argentina or put the money into any economic activities.

[123] The underwriters as earlier stated only held the sovereign bonds for seconds.

[124] The majority tribunal confused risk of non-performance with operational risk. Risk of non-performance is a contractual/commercial/business risk, usually with a specified remedy. However, the risk contemplated under investment law is a risk of loss or uncertainty of return even if all parties had performed their obligations. See: *Romak S.A. v. The Republic of Uzbekistan* PCA-UNCITRAL Arbitration Rules Award (26 November 2009) ("Romak"), paras. 229-30

[125] Underwriters are financial intermediaries that evaluates and assumes risk for a fee. Sometimes they purchase an entire placement from the issuer and then resell to institutional and retail investors.

[126] *Mihaly International Corporation v. Democratic Socialist Republic of Sri Lanka* ICSID Case No. ARB/00/2 Award (15 March 2002) para. 24.

[127] *Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic* ICSID Case No. ARB/13/8 Award (15 April 2015).

electronically through depositories, such as Clearstream. The claimants did not participate in the initial issuance of GGBs and its distribution in the secondary market. The claimants acquired GGB interests between January 2010 and April 2010 from Clearstream. Between 2010 and 2011, the Greek government paid interests on the GGBs, and paid principal on GGBs due in 2011 to the claimants. However, in July 2011, rating agencies further downgraded the GGBs in view of the deteriorating economic conditions. Consequently, IMF suggested that a Private Sector Involvement (PSI) be adopted to help with the fiscal deficits before official support can be made. A PSI is an arrangement where private holders of government debt agree to accept reduced principal, or interests or both through an exchange. Under this arrangement, GGB holders will take a haircut. The claimants were not part of this arrangement. The Greek Bondholder Act-Law 4050/2012 was passed to facilitate the restructuring.

Pursuant to the restructuring, the claimants brought this claim against the respondent restructuring which affected the value of their investments. The Respondent in turn, raised preliminary objections challenging the jurisdiction of the ICSID tribunal to entertain and maintain the claim on the ground that the GGBs were not investments under the Slovakia-Greece BIT, Article 1(1) and the ICSID convention, Article 25.

In refusing jurisdiction, the tribunal determined whether the GGBs were investments under the Slovakia – Greece BIT and under the ICSID convention. Under Slovakia-Greece BIT, Article 1(1), the tribunal found that its definition of investment contained an inexhaustive list. It held that the fact a list is inexhaustive does not mean that all categories of assets listed are to be considered an investment, or for a category to be excluded as an investment, it must be express.[128] An isolated construction of the chapeau of Article 1(1) would mean that any asset would qualify as an investment. The effect will render any subsequent examples listed of redundant.[129] Thus, the meaning of investment under Article 1(1) must be interpreted as a whole in accordance with the principle of effectiveness. To this end, the tribunal considered the entire provisions of Article 1(1).

In reaching its conclusions, the tribunal held that Article 1(1) did not reference public debt, or sovereign bonds. Rather what was referred to was corporate bonds. Reliance on *Abaclat* would

[128] *Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic* para 286-287.
[129] *Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic* para 312-313.

not avail the claimants because there was no reference to 'obligations' generally in Article 1(1) unlike the Argentine- Italy BIT which was the subject of dispute in *Abaclat & Ufficio.* Furthermore, the GGBs are not loans. Loans requires privity of contract between debtor and creditor unlike sovereign bonds which are held by large group of creditors who are mostly anonymous. In the instant case, Greece had privity with the intermediaries, and not Postova which was why Postova could sell and reacquire the GGBs without the knowledge of Greece.[130] Additionally, the tribunal was not convinced by the claimants contention that the GGBs amounted to claims to money under Article 1(1)(c). The tribunal held that under the provision, claims to money must arise under 'contract having a financial value'. Thus, there is a need for a contractual relationship between Greece and Postova for Article 1(1)(c) to be applicable.[131]

Regarding the ICSID convention, the tribunal acknowledged the absence of definition of investment under Article 25. Nevertheless, the tribunal adopted the 'objective test' (contribution, duration and risk) in determining the meaning of an investment under Article 25 ICSID. The tribunal held that determining the meaning of investment under Article 25 using the objective test will bring about the same outcome of denying jurisdiction as construing the meaning under Article 1(1) of the Slovakia- Greece BIT. [132]

In terms of contribution, the tribunal held that the GGB securities did not satisfy this requirement because they did not create economic value. Proceeds from the GGB securities were not used for economically productive activities but for financing budget deficits arising from other public debts. The tribunal distinguished between bonds used for financing deficits, and those used to finance specific public works. It held the latter as falling within ICSID jurisdiction. In determining duration, the tribunal found the duration requirement as satisfied. It however did not go into how this was satisfied, despite stating in its finding of facts that bonds are more liquid than loans and can change hands within hours.[133] Finally, the tribunal held that investment/operational risk was absent, rather the type of risk present was commercial risk which is the risk of default in contractual obligations. As a result, the risk requirement was not satisfied thereby denying Postova jurisdiction.

[130] *Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic* para 338-339.
[131] *Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic* para 342-344.
[132] *Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic* para 352-355.
[133] *Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic* para 337.

4.2.6 *Gruslin v Malaysia*

In 1996, the claimant invested in securities in the Kuala Lumpur Stock Exchange (KLSE) through a mutual fund (EAMEC Portfolio) managed by Citiportfolio S.A. At the direction of Citiportfolio, the EAMEC portfolio fund was invested in KLSE listed securities by and in the name of Citibank S.A. Owing to capital controls imposed by the respondent in September 1998, in the wake of the Asian Financial Crisis,[134] the claimant claimed to have suffered loss in his entire investment in the KLSE listed securities. The claimant then instituted this claim before ICSID against the respondent for loss of value of his investments arising from the breach of the Intergovernmental Agreement (IGA) entered between the respondent and the Belgo-Luxemburg economic union in 1979. The Claimant's claim against the respondent relates to the respondent's imposition of exchange controls in 1998, which is a breach of its obligation under the IGA. The claimant claimed that the proportion of his investment in the EAMEC portfolio, invested in the KLSE listed securities amounted to an investment under Art 1(3) of the IGA. In response, the respondent raised an objection challenging the jurisdiction of the claim before ICSID on the basis that claimant was not the investor, and the fund invested in the KLSE was not an investment under Article 1(3) of the IGA for not satisfying the requirement of proviso (i) to Article 1(3) which mandates the listed investments to be tied to an approved project.

The Claimant argued that the term 'project' was used in the sense of an activity, and acquiring securities is an investment activity within the contemplation of the project requirement. Furthermore, an approval from the respondent's Capital Issues Committee (CIC) for listing of securities on the KLSE for investment activities is an approved project. Thus, CIC approval for the listing of securities, which were then the subject of the funds' investment, satisfied the requirement of Article 1(3) proviso (i). However, the tribunal rejected the claimant's submission.[135] The tribunal held that what is contemplated under proviso (i) is a regulatory approval of a project. Thus, the CIC approval for share listing does not suffice to satisfy the requirement of approved projects under proviso (i). Tribunal went on to add that mere investments in shares, in stock markets that are easily tradeable, and unconnected to an approved project are not covered by the IGA.

[134] Factbox: Malaysia After Capital Controls FACTBOX: Malaysia after capital controls | Reuters
[135] *Gruslin v. Malaysia* para 24-26,

This case demonstrates another instance where host state macroeconomic decision collides with portfolio investments. If the IGA under proviso (i) of Article 1(3) did not contain the requirement that the investments must be invested in an approved project, there is a high chance that a construction of the IGA would have resulted in jurisdiction being found, and Malaysia paying for the claimant's losses arising from its macroeconomic decision to impose controls to stem the tide of the Asian Financial Crisis.

The central theme in these arbitration claims involves host state macroeconomic decisions such as default and restructuring of sovereign debts, guarantee of payments to domestic financial institutions (Bailouts), and foreign exchange economic policies which affected the value of portfolio investments. In relation to equity and corporate bond FPIs, it is rather straightforward to argue that given their very liquid nature, it is easier to come in for quick, speculative short-term gains,[136] with greater likelihood to constrain macroeconomic policy if protected. Thus, they should clearly not be granted access to ICSID and consequently should not be protected.

However, the challenge remains with sovereign debt portfolio investments. The issue with debt portfolio investments concerns whether ICSID should grant access to claims regarding host state default and restructuring of sovereign debts? Should holders of sovereign debt either directly or indirectly in the form of security entitlements be allowed individually or in a mass claim, to bring action under ICSID to recover said debt? It is seriously contended that it should not. Firstly, debt restructuring is not alien to law, it is permitted under bankruptcy and insolvency laws,[137] hence States are, and should be within their rights to restructure whether or not it affects bondholders. Secondly, it is in the state's best interest to repay debts,[138] and host state's macroeconomic policy decision to restructure debts indicates a willingness to repay the debt, perhaps under different circumstances owing to prevailing economic conditions.[139] Thirdly, the policy decision to restructure and repay the debt under different circumstances may reflect an inability of the host state to repay the debt at that time, owing to economic conditions within the state such as deep debt distress, or economic crisis which was existing in the cases under review, such that repayment of the debt at face value when due may have severe

[136] *Fedax v. Venezuela* etc

[137] James Roome et al, 'Restructuring and insolvency in the UK (England & Wales): Overview' Restructuring and insolvency in the UK (England & Wales): overview | Practical Law (thomsonreuters.com).

[138] Why should state's repay sovereign debts.

[139] The objective of sovereign debt restructuring is to preserve the functioning of the defaulting State and the global financial system, while protecting the interest of the investor. See, *Abaclat & Others v. Argentine Republic* para 29.

economic, health, and social impact on the state. Fourthly, the nature of the debt market now is such that short-term, foreign currency denominated debt are the most volatile, and they pose the most risk to economies especially middle and low income economies.[140] Finally, risk of default in payment is a commercial risk, and claims for repayment are commercial claims which are outside the jurisdictional remit of Investment Arbitration since sovereign bonds are essentially financial products sold by the host state in return for high coupon payments, or high yield upon liquidation. They are not operational risks as intended by investment arbitration.[141]

The implication of recognising sovereign debts as investments will be the use of ICSID arbitration to undermine sovereign debt restructuring efforts, and other macroeconomic measures with severe consequences for economic development of the host State. It will result in the worsening of a moral hazard problem whereby 'vulture funds'[142] will seek out discounted sovereign debts of emerging and frontier economies in deep debt distress, with difficult repayment change clauses and BIT protection. These vulture funds refuse restructuring to ensure default so they can bring investment arbitration claims for the debt face value, thereby making profit. It is submitted that this is inconsistent with the basic tenets of the investment law regime which was historically designed to target, and offer protection against arbitrary, unjust, and unreasonable host state actions,[143] and to promote host state economic development.[144]

Aside, tribunal decisions, academic commentators have attempted to provide justification directly[145] or indirectly[146] for extending ICSID access to portfolio investments. Dekastros argues that it is surprising that certain assets are recognised as investments by IMF, but are not considered as ICSID protected investments.[147] This argument clearly stems from a

[140] Barry Eichengreen, Ricardo Hausmann and Ugo Panizza, 'The Pain of Original Sin' (August 2003) 3 https://eml.berkeley.edu/~eichengr/research/ospainaug21-03.pdf Accessed 11/11/2022.
[141] *Romak S.A. v. The Republic of Uzbekistan*
[142] Usually hedge Funds that acquire discounted financial assets, especially fixed income assets with high yields, and high chances of default.
[143] A Reinisch & C Schreuer, 'Protection against Arbitrary or Discriminatory Measures'. In *International Protection of Investments: The Substantive Standards* (Cambridge: Cambridge University Press 2020) 813-854
[144] Omar E. Garcia-Bolivia, 'Economic Development at the Core of the International Investment Regime' In C. Brown & K. Miles (eds) *Evolution in Investment Treaty Law and Arbitration* (Cambridge University Press, 2011) 586-605
[145] Michail Dekastros, 'Portfolio Investment: Reconceptualising the Notion of Investment under the ICSID Convention' (n 42) 311.
[146] Julian Davies Mortenson, 'The Meaning of "Investment" (n 28).
[147] Michail Dekastros, 'Portfolio Investment: Reconceptualising the Notion of Investment under the ICSID Convention' (n 42) 311.

misunderstanding of the purport of the categorisation, which is for Balance of Payment (BoP) purposes.[148] Furthermore, it is not enough to merely identify these assets as investments, for access to ICSID jurisdiction, they must conform to the object and purpose of the ICSID convention, which is economic development.[149]

Mortenson basically argues for a consensual approach to defining investment. That is, a BIT centric, party autonomy approach where the meaning of investment is to be gotten from the parties' commitments contained in their BITs. The basis for this is that allegedly, the drafters of the ICSID convention in not adopting a definition, intended for a broad definition, to be determined by party consensus contained in the BIT.[150] According to him, this is consistent with the 'grand bargain' theory of international investment law;[151] and to ensure State flexibility on investment policies from time to time.[152] Furthermore, a continuous reliance on the *Salini* typical characteristics approach will result in alienating **stocks and bond** investments captured within BIT definitions, leading to an abandonment of ICSID.[153] He further contends that the ICSID definition should be considered as encompassing any plausibly economic activity or asset, but excludes BIT definitions of investment which are absurd, owing to their disconnection from meaningful economic activities.[154] And if host States intends to exclude any category of investments, recourse should be had to Article 25(4) ICSID convention.[155]

Granted, Article 25(1) of the ICSID convention did not define investment. However, a broad BIT-centric definition will be so wide as to encompass anything, including volatile, short-term speculative investments as could be seen in *Olquin v Paraguay*[156] where an obviously speculative investment was undertaken purely to profit from higher interest rates. It is without doubt that Mortenson will not want that,[157] hence the adoption of limiting phrases like

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[148] Balance of Payment is a statement of all transactions between private and public entities in a State and the rest of the World, which is essential for formulating domestic and international economic policy.
[149] *Enron v Argentina* para 42
[150] Julian Davies Mortenson, 'The Meaning of "Investment" (n 28) 280-296.
[151] Ibid 271; Jeswald Salacuse & Nicholas Sullivan, 'Do BITs Really Work: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain' (2005) 46 Harvard International Law Journal.
[152] Ibid 261.
[153] Ibid 279.
[154] Ibid 261.
[155] Ibid 295; Article 25(4) ICSID provides that '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).'
[156] *Olguin v Paraguay* para 28
[157] Julian Davies Mortenson, 'The Meaning of "Investment" (n) 261

‘plausibly economic activities. The adoption of ‘plausibly economic activities’ as a qualification for the type of investments that should be protected, recognizes that jurisdictional boundaries need to be placed in view of how wide BIT definitions can get. However, the constituents of ‘plausibly economic activities’ and ‘meaningful economic activities’ in relation to the ICSID convention were vague for the purposes of delineating the jurisdictional boundaries.

Furthermore, it is uncertain what the effect of Article 25(4) of the ICSID convention when utilised to exclude portfolio investments is. Is it an outright bar on the investments listed therein, or is it an interpretational guide? This is because during the drafting stage, it was initially expressed as limiting ICSID jurisdiction upon notification by a contracting State. It was subsequently said to be an interpretational tool to be used in conjunction with the parties’ BIT rather than being an outright bar.[158] What the latter means is that a very broad investment definition in a BIT could be interpreted to allow investments which have initially been excluded by notifications in accordance with Article 25(4) of the ICSID convention, where the notifications are not properly, clearly, and specifically stated even though intended to be excluded. Whatever happened to party autonomy?

A better analysis of Article 25(4) is one which sees it as being interpreted in conjunction with Article 25(1) as a bar to investments which ordinarily would be investments under Article 25(1), but a party chose to exclude by notification.[159] To be able to exclude under Article 25(4), the investment sought to be excluded must first be a recognised investment under Article 25(1). Therefore, in relation to foreign portfolio investments, Article 25(4) of the ICSID convention will be irrelevant since they ordinarily are not investments *ab initio* within the contemplation of Article 25(1). Therefore, Article 25(4) ICSID convention should be used to exclude actual, recognisable investments.

In so far as ICSID seemingly adopted a broad interpretation,[160] in the final analysis, it is submitted that the definition of investment in relation to ICSID jurisdiction must be qualified

[158] See, Julian Davies Mortenson, ‘The Meaning of “Investment” (n 28) at 295.
[159] *Ambiente Ufficio SpA & Ors v. Argentina* Dissenting Opinion para para 220.
[160] I strongly doubt this conclusion because I view the decision not to include a definition as one taken as a mere compromise between the conflicting interests to make progress, rather than a conscious decision to expand the jurisdictional boundaries of ICSID based on subjective definitions in BITs. See, Michael Waibel, ‘Opening Pandora’s Box: Sovereign Bonds in International Arbitration’ 730 where he said the refusal to adopt a meaning does not entail a broad definition by default.

and limited in accordance with an objective ordinary meaning of investment in line with the object and purpose of ICSID,[161] which is the mandate of economic development. It will be argued in the next section that in determining ICSID jurisdiction, the meaning of investments ought to be considered in terms of economic development. However, the requirement of economic development should not only be viewed promotionally, from a contributory perspective as has been done on some occasions like in the *Mitchell v DRC*, decision,[162] but also from a subversive perspective i.e., whether such investments can also potentially undermine economic development because of their, volatility, proclivity for crisis, and the restrictive effects on macroeconomic policies directed at averting or mitigating crisis. To this end, it will be argued based on ICSID teleology that owing to the volatility of FPI, and the direct impact FPI claims can have on a host State macroeconomic policymaking freedom for economic development, it ought not to be conceived of as an investment, thus should not be protected.

Part C

4.3 A Teleological Paradigm for Defining the concept of Investment within the International Investment Regime to the exclusion of Foreign Portfolio Investments.

The argument proffered in support of permitting foreign portfolio investment into the ICSID and international investment law framework essentially stems from a subjectivist interpretation of Article 25 of the ICSID Convention and an elevation of the party autonomy interpretation of BITs. While those arguments at first instance seem logical, they do not appreciate the true purport of the international investment regime, and the implications of covered portfolio investments.

Before delving in, it is necessary to point out the manifest procedural effect of permitting portfolio investments access to ICSID protection. Tribunals of an attitude to extend protection[163] based on their liberalised capital inclinations, will willingly rely on decisions

[161] The object and purpose of the ICSID convention the promotion of international private investment for economic development.
[162] *Patrick Mitchell v. Democratic Republic of the Congo*.
[163] M. Sornarajah believes it is an attitude issue. Tribunals who consider portfolio investments as investments will find a way of holding them as investments. See, M. Sornarajah, 'Portfolio Investments and Definition of Investment' (2009) ICSID Review - Foreign Investment Law Journal 519.

favouring expansion as a basis for expanding the outer limits of ICSID jurisdiction even though they are not bound to follow those decisions since the doctrine of judicial precedent is inapplicable to investment law jurisprudence.[164] Tribunals are allowed to oppose or disagree with previous tribunal decisions.[165] An instance of tribunal's naked reliance on previous decisions to permit portfolio investment into the international investment regime, is the seemingly helpless reliance on the *Abaclat*[166] and *Fedax*[167] decisions by *Ufficio*[168] and other investment decisions. In fairness, logic can be found for the reliance on *Abaclat* within the narrative of seeking to achieve consistency and coherence within the international investment regime.[169] However, reliance will only be apt where coherence can be achieved within the definition of the notion of investment in international investment law. At this time, no such coherence exists. Thus, this Thesis attempts to provide an interpretative framework for coherence.

4.3.1 Defining Investment in Accordance with the Object and Purpose (Teleology) of the ICSID Convention

Section 25(1) of ICSID provides that:

> '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 Supplied).

"…arising directly out of an investment" imposes an objective boundary for the interpretation of Article 25(1) for access to ICSID. It requires the legal dispute to emanate directly out of an 'investment', not a commercial transaction or any other transaction[170] regardless of whatever parties have agreed. In *Joy Mining v Egypt*, the tribunal held that:

[164] *AES Corporation v Argentine Republic* para 17-33; *Daimler Financial Services v. Argentine Republic*
[165] *SGS .v. Philippines* para 97.
[166] *Abaclat v. Aregentine Republic*
[167] *Fedax v. Venezuela*
[168] *Ambiente Ufficio SpA & Ors v. Argentine Republic* para 60 -62.
[169] *Saipem SpA .v. Bangladesh* Decision on Jurisdiction (21 March, 2007) para 67.
[170] Christoph Schreuer et al, *The ICSID Convention: A Commentary* (n 44) p. 117.

> ‘The parties to a dispute cannot by contract or treaty define as investment, for the purpose of the ICSID jurisdiction, something which does not satisfy the objective requirement of Article 25 of the Convention. Otherwise, Article 25 and its reliance on the concept of investment, even if not specifically defined, would be turned in a meaningless provision.’[171]

Also in *Phoenix Action v. Czech Republic*, the tribunal held that:

> ‘There is nothing like a total discretion, even if the definition developed by the ICSID case law is quite broad and encompassing. There are indeed some basic criteria and parties are not free to decide in BITs that anything [...] is an investment.’[172] […] At the outset, it should be noted that BITs, which are bilateral arrangements between two States parties, cannot contradict the definition of the ICSID Convention. In other words, they can confirm the ICSID notion or restrict it, but they cannot expand it in order to have access to ICSID. A definition included in a BIT being based on a test agreed between two States cannot set aside the definition of the ICSID Convention, which is a multilateral agreement. As long as it fits within the ICSID notion, the BIT definition is acceptable, it is not if it falls outside of such definition

Consequently, there is an investment requirement. It is critical that the investment in question falls within the understanding of an investment as contemplated by ICSID. The BIT cannot expand the meaning of investment beyond what is contemplated by the ICSID convention. To know what is contemplated by the ICSID convention, the Vienna Convention on the Law of Treaties (VCLT) will be apt.

In interpreting investment treaties, tribunals rely on the Vienna Convention on the Law of Treaties. In this regard, construction of provisions and terms are carried out in accordance with international law. Therefore, resort will be sought in Art 31 & 32 VCLT.

Article 31(1)(a) provides 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”.

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[171] *Joy Mining Machinery Limited v. Arab Republic of Egypt* para. 50
[172] *Phoenix Action Ltd v. Czech Republic* para. 82 & 96.

In its commentary on Article 31(1) (a) VCLT, the International Law Commission stated that:

> 'The first - interpretation in good faith - flows directly from the rule *pacta sunt servanda*. The second principle is the very essence of the textual approach: the parties are to be presumed to have that intention which appears from the ordinary meaning of the terms used by them. **The third principle is one of both common sense and good faith; the ordinary meaning of a term is not to be determined in the abstract but in the context of the treaty and in the light of its object and purpose.** These principles have repeatedly been affirmed by the Court.' [173] (Emphasis Supplied).

Tribunals have commonly interpreted investment treaties and the ICSID convention with regards to their objects and purposes by referring to their preamble.[174] Consistent with the provision of Article 31(2) VCLT which provides that context in the light of its object and purpose could be deduced from the preamble.[175] In that regard, the preamble to the ICSID convention will then be examined to determine what the ICSID contracting parties consented to. Remarkably, in *Plama v Bulgaria,* reliance on the preamble to determine the objects and purpose of the convention was rejected and criticised.[176] However, we will confine ourselves with the clear provisions of Article 31(2) VCLT.

The preamble to the ICSID convention has as its opening statement the following[177]:

> 'The Contracting States
> Considering the need for international cooperation for economic development, and the role of private international investment therein…Have agreed as follows'

Upon consideration of the provisions from the preamble, it is quite clear that ICSID is established to be an international forum for the settlement of investment disputes, particularly disputes arising from private international investment activities. Importantly, not just any

[173] Report of the United Nations Conference on the Law of Treaties, First and Second Sessions, Vienna, 26 March-24 May 1968 and 9 April-22 May 1969, Documents of the Conference (United Nations publication, Sales No. E.70.V.5) ("UN Publication on the Law of Treaties") p 38 para 5.
[174] *Continental Casualty v Argentina* (Decision on Jurisdiction) 22 February 2006 para 80.
[175] Giogio Risso, 'Portfolio Investment in ICSID Arbitration: Just A Matter of Consent?' (2020) 37(3) Journal of International Arbitration
[176] *Plama v Bulgaria* (Decision on Jurisdiction) 8 February 2005, para 193.
[177] Convention on the Settlement of Investment Disputes between States and Nationals of other States 1965, Preamble.

private international investments, but private international investment activities which play a role in economic development.[178] Economic development is fundamental to ICSID and its parent organisation the World Bank,[179] which also has as one of its objectives: 'assisting in the development of territories of members by facilitating the investment of capital for productive purposes.'[180] Thus, investment must be deployed for productive purposes to facilitate development. To this end, it is submitted that upon conflating the context of the operation of ICSID and the World Bank, the thrust of ICSIDs entire activities including private international investment promotion, must be directed at private international investment activities critical to economic development, even in determining its threshold requirement.

Much effort has been expended at establishing that the drafters of the ICSID convention did not define investment in Article 25 ICSID convention because they did not intend for there to be a definition of investment, for the purposes of allowing a broad definition.[181] Assuming this narrative is correct, it is strongly contended that whatever definition or approach at definition that is adopted, the objective metric of evaluation has to be: whether the 'private international investment activity' in this case, foreign portfolio investment acquisition, or sale played a role in economic development. Critically, because the preamble used the phrase 'the role' to suggest the importance of private international investment in achieving economic development.[182] Research seemingly suggests that FDI has a more positive correlation with economic growth and development,[183] while FPI's effects are mixed and uncertain, though there seem to be understanding on its propensity for economic distress and crisis.

The requirement of playing a role in economic development connotes active participation or contribution. It requires the investment to act positively, clearly, and demonstrably towards economic development. However, it does not require investments with uncertain and

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[178] See Executive Directors Report: Aron Broches Paper Presented to the American Society of International Law Panel on Development of Rules on International Trade and Investment p. 10

[179] A. F Lowenfeld, 'The ICSID Convention: Origins and Transformation' (2009) 38(1) Georgia Journal of International and Comparative Law 49-50. 53.

[180] Articles of Agreement of the International Bank for Reconstruction and Development, Article I.; See *Abaclat Dissenting Opinion* para 46-48.

[181] Julian Davies Mortenson, 'The Meaning of "Investment" (n 28); Michail Dekastros, 'Portfolio Investment: Reconceptualising the Notion of Investment under the ICSID Convention' (n 42); *Abaclat v. Argentine Republic* para 347.

[182] See, Convention on the Settlement of Investment Disputes between States and Nationals of other States 1965, Preamble.

[183] Usha Nair-Reichart & Diana Weinhold, 'Causality Tests for Cross-Country Panels: A New Look at FDI and Economic Growth in Developing Countries' (2001) 63(2) Oxford Bulletin of Economics and Statistics.

ambiguous development credentials, and it most certainly does not require investments that their protection can detract from economic growth and development. Consequently, in the light of ICSID's object and purpose of promoting economic development, it is logical that ICSID as an investment dispute settlement centre, will seek international cooperation through fair dispute settlement of disputes arising from private international investment activities with positive effects on growth and development. Otherwise, why would ICSID want to settle disputes arising from non-economically productive investment activities?

Similarly, it has been argued by Michael Waibel that it is only transactions which contribute to economic development that deserves access to ICSID.[184] In the dissenting opinion of *Abaclat,* Professor George Abi Saab held that:

> 'The investment that the Convention seeks to encourage by providing it with an international procedural guarantee is that which contributes to the economic development of the host country, i.e. to the expansion of its productive capacity, a contribution that presupposes a commitment to this task not only of economic resources, but also in terms of duration in time and the taking of risk, with the expectation of reaping profits and/or revenue in return.'[185]

It is a compelling and convincing argument which is why in relation to foreign portfolio investments, it is only investments though categorised as foreign portfolio investments for BoP purposes such as equity less than 10%, but translates into management and control, and contributes to economic development that can be considered as investments under ICSID.[186]

This thesis agrees with the fundamental requirement of productive activity and economic development as the benchmark for determining whether a transaction is an investment under ICSID. It however goes further to contend that in addition to the general requirement of inquiring if the investment brings about economic development, it is pertinent to consider if protecting that particular investment might undermine economic growth and development.

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[184] Michael Waibel, 'Opening Pandora's Box: Sovereign Bonds in International Arbitration' (2007) 101 American Journal of International Law 722-723; Giorgio Risso, Portfolio Investment in ICSID Arbitration: Just A Matter of Consent?' (2020) 37(3) Journal of International Arbitration

[185] *Abaclat v. Argentine Republic* Dissenting Opinion para 50; Ufficio Dissenting Opinion para 203.

[186] Interestingly, Michail Dekastros, 'Portfolio Investment: Reconceptualising the Notion of Investment under the ICSID Convention' (n 42) at 301 argues that the economic development objective of ICSID does not limit the scope of the notion of investment. He states that any economic transaction constituting investment whether direct or portfolio contributes to the economic development of the host State. He however did not provide any basis for this assertion. It can only be explained as arising from a misunderstanding of the objectives of ICSID.

There seems to be agreement on the fact that macroeconomic policies are essential tools in economic development in terms of poverty reduction, unemployment etc; and it is fundamental for States to have the autonomy to be flexible with their macroeconomic policies.[187] It is also not in dispute that FPIs are highly sensitive to macroeconomic policy changes, such that an FPI claim for losses will almost always be challenging a host State's macroeconomic measure possibly aimed at improving or stabilising economic conditions in the State; or aimed at averting or managing a crisis. It is assumed that economic policies are undertaken in the interest of the State and its citizens. Given the significance of macroeconomic policies and policymaking for economic stability, growth and development, and the potential for an FPI claim to challenge host State macroeconomic policies, it goes without saying that such vires to challenge macroeconomic measures can only strain host State macroeconomic flexibility with consequences for economic development, especially in times of, or impending crisis. It is the potential for macroeconomic constraint with repercussions for economic growth and development that makes FPI unworthy of ICSID protection because investment disputes arising from FPI can serve to constrain macroeconomic independence and flexibility where most necessary, and potentially undermine economic development.

Macroeconomic changes have huge impacts on portfolio investment returns i.e., in terms of capital gains/dividends, and yields/interests both positively, and negatively because of their sensitivity.[188] The likely outcome where such macroeconomic changes negatively affect foreign portfolio investment value where portfolio investments are protected will be an investment arbitration challenge of the offending policy, and a constriction of host state economic policy autonomy.[189] Consequently, foreign portfolio investors spurred by the adoption of a strict liability[190] type approach in international investment law, will become empowered to challenge any host state macroeconomic decisions that negatively impact their returns, to the detriment of the economic objective and wellbeing of the State and its citizens.

A glimpse of this reality can be seen from some of the cases reviewed in the previous section. For instance, Argentina and Greece's decision to restructure sovereign bonds in the event of

[187] Macroeconomic Policy and Poverty Reduction (imf.org)
[188] Adam Hayes, 'Sensitivity' Investopedia 10 June 2020 https://www.investopedia.com/terms/s/sensitivity.asp
[189] R Polanco, 'The Rise of and Backlash against Investor–State Arbitration' In The Return of the Home State to Investor-State Disputes: Bringing Back Diplomatic Protection? (CUP, 2019) 29-52.
[190] Strict liability regime imposes legal liability on a party for causing loss or injury on another party even though the damage or loss was not caused by negligence or fault.

default, to ensure its continued survival and development, saw its decision challenged before ICSID in the *Abaclat,*[191] *Ufficio,*[192] and *Postova*[193] claims. It is submitted that jurisdictional and substantive successes of sovereign bond claims without a doubt will incentivise holdout actions, frustrate restructuring and impede further developmental activities within these States.[194] It goes without saying what ICSID access will do to macroeconomic policies. Furthermore, Malaysia's decision to alter its foreign exchange policy to manage an economic crisis, saw ICSID arbitration claims brought against it by an equity portfolio investor where such alterations affected his returns negatively.[195] In effect, host State's that alter macroeconomic policies to the detriment of foreign portfolio investors' investments, may find themselves as respondents in investment arbitration. The consequence will see host states being cautious of ICSID arbitration by maintaining their macroeconomic regimes to suit foreign portfolio investors to avoid investment claims to the detriment of its economic and financial situation or international economic commitments. The case of Indonesia during the Asian Financial Crisis, maintaining its currency peg to please foreign investment interest which ended in catastrophe[196] illustrates the danger of policy freeze, and the advantage of flexibility. Without saying more, granting foreign portfolio investment access to ICSID will result in economic system-wide impacts, with potential economic development implications in the face of crisis. Therefore, it is submitted that portfolio investments protected by a grant of access to ICSID can undermine economic development.

Furthermore, foreign portfolio investments tend to be volatile, speculative, liquid, remote and unconnected to host states largely owing to IT evolution and the proliferation of financial technologies. The host States of foreign portfolio investments are often not recipients of the capital. They are short-term, usually in for quick gains and leave immediately thereafter with little control from the host State, yet they are sensitive to macroeconomic changes and market risks taking place in the host State.[197] Even though the macroeconomic changes are sometimes

[191] *Abaclat v. Argentine Republic*
[192] *Ambiente Ufficio SpA & Ors v. Argentine Republic*
[193] *Poštová banka, a.s. and Istrokapital SE v. Hellenic Republic*, ICSID Case No. ARB/13/8 Award (9 April 2015).
[194] See the above Argentine and Greek Sovereign Bond Cases.
[195] *Gruslin v Malaysia*
[196] Barry Eichengreen, *Globalising Capital: A History of the International Monetary System* (Princeton University Press 2nd edn, 2008) 193-194.
[197] Patricia L. Makoni, 'Foreign portfolio investments, Exchange Rates and Capital Openness: A Panel Data Approach' (2020) 8(2) International Journal of Economics and Business Administration; Patricia L. Makoni, 'FDI and Portfolio Investment Determinants in Developing African Countries'; Chukwuemeka P. Ekeocha et al, 'Modelling the Long Run Determinants of Foreign portfolio investments in Nigeria' (2012) 3(8) Journal of Economics and Sustainable Development 195.

a function of factors autonomous to the host state. For instance, IMF conditionalities; or are directed by the host state[198] for the benefit and wellbeing of citizens.

From the foregoing analysis, it is submitted that the meaning of investment should be determined in terms of ICSID's object and purpose as captured in its preamble.[199] Thus, portfolio investments which are highly sensitive to macroeconomic variations and market risks, and are liquid should be barred, because protecting them will give rise to foreign portfolio investment disputes which can undermine host State economic policy flexibility to the detriment of economic development. Consequently, tribunals at the jurisdictional stage can evaluate investments to determine whether they contribute productively to the host State economy, and if they challenge macroeconomic policies adopted to prevent or manage crisis. This is not a novel practice. Tribunals when considering the typical characteristics approach or just mere contribution, have conducted similar kinds of evaluations to determine contribution to host State development.[200] Therefore, it will not be uncommon if tribunals evaluate foreign portfolio investments to see what type of investments they are and what their effects are on macroeconomic flexibility, and if they could subvert economic development by inquiring about how prone to systemic risks they are.

To identify transactions with volatile, speculative, and systemic risk features and effects described above, which are typically portfolio investments, tribunals will have to adopt and modify two (2) characteristics of the ordinary objective meaning of investments as parameters, to evaluate and exclude such investments from gaining access namely: the duration and assumption of risk requirements. The adoption and modifications of these characteristics are not out of place primarily because it has been recognised that tribunals may remove or add to the *Salini test.*[201] Tribunals have also endorsed their use for the purpose of restricting the jurisdictional boundaries of investments;[202] and academic critics of the *Salini test* either did not

[198] Christina Romer & David Romer, 'The Determinants of Macroeconomic Policy' University of California, Berkley Economics 210c/236a Lecture 12 November 30, 2016.
[199] Tribunals have taken object and purpose into consideration in *Saluka v. Czech Republic* para 300; *Continental Casualty v. Argentina* para 258.
[200] *Phoenix Action, Ltd. v. The Czech Republic*; *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan* etc.
[201] *Quiborax S.A., Non Metallic Minerals S.A. and Allan Fosk Kaplún v. Plurinational State of Bolivia,* ICSID Case No. ARB/06/2 Decision on Jurisdiction (27 September 2012) para 211-217.
[202] *Inmaris Perestroika v. Ukraine* (n) para 131. Held that Salini test could be used to limit overly broad definitions in the BIT. This was criticised for being a middle ground position, thus methodologically weak. See Dekastros 298.

provide another means of determining their proposals, or have adopted the *Salini* typical characteristics to justify the inclusion of portfolio investments into ICSID.[203]

A consideration of the proposed modified typical characteristics for the evaluation and exclusion of portfolio investments are as follows:

(a) Duration: Issue of Liquidity.

It remains indisputable that tribunals have cursorily recognised that quick, occasional financial arrangements that comes in for quick gains and leaves immediately ought not to be considered as investments.[204] This is consistent with the position that rapidly concluded financial facilities were excluded from the concept of "investment".[205] This accurately describes modern portfolio investments. Portfolio investments are known for their herd mentality and will move at the slightest indication of loss of value or price fall.[206] Activated by the necessity for capital gains, yields, coupons etc, portfolio investments will move to where it is better off. The ease of mobility is boosted by the advancement of financial technology which has ensured sudden and immediate exit at the first signs of danger i.e. risk of loss, or sudden and immediate entry, at the prospect of capital gains. Thus, assets which can be easily liquidated in seconds should not be protected. According to UNCTAD, 'liquidity as much as maturity is the distinctive feature'[207] of short-term volatile investments. Fundamentally, this is a key feature which tribunals must take note of before reaching a decision whether foreign portfolio investments are investments.

(b) Assumption of Risk

Assets subject to credit risks, and price volatility risks ought to be excluded because they can result in purely commercial arbitration claims. Covered investments ought to be investments

[203] Michail Dekastros, 'Portfolio Investment: Reconceptualising the Notion of Investment under the ICSID Convention' (n 42) 311-317; *Abaclat v. Argentine Republic* para 370-371; *Ambiente Ufficio SpA & Ors v. Argentina* 393-398.
[204] *Fedax v. Venezuela*.
[205] See George R. Delaume, 'ICSID & the Transnational Financial Community' (1986) 1(2) ICSID Review - Foreign Investment Law Journal 237 at 242 while commenting on the first draft of the ICSID convention which required investments to have indefinite periods or at least, a period not less than 5 years. See, Convention on the Settlement of Investment Disputes between States and Nationals of Other States –Documents Concerning the Origin and Formation of the Convention (1968) 623.
[206] David S. Scharfstein & Jeremy C. Stein, 'Herd Behaviour and Investment' (1990) 80(3) The American Economic Review 465; Robert J Shiller, 'From Efficient Market Theory to Behavioural Finance' (2003) COWLES Foundation Paper 1055.
[207] United Nations Conference on Trade and Development (UNCTAD), Trade and Development Report (1999) 112.

exposed to the operational risk of arbitrary host state intentional wrongful conduct,[208] rather than risks of default in contractual obligations or systematic/market risks of changing economic conditions.[209]

To buttress this point, market risks are non-diversifiable risks. They are risks that affects the entire financial market and economic system, such that from a risk management point of view, nothing can be done about them. If that is the case, why then should a foreign portfolio investment be protected from a democratised risk which all assets and investments are exposed to? Given that portfolio investments are highly susceptible to[210] macroeconomic changes and market risks within an economic system; these risks are already accounted for in the price of the asset,[211] and the changes most often than not are not the consequence of host state intentional, arbitrary wrongful acts against the portfolio investments but necessary decisions in times of distress or crisis. The foundation of the international investment regime is the protection of foreign property from the deliberate wrongful act of host states. Recognizing as investment, assets sensitive to every pulse of the economy, and at risk of any change within the system, whether intentional or unintentional, whether wrongful or not, will derogate from the object of the international investment law regime, and open it to a floodgate of frivolous claims against the host state. Particularly holdouts who wish to capitalise on the broad definitions of investments in BITs, and subjectivist[212] interpretations of Article 25 ICSID, to undermine collective action efforts in sovereign bond restructuring. Granting sovereign bond holdouts access to the investment regime, will widen the fault lines between international investment

[208] *Eskosol SpA .v. Republic of Italy* ICSID Case No. ARB/15/50 Award (4 September 2020). See also, *Romak S.A. v. The Republic of Uzbekistan* (PCA Case No. AA280) Award of November 26, 2009, paras 229-230.
[209] https://www.investopedia.com/ask/answers/040615/what-are-biggest-risks-fixedincome-investing.asp
[210] Regional and national economic factors, such as tax and interest rate policies, can significantly contribute to the directional change of the market and greatly influence volatility. For example, in many countries, when a central bank sets the short-term interest rates for overnight borrowing by banks, their stock markets react violently. Changes in inflation trends, plus industry and sector factors, can also influence the long-term stock market trends and volatility. Also, a major weather event in a key oil-producing area can trigger increased oil prices, which in turn spikes the price of oil-related stocks. https://www.investopedia.com/articles/financial-theory/08/volatility.asp
[211] This is consistent with the efficient market hypothesis which holds that all information relevant to securities prices are freely and widely available and shared among investors. Given the preponderance of buyers and sellers within the financial market price movement occurs efficiently to ensure that securities prices are always trading at their current market value. What is the Efficient Market Hypothesis https://corporatefinanceinstitute.com/resources/knowledge/trading-investing/efficient-markets-hypothesis/#:~:text=The%20Efficient%20Markets%20Hypothesis%20(EMH,impossible%20to%20consistently%20%E2%80%9Cbeat%20the; See also, Eugene F Fama, 'Efficient Capital Markets: A Review of Theory and Empirical Work' (1970) 25(2) The Journal of Finance.
[212] Emmanuel Gaillard, 'Identify or Define? Reflections on the Evolution of the Concept of Investment in ICSID Practice' in Christina Binder et al., (eds) *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer* (OUP, 2009).

law and global financial law,[213] and create an incentive for holdouts to continue to holdout, to the detriment of the integrity of sovereign debt contracts and even the entire global financial system.

Part D

4.4 Interpreting Broad Descriptions of Investment in BITs

Investment treaties usually provides for a definition of the term 'investment' which could be broad or narrow; and could emphasise the characteristics of the investment or limit it to only economic activities.

Article 8 of the German-Pakistan BIT[214] defines 'investment' in very general terms without expressly excluding foreign portfolio investment investments. It provides that:

> (a) 'The term "investment" shall comprise capital brought into the territory of the other Party for investment in various forms in the shape of assets such as foreign exchange, goods, property rights, patents and technical knowledge. The term "investment" shall also include the returns derived from and ploughed back into such "investment".

Also, Article 14.1 USMCA[215] provides that:

> 'Investment means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. An investment may include:
> (a) an enterprise;
> (b) shares, stock and other forms of equity participation in an enterprise;
> (c) bonds, debentures, other debt instruments, and loans;
> (d) futures, options, and other derivatives;
> (e) turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts;

[213] This can lead to further fragmentation of the international economic law regime. See Chapter 7 for a detailed discussion on Portfolio Investment protection and fragmentation of the international economic law system.
[214] Treaty between the Federal Republic of Germany and Pakistan for the Promotion and Protection of Investments 1959.
[215] USMCA 2018, Chapter 14, Art. 14.1. It goes further to say that certain types of debt, such as bonds, debentures, and long-term notes or loans are likely to have the characteristics of an investment, while other forms of debt, such as claims to payment that are immediately due, are less likely to have these characteristics.

(f) intellectual property rights;

(g) licenses, authorizations, permits, and similar rights conferred pursuant to a Party's law; and

(h) other tangible or intangible, movable or immovable property, and related property rights, such as liens, mortgages, pledges, and leases,

but investment does not mean:

(i) an order or judgment entered in a judicial or administrative action;

(j) claims to money that arise solely from:

(i) commercial contracts for the sale of goods or services by a natural person or enterprise in the territory of a Party to an enterprise in the territory of another Party, or

(ii) the extension of credit in connection with a commercial contract referred to in subparagraph (j)(i);'

Towing a different line, the Brazil-India BIT[216] in Article 2.4.1 excludes as an investment:

2.4.1 For greater certainty, "Investment" does not include the following:

i) an order or judgment sought or entered in any judicial, administrative or arbitral proceeding;

ii) debt securities issued by a Party or loans granted from a Party to the other Party, bonds, debentures, loans or other debt instruments of-a State-owned enterprise of a Party that is considered to be public debt under the law of that Party;

iii) any expenditure incurred prior to the obtainment of all necessary licenses, permissions, clearances and permits required under the law of a Party;

iv) portfolio investments of the enterprise or in another enterprise;

v) claims to money that arise solely from commercial contracts for the sale of goods or services by a national or an enterprise in the territory of a Party to an enterprise in the territory of another Party;

vi) goodwill, brand value, market share or similar intangible rights;

vii) claims to money that arise solely from the extension of credit in connection with any commercial transaction; and

viii) any other claims to money that do not involve the kind of interests or operations as set out in the definition of investment in this Treaty.'

It appears that investments treaties between states with asymmetrical economic powers tend to adopt a broader definition of investment, when compared to investment treaties between states with almost symmetrical economic power. For instance, Nigeria – Morocco & Nigeria –

[216] Investment Cooperation and Facilitation Treaty between the Federative Republic of Brazil and the Republic of India 2020, Article 2.4.1

Turkey BITs have restrictive definitions,[217] when compared to Canada-Nigeria BIT.[218] Furthermore, since terminating over 70 BITs, and establishing a model BIT in 2016, which restricted its definition of investment, India has signed only 3 BITs with Belarus, Kyrgyzstan and Brazil respectively.[219] Each of which adopts a more restrictive definition. It could even be argued that it is only emerging and frontier countries, including least developed countries that have embraced the express provisions limiting foreign portfolio investments from the definition of investment.[220] Such narrative is consistent with the historical opposition of low & middle-income capital importing states to capital account liberalisation, seen in international investment law through a broad definition of investments BITs/IIAs and under the ICSID convention.[221] The opposition is currently manifested within recent treaties where parties of seemingly symmetrical economic power are able to assert themselves and restrict the definition of an investment. This is consistent with the political economy of BIT negotiations where asymmetric bargaining power is critical to the content of BITs after negotiation. Here, negotiators from capital-importing countries have little leverage in determining treaty content.[222]

For the purposes of clarity, this thesis is concerned with extant BITs/IIAs between developed states and emerging and frontier economies with broad definitions of investment capable of accommodating all kinds of transactions and resulting in absurdity.[223] Instances of absurdity may be seen when retail investors using online brokerages and trading platforms with no connection to the host States are extended protection. It has been submitted earlier that to gain access to ICSID, parties' consent must be subsumed under Article 25 of the ICSID convention's contemplation of investment.[224]

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[217] See Agreement between the Government of the Republic of Turkey and the Government of the Federal Republic of Nigeria Concerning the Reciprocal Promotion and Protection of Investment 2011, Article 1; Reciprocal Investment Promotion and Protection Agreement between the Government of the Kingdom of Morocco and the Government of the Federal Republic of Nigeria 2016, Article 1.
[218] Canada-Nigeria BIT 2014
[219] See India-Brazil BIT 2020; India-Kyrgyzstan BIT; and India- Belarus BIT; See generally, India | International Investment Agreements Navigator | UNCTAD Investment Policy Hub
[220] The following BITs limit Portfolio Investments. It is manifestly clear that these countries are developing and least developed countries.
[221] Julian Davies Mortenson, 'The Meaning of "Investment" (n 28) 284
[222] Kevin Gallagher, *Ruling Capital: Emerging Markets and the Reregulation of Cross-Border Finance* (Cornell University Press, 2014) 195. A similar dynamic is said to be found within International Trade. See Albert Hirschman, *National Power, and the Structure of Foreign Trade* (University of California Press, 1945)
[223] Vienna Convention on the Law of Treaties, Article 32.
[224] *Phoenix Action, Ltd. v. The Czech Republic*, para 82; *Patrick Mitchell v. Democratic Republic of the Congo* para. 31

In *Joy Mining v Egypt*, the tribunal held that:

> 'The parties to a dispute cannot by contract or treaty define as investment, for the purpose of the ICSID jurisdiction, something which does not satisfy the objective requirement of Article 25 of the Convention. Otherwise, Article 25 and its reliance on the concept of investment, even if not specifically defined, would be turned in a meaningless provision.'[225]

However, to address a broad definition of investment on its own merit where literal interpretation will result in absurdity, and where Investment Arbitration is *ad hoc* such as arbitration done under the UNCITRAL Rules. It is respectfully submitted that emerging/frontier economies may find wisdom in the approach adopted in the PCA decision of *Romak S.A. v. Uzbekistan* that was determined under the UNCITRAL Arbitration Rules. There the tribunal stated that:

> The Arbitral Tribunal therefore considers that the term 'investments' under the BIT has an inherent meaning (irrespective of whether the investor resorts to ICSID or UNCITRAL arbitral proceedings) entailing a contribution that extends over a certain period of time and that involves some risk ... By their nature, asset types enumerated in the BIT's non-exhaustive list may exhibit these hallmarks. But if an asset does not correspond to the inherent definition of "investment," the fact that it falls within one of the categories listed in Article 1 does not transform it into an 'investment'.[226]

The tribunal here held that the 'objective test' (contribution, duration and risk) should be the basis for determining the meaning of investment in the BIT whether the claim is before ICSID or not. If this is adopted, FPI will be scrutinised under the typical characteristics test, and based on the analysis conducted under Part C, may be denied jurisdiction. However, the likelihood of this being adopted may be slim, owing to the absence of the doctrine of judicial precedence in investment arbitration. Although arbitrators can be influenced by previous decisions.

Alternatively, recourse may be had to the Vienna Convention on the Law of Treaty. It is noteworthy that Article 32 provides for supplementary means of interpretation in the event, an

[225] *Joy Mining Machinery Limited v. Arab Republic of Egypt* para. 50
[226] *Romak S.A. v. The Republic of Uzbekistan* (PCA Case No. AA280) Award of November 26, 2009, paras 180 & 207

interpretation under Article 31 turns out to be absurd and obscure. It allows a resort to the *travaux preparatoires*.

Article 32 provides that:

> 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.

If available, it is quite difficult to obtain the *travaux* of BITs signed between States,[227] as a result, it is quite rare to have them before tribunals.[228] In reality, they are usually unavailable. This is understandable. The global desire and competition for foreign capital, particularly amongst emerging/frontier economies[229] is enough incentive to sign whatever is presented to them, without proper information, negotiation, and deliberation.[230] Thus, the unavailability of the *travaux* makes it an uphill task to determine if the parties intended the definition to encompass foreign portfolio investments.

However, current subsequent practice by emerging/frontier economies, of excluding foreign portfolio investment supports the argument against inclusion as can be seen in BITs signed recently.[231] According to UNCTAD, 45% of BITs concluded between 2012 and 2016 excluded portfolio investments or sovereign debt obligations from the definition of investment.[232] Nonetheless, resort to subsequent State practice, is unhelpful as a means for the interpretation

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[227] Esme Shirlow & Michael Waibel, 'A Sliding Scale Approach to Travaux in Treaty Interpretation: The Case of Investment Treaties' (2021) The British Yearbook of International Law 5; Klager, Fair and Equitable Treatment 46(

[228] Rudolf Dolzer & C Schreuer, *Principles of International Investment* Law (OUP 2nd edn, 2015) 208.

[229] Z Elkins, A Guzman and B Simmons, 'Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960 – 2000' Berkley Program in Law and Economics Annual Papers 2006; Eric Neumayer & Laura Spess, 'Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries' in K. P Suavant & Lisa E. Sachs (eds) *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (OUP, 2009). Compare with Jason Yackee, 'Do BITs Really Work? Revisiting the Empirical Link between Investment Treaties and Foreign Direct Investment' in K. P Suavant & Lisa E. Sachs (eds) *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (OUP, 2009) 386 -387

[230] Julian Davies Mortenson, 'The Meaning of "Investment" (n 28).

[231] See the over 30 BITs signed excluding portfolio investments. See aslo Biwater Gauff (Tanzania), Ltd. v. Tanzania, ICSID Case No. ARB/05/22, Award, 24 July 2008, para. 314; Fedax N.V. v. Venezuela, ICSID Case No. ARB/96/3, Decision on Jurisdiction, 11 July 1997, paras. 34-36; see Julian Mortenson, 'The Meaning of "Investment" (n 28) 277 & 303.

[232] United Nations Conference on Trade and Development (UNCTAD World Investment Report 2016 114.

of broad BIT definitions of investment in the light of the provisions of Article 31(3)(b) VCLT which provides that:

> 'There shall be taken into account, together with the context:
> any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;'

To this end, it must be shown that both parties to the BIT in their subsequent relationship in relation to the BIT have established a system of interpreting the treaty. Ordinarily, it should not apply to unilateral efforts,[233] as can be seen recently in the moves to exclude portfolio investments from the definitions of BITs. However, state unilateral conduct may be argued to amount to State practice. Thus, where subsequent exclusion of foreign portfolio investments exists, such as in recent BITs/Investment Chapters by emergin/frontier states or interpretation statements are made arguing for exclusion, it may be contended that it constitutes state practice. Nevertheless, it is uncertain if this reasoning will be upheld by an investment arbitration tribunal.[234]

Innovatively, tribunals may be pressed to request information from both state parties on treaty interpretation based on the equivalent of Rule 34 of the ICSID Arbitration Rules,[235] in the *ad hoc* Arbitration Rules, such as UNCITRAL Arbitration Rules.[236] In *Agua Del Tunari v Bolivia,*[237] the tribunal recognised the possibility of requesting and obtaining information from the home state for the interpretation of investment treaties. Bearing in mind that emerging/frontier economies were opposed to a broad definition of investment under ICSID and are mostly excluding portfolio investments from the BITs they sign amongst themselves; it is only fair that tribunals should request information from both states to determine if foreign portfolio investments are recognised as investments. However, this can only be successful if both State parties issue a joint statement or agreement to constitute a 'subsequent agreement between the parties' excluding portfolio investments.[238] The likelihood of that is low to impossible.

[233] *Kasikili/Sedudu Island (Botswana/Namibia), Judgement, ICJ Report 1999 para 49, 52-79;* Malcolm Evans (ed), *International Law* (OUP 4th edn, 2014) 180.
[234] *National Grid PLC v. Argentine Republic,* UNCITRAL, decision on jurisdiction (June 20, 2006), para. 85, p. 26
[235] International Centre for the Settlement of Investment Dispute Arbitration Rules, Rule 14.
[236] United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules https://uncitral.un.org/en/texts/arbitration/contractualtexts/arbitration
[237] *Agua Del Tunari v Bolivia* Decision on Jurisdiction (21 October 2005) para 47; 249 – 263.
[238] *Agua Del Tunari v Bolivia* para 251

Therefore, this demonstrates the expedience for the departure from a party autonomy, broad encompassing definitions found in some BITs to a more restrictive definition of investment. The recognition of ensuring a limit is placed on the meaning of investment as was echoed in the *Biwater decision,* as well as the recognition of the exclusion of commercial transactions including volatile, short-term investments in *Fedax* should influence the reasoning of the *ad hoc* arbitral tribunal. Alas, this may not be possible with *Ad hoc* arbitration or a subjective, BIT autonomy approach. Consequently, the only other option to emerging/frontier economies is putting up substantive defences during trial stage.

Part E

4.5 Effects & Policy Options arising from the Internationalisation of Foreign Portfolio Investment Disputes Through Investment Treaties and Investment Arbitration.[239]

As earlier argued, certain financial assets given their nature ought not to be included within the conception of investments primarily because their inclusion will be inconsistent with the objects and purpose of the ICSID convention.[240] The absence of a coherent means of defining investments under ICSID, will see tribunals relying on broad definitions of investments in investment agreements, to permit access to ICSID to all kinds of activities which they relatively conceive to be investments, despite the detrimental effect according protection may create. A broad, all asset inclusive protection conception of investment, will be a very investor-centric means of viewing investments, without taking cognizance of the other objective of economic development which is an aim of the host states. Consequently, a continued recognition of portfolio investments may result in the internationalisation of portfolio investments instruments and tribunalisation of alleged disputes through access to Investor-State Dispute Settlement ISDS) mechanism.

ISDS will thus be open to a floodgate of portfolio investment asset holders with no connection to the host State, but with claims against the host state for carrying out macroeconomic policies which affects their assets. Access to ISDS will also incentivise creditor fragmentation leading to increase in holdouts' actions, thereby undermining host state sovereign debt restructuring

[239] Additionally, IIR is very expensive to commence and maintain, what is the logic behind permitting the exercise of a right, when the right may not be exercisable owing to high cost. Interestingly enough, the reason why a claims threshold of $100, 000 was rejected was to attract small claims as test cases. See Moretenson, Meaning of Investment.

[240] Executive Directors Report, While the broad objective of the Convention is to encourage a larger flow of private international investment, the provisions of the Convention maintain a careful balance between the interests of investors and those of host States, number 13.

efforts, and other potential sovereign debt insolvency mechanisms.[241] Therefore, interfering with the ability of the State to adequately respond to, or participate in other global financial commitments and policies beneficial to its economic development. The outcome could be States' constantly walking on eggshells, and anxiously looking over their shoulders each time they make an economic decision.

Express exclusion of ISDS and mass claim arbitration in sovereign bond contracts and other portfolio investment financial instruments can aid in stemming the tide of the tribunalisation of foreign portfolio investment instruments.[242] The issue with this is that like the decision in *Abaclat*[243] the tribunal may consider the claim a treaty claim and ignore the contents of the contract. There the tribunal ruled that the forum selection clause which specified federal courts in New York as the forum for dispute settlement were irrelevant because the bondholders' claims were treaty claims and not contract claims. In reaction to this, in the subsequent sovereign bond issuance of 2016, Argentina added the word 'exclusive' to the forum clause of its sovereign bond contracts.[244] The jury is not yet out on its effectiveness.

Furthermore, investment treaties could be recalibrated to remove portfolio investments from the definition of investments or exclude claims relating to debt restructuring from ISDS like in the US-Peru & Colombia Free Trade Agreement.[245] This appears to be the trend in treaty practice currently, particularly by emerging/frontier countries. However, expressly excluding portfolio investment without defining it, or describing it in the BIT, as can be commonly seen[246] could create uncertainty, considering the broad categories of what constitutes portfolio investment. The issue with this approach could be the unwillingness of other state parties to negotiate or execute such treaties, particularly developed countries. Most of the treaties excluding portfolio investment from investment, and sovereign debt restructurings as a claim against a host state are intra-emerging/frontier economies' BITs. Ever since India recalibrated its investment treaty framework in 2016, it has signed only 3 Bits thus far, and of the 3 treaties,

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241 William W. Bratton & G. Mitu Gulati, 'Sovereign Debt Reform and the Best Interest of Creditors' (2004) 57 Vanderbilt Law Review 20–22.
242 Stephen J. Choi et al, 'The Evolution of Contractual Terms in Sovereign Bonds' (2012) 4 Journal of Legal Analysis 133
243 *Abaclat v. Argentine Republic* para 498-499.
244 Stephen Kim Park & Tim R Samples, 'Tribunalizing Sovereign Debt: Argentina's Experience with Investor–State Dispute Settlement' (2017) 50 Vanderbilt Journal of Transnational Law.
245 See, Morocco-Nigeria BIT Article 1; India-Kyrgyzstan BIT Article 1; US-Peru & Colombia FTA Article 1.
246 See, India's current BIT practice, Nigeria's current BIT practice, Rwanda-UAE BIT and a host of others.

none is with a major economy.[247] It is uncertain if this is a function of the decline in BIT public opinion globally owing to a backlash against the international investment regime, particularly ISDS; or a reaction to the radical changes made to India's international investment policy. Only time will tell. Finally, it is noteworthy that the Argentina-Qatar BIT,[248] which was the first BIT signed by Argentina in 15 years, narrowed its definition of an investment.

Host states could attempt to renegotiate the existing treaties, or selectively terminate treaties with very broad definitions. Bolivia[249] and South Africa[250] have selectively terminated treaties in the past.[251] India quite recently in 2016, as earlier mentioned, terminated all its BITs, and replaced them with a new model BIT with significant changes.[252] Alternatively: states parties' could renegotiate BITs with a view to excluding portfolio investment claims from ISDS access, or exclude ISDS completely as a dispute resolution mechanism; [253] or renegotiate to include non-precluded measures (NPM) clauses where not available, to be able to take actions which may appear to be breaches of treaty obligations, but necessary to ensure public order, security and public health.[254] Inasmuch as, the doctrine of *rebus sic stantibus* is available to states in the exercise of their sovereignty, termination of treaties may have consequences for the integrity and purpose of international law. Also, it may be difficult to convince the other state party to the treaty of the need to renegotiate when it isn't their priority. States could also withdraw from ICSID like Bolivia, Ecuador and Venezuela did.

Admittedly, denying foreign portfolio investments protection by not recognising them as investments can potentially enable emerging and frontier host states to be able to avoid investment arbitration challenges against their policies to the detriment of the investment landscape. It may likely result in foreign portfolio investors losing the value of their investments, or their investments entirely. With the effect of the international investment regime losing its reputation as a robust and effective framework for protecting investments,

[247] See generally, India | International Investment Agreements Navigator | UNCTAD Investment Policy Hub

[248] The Reciprocal Promotion and Protection of Investments between The Argentine Republic and The State of Qatar 2016, Article 1.2 which limited investments to commitment of resources in the territory of Argentina.

[249] Bolivia notifies World Bank of withdrawal from ICSID, pursues BIT revisionshttps://www.bilaterals.org/?bolivia-notifies-world-bank-of&lang=es

[250] South Africa begins withdrawing from EU-member BITs https://www.iisd.org/itn/en/2012/10/30/news-in-brief-9/

[251] Leon E. Trakman & David Musayelyan, 'The Repudiation of Investor-State Arbitration and Subsequent Treaty Practice: The Resurgence of Qualified Investor-State Arbitration (2015) 31 ICSID Review 199–203.

[252] Discuss the changes introduced by the Indian Model BIT of 2016.

[253] In the Australia-US FTA as well as TTIP ISDS was completely excluded as a dispute settlement mechanism.

[254] Stephen Kim Park & Tim R Samples, 'Tribunalizing Sovereign Debt: (n) 1056-1057.

albeit portfolio investments specifically. However, it is fundamental to note that, in deciding to invest in emerging and frontier economies, foreign portfolio investors accepted the risk of losses occasioned by non-diversifiable market risks in the form of macroeconomic policies.

Finally, adopting the teleological paradigm for defining investments under ICSID as advanced in this part, is not bereft of challenges. The biggest challenge appears be the willingness of investment arbitrators to adopt a more restrictive definition when faced with portfolio investment claims under ICSID where investment is broadly defined in the IIAs/BITs. Another challenge will be the willingness of contracting parties to enter into treaties whereby jurisdictional access through the definition of investment is narrow so as to exclude foreign portfolio investments. A third challenge could be the potential partiality of Arbitrators. Generally, Arbitrators are appointed by the parties. However, there may be professional incentive for the arbitrators to lean towards a broad interpretation of the meaning of investments to favour extending foreign portfolio investment protection. This is to shore up the investment protection credentials of the international investment regime and encourage foreign investors to seek out remedies where there exist alleged violations of IIAs/BITs, thereby creating more work for themselves.[255]

4.6 **Conclusion**.

In uncovering the meaning of 'investment,' recourse has been had to just the specific definitions contained in Bilateral and Multilateral investment treaties,[256] or the ordinary objective meaning of the word from usage.[257] For the latter approach to be within the framework of the ICSID convention demands examining the meaning of the word, 'investment' within the context of the convention.[258] This can be achieved if ICSID tribunals move from a BIT-party autonomy subjectivist conception of investments which encompasses portfolio investments,[259] to a more objective meaning of investments related to the object and purpose

[255] Jasper Krommendjik & John Morjin, 'Proportional by What Measure(s)? Balancing Investor Interests and Human Rights by way of Applying the Proportionality Principle in Investor-State Arbitration' in Pierre- Marie Dupuy (ed) *Human Rights in International Investment Law & Arbitration* (OUP, 2009) 449.

[256] *Lanco Int'l Inc v. Argentina* (ICSID Case No. ARB/97/6) Decision on Jurisdiction and Admissibility of 8 December 1998 para 48.

[257] *Fedax N.V v. The Republic of Venezuela* (n 4); *Salini Costruttori S.p.A v. Kingdom of Morrocco* ICSID Case No. ARB/00/4 Decision on Jurisdiction 23 July 2000.

[258] Rudolf Dolzer & Christoph Schreuer, *Principles of International Investment Law* (OUP 2nd edn, 2012) p. 61.

[259] Julian Davies Mortenson, 'The Meaning of "Investment": ICSID's Travaux and the Domain of International Investment Law [2010] 51 Harvard International Law Journal 281; Emmanuel Gaillard, 'Identify or Define? Reflections on the Evolution of the Concept of Investment in ICSID Practice' in Christina Binder et al., (eds) *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer* (OUP, 2009).

of the ICSID which is economic development. It is the narrative of BIT deference that has led to the expansion of the meaning of investment to encompass portfolio investments in the form of sovereign bonds,[260] corporate bonds,[261] and potentially, investment funds.[262]

Consequently, ICSID tribunals have to consider whether protecting portfolio investments can derogate from host State economic development owing to their chilling effect on host State macroeconomic policy. For instance, protecting sovereign bonds as investments have been known to undermine host State sovereign debt restructuring efforts.[263] Therefore, it is contended in the thesis that extending ICSID coverage to portfolio investments exposes the State to potential challenges of its macroeconomic and macro-prudential policies, which could result in undermining host State economic development.

[260] *Abaclat & Others v. Argentine Republic*; *Ambiente Ufficio SPA & Ors v. Argentine Republic*.
[261] *Olguin v. Republic of Paraguay*.
[262] *Gruslin v. Malaysia*.
[263] *Abaclat & Others v. Argentine Republic*; *Ambiente Ufficio SPA & Ors v. Argentine Republic*.

Chapter Five

Assessing Fair and Equitable Treatment Standards of Protection for Foreign portfolio Investments Protection

5.0 Introduction

Generally, this thesis considers the jurisdictional and substantive issues determining the protection of portfolio investments, especially in the wake of economic/financial crisis, under the International Convention for the Settlement of Investment Disputes (ICSID)[1] and International Investment Agreements (IIA)/Bilateral Investment Treaties (BITs). Meanwhile, without prejudice to the jurisdictional issue affecting extending investment coverage to foreign portfolio investments in times of crisis, as discussed in the previous Chapter,[2] this Chapter zooms in on the Fair and Equitable substantive standard of protection. It argues that host State macroeconomic measures[3] deployed to avert or mitigate economic and financial crisis[4] (such as sovereign debt crisis,[5] currency crisis[6] etc.,) that incidentally affects foreign portfolio investments, may not to be in breach of the Fair and Equitable Treatment (FET) standard of protection. This is because in determining FET protection generally, tribunals consider the circumstances of each case, and context of each situation (such as the nature of State guarantee, the economic condition of the host State etc.[7] Furthermore, where FET is tied to the minimum standard of treatment under customary international law[8] like in US and Canadian treaties, a

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[1] Convention on the Settlement of Investment Disputes between States and Nationals of other States 1965 established the International Centre for the Settlement of Investment Disputes (Centre).

[2] Chapter 3 argues against the extension of investment protection to foreign portfolio investments in times of crises owing to its inconsistency with Article 25 of ICSID, and the preamble to ICSID. See Chapter 3 for a full discussion.

[3] Macroeconomic policies are policies which concern the economy generally and are directed at ensuring the stability of the economy for economic growth which is necessary for employment, wealth creation and better living standards. Policies like exchange rates, interest rates, inflation rates, debt restructuring economic stability and growth etc., are part of macroeconomic policies. See, https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/BriefingBook44p/MacroeconomicPolicy

[4] Macroeconomic policy for prudential or countercyclical purposes.

[5] A sovereign debt crisis occurs when a State is no longer capable of paying its debt leading to lenders requiring higher yields (interest) to refinance the debt, until the State defaults. Instances of the sovereign debt crisis can be found in the Eurozone debt crisis, the Argentinian debt crisis etc.

[6] A currency crisis is a steep decline in the value of a State's currency that affects the economy by affecting the exchange rate of the currency, which can lead to capital flight. Examples of currency crises are the Latin American crisis of 1994, and the Asian Financial Crisis of 1997.

[7] *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*, ICSID Case No. ARB/99/2 Award 25 June 2001; *LG&E Capital Corp., and LG&E International, Inc .v. Argentine Republic* (ICSID Case No. ARB/02/1) Award 25 July 2007; *Waste Management, Inc. v. United Mexican States* ("Number 2") (ICSID Case No. ARB (AF)/00/3) Award 30 April 2004.

[8] This is in respect to situations where the definition of FET is linked to the minimum standard of treatment (MST) under customary international law. See *Glamis Gold v. United States* UNCITRAL Award (2009) para 627.

stricter standard based on the egregiousness or outrageousness of the macroeconomic measure is required.

Financial/economic crises are rare and extreme events with uncertain correlation between the cause and the effect[9] but with massive economic and social cost implications[10] for the State in question or the global economy. Hence it is fundamental that the State acts to try and avert such crisis or mitigate its impact. Research by Minsky and Bluwstein et al., respectively, has identified credit growth[11] inverted yield curve[12] as some of the likely warning signals of an impending financial crisis.[13] Once these indicators, as well as relevant ones are identified, it is only reasonable that timeous macroeconomic and counter-cyclical measures for prudential purposes are undertaken to reduce the likelihood of the crisis or its severity.[14] The sole objective of the macroeconomic measures is purely to avert the crisis or ameliorate its impact.

However, host State macroeconomic measures will likely affect portfolio investments favourably or adversely. Host State macroeconomic measures affect portfolio investments because of their sensitivity to it.[15] A recent indication of this can be seen when China expressed concerns over the influence of games on minors, referring to them as 'opium of the mind' indicating an intention to clampdown on tech companies in China, and this wiped out about 11% of Tencent's value.[16] Furthermore, the refusal of China to bail out Evergrande from its

[9] Lucia Alessi & Carsten Detken, 'Identifying Excessive Credit Growth and Leverage' [2018] 35 Journal of Financial Stability 215-225.

[10] Glenn Hoggarth et al., 'Costs of Banking System Instability: Some Empirical Evidence (2002) 26(5) Journal of Banking & Finance 825-855; Patrice Olivaud & David Turner, 'The Effect of the Global Financial Crisis on OECD Potential Output' (2015) 2014(1) OECD Journal: Economic Studies 41-60.

[11] Increased credit growth is a pointer to a period of excessive risk-taking which may lead to financial stability. Minsky 1977.

[12] Yield curve is a curve on a graph depicting the yield (interest rates) of bonds or other fixed interest assets of the same quality plotted against their maturity dates. An upward slope of the curve indicates economic expansion, while an inverted curve (downward slope) indicates economic recession. See Investopedia on Yield Curve.

[13] Kristina Bluwstein et al., 'Credit growth, the yield curve and financial crisis prediction: evidence from a machine learning approach' (2020) Bank of England Staff Working Paper No. 848, 2; Claudio Borio & Phillip Lowe, 'Asset prices, financial and monetary stability: exploring the nexus' (2002) BIS Working Papers 114, Bank for International Settlements; Julia Giese et al., 'The credit-to-GDP gap and complementarity indicators for macroprudential policy: Evidence from the UK' (2014) 19(1) International Journal of Finance & Economics 25–47.

[14] Julia Giese et al., 'How could macroprudential policy affect financial system resilience and credit? lessons from the literature' (2013) Bank of England Financial Stability Papers, No. 21; Ozge Akinci and Jane Olmstead-Rumsey, 'How effective are macroprudential policies? an empirical investigation [2018] 33 Journal of Financial Intermediation 33.

[15] William Sharpe, 'Risk, Market Sensitivity and Diversification' (1972) 28(1) Financial Analyst Journal 74.

[16] China's Regulatory campaign against tech sector Tech sell-off pushes Hong Kong stocks into bear market | Financial Times (ft.comhttps://www.ft.com/content/c5572f5a-d086-4ca2-995a-7b559f4e1d32); https://www.wsj.com/articles/tencent-selloff-shows-deep-scar-tissue-in-chinese-markets-11628063785 Accessed 17/07/2021.

debt crisis, saw the price of its (Evergrande's) bond held by foreign investors being discounted because of its potential default.[17] Even more recently, the mini-budget announcement by the Liz Truss conservative government saw the UK economy go into tailspin with bond prices loosing value.[18]

Changes to macroeconomic conditions by the host state such as foreign exchange policy, or sovereign debt restructuring during times of crisis, done to address such crisis, could be considered by an aggrieved investor as a breach of the FET treaty provisions where such portfolio investments incur losses owing to the measures.[19] The effect will then be that the host State's macroeconomic policies will be open for review before investment arbitration tribunals. This may hamper the willingness of a host State to make such economic policies in the future to the detriment of its economic conditions and public interest.

The potential for portfolio investment protection through the FET standard to undermine host State response in times of economic crisis is a valid reason to refuse investment protection, given the likelihood of its negative economic and social costs. Nevertheless, the nebulous[20] nature of the FET standard owing to its varied form and content,[21] and the developing attitude of treating each claim according to its context and circumstance[22] creates an air of optimism that host state macroeconomic measures genuinely deployed to avert or mitigate economic and financial crises may not be found to be in breach of the Fair and Equitable Treatment (FET) standard of protection.

[17] Evergrande bondholders left in the dark as crucial deadline passeshttps://www.ft.com/content/e7c0f31d-4dff-4992-88e6-a70402b7b4bc; Xi Jinping weighs future of Evergrande as he targets third term https://www.ft.com/content/4404ded1-82b0-475f-93cd-c54bba17d085. It is noteworthy that not long ago, China bailed out two conglomerates burdened with debt. This could be discriminatory. May give rise to claims by Evergrande's foreign creditors, but very doubtful it will succeed.

[18] George Parker et al, 'Liz Truss apologises for chaos caused to Britain by mini-Budget in London' Financial Times 17 October 2022 https://www.ft.com/content/d4f8b0c9-1c45-464b-b7d1-c1c2d37311e6. 1/11/2022.

[19] See *Abaclat & Others v. Argentine Republic* ICSID Case No. ARB/07/5 Decision on Jurisdiction and Admissibility (4 August 2011); *Ambiente Ufficio SPA & Ors v. Argentina* (ICSID Case No. ARB/08/9) Decision on Jurisdiction and Admissibility of 8 February 2013.

[20] M. Sornarajah, *The International law on Foreign Investments* (CUP, 2010) 349

[21] Rudolf Dolzer & Christoph Schreuer, *Principles of International Investment Law* (OUP 2nd edn, 2012) p. 132.

[22] *Mondev International Ltd. v. United States of America* (ICSID Case No. ARB (AF)/99/2) Award, 11 October 2002 para 118; *Waste Management, Inc. v. United Mexican States* ("Number 2") (ICSID Case No. ARB (AF)/00/3) Award 30 April 2004 para 99.

This Chapter is divided into five parts. Part A examines the source and content of FET as a protection standard. Part B relies on the *Abaclat,*[23] and *Ufficio*[24] claims, to demonstrate how foreign portfolio investors can use the FET protection standard to challenge host State macroeconomic measures. Part C analyses the types, categories, and applicability of the FET standards to claims for breaches of foreign portfolio investors' legitimate expectation, denial of justice, and lack of transparency against host State macroeconomic measures undertaken to avert or mitigate economic/financial crisis. Part D considers the effect of the FET protection standard as a stifler of host State macroeconomic policy autonomy and suggests ways emerging/frontier economies can circumvent this challenge, including the MFN problem. Part E concludes.

PART A

5.1 Examining the Protection Standard of Fair and Equitable Treatment (FET)

Traditionally, the Fair and Equitable Treatment standard of protection (FET) was viewed as part of the Customary International Law International Minimum Standard of Treatment (MST).[25] Interestingly, FET, as a standalone standard, is also considered as being customary international law because it has attained customary international law character, owing to its generalisation in similar treaties with exact, or slightly varied content.[26]

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[23] *Abaclat & Others v. Argentine Republic* ICSID Case No. ARB/07/5 Decision on Jurisdiction and Admissibility (4 August 2011).

[24] *Ambiente Ufficio SPA & Ors v. Argentina* (ICSID Case No. ARB/08/9) Decision on Jurisdiction and Admissibility of 8 February 2013

[25] Provisions consistent with the traditional view can be seen in: Article 1105(1) NAFTA (Notes on Interpretation in respect of Article 1105(1) NAFTA, now replaced by Article 14.6 USMCA; Article 5 of the US Model BIT 2012; Article 6 of the Canada Model FIPA (2014) which all includes FET as part of the customary law MST. Interestingly, in the recent Canadian Model FIPA (2021), Article 8 in establishing the MST standard is silent on its connection to FET. However, in *Pope & Talbot Inc v. Canada,* UNCITRAL Case, Final Merits Award 10 April 2001 105-118 the tribunal separated the link between FET and MST and held that FET possessed an evolutionary nature, and ought to be treated according to the circumstances of each case. See also *Mondev International Ltd. v. United States of America* (ICSID Case No. ARB (AF)/99/2) para 116.

[26] *Mondev International Ltd. v. United States of America* (ICSID Case No. ARB (AF)/99/2); Report of the International Law Commission Covering the Work of its Twelfth Session (1960) Yearbook of the International Law Commission UN Doc A/4425 para 21, p. 145; Iona Tudor, *FET in International law of Foreign Investment* (OUP, 2008) 54 & 56. It is noteworthy that there are instances where multiple treaties are signed with similar contents, yet they do not create customary international law. See, B. Kishioyian, 'The Utility of Bilateral Investment Treaties in the Formulation of Customary International Law (1994) 14 Journal of International Law and Business 341; Marcela Klein Bronfman, 'Fair and Equitable Treatment: An Evolving Standard' in A Von Bogdandy & R Wolfrum (eds) *Max Planck Year Book of United Nations Law* 10 (Brill, 2006) 656 questioned the narrative that the preponderance of FET clauses in IIAs has conferred FET with CIL status, by asking what constituted *opinion juris,* and given the lack of uniformity in describing FET in IIAs, could it be said State Practice exists?

Historically, MST was developed owing to the dissatisfaction with the inadequacy of National Treatment for the treatment of aliens. MST, as a customary international law norm, provides for minimum principles host States ought to adhere to when dealing with foreigners, and their properties.[27] While National Treatment requires equality of treatment between foreigners and nationals, MST requires treatment expected under international law for foreigners regardless of treatment extended to nationals or other foreigners, the breach of which results in state responsibility enforceable by diplomatic protection.[28] In this regard, MST expects a preferential standard of treatment for foreigners.[29]

The treatment of foreigners liable to be an infraction of the MST include physical injury to foreigners by the State or agents of the State, or procedural shortcomings of the state in handling alleged injury to foreigners (denial of justice).[30] The standard of treatment under MST, was laid in the *Neers case* where it was held that for treatment of an alien to amount to an internationally wrongful act, the treatment had to be outrageous, be in bad faith or to fall short of international standards such that a 'every reasonable and impartial man will recognize its insufficiency'.[31] Putting it clearly, the Mexican-US Claims Commission held that:

> The propriety of governmental acts should be put to the test of international standards…the treatment of an alien, in order to constitute an international delinquency should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognise its insufficiency.[32]

[27] Iona Tudor, *FET in International law of Foreign Investment* (OUP, 2008) 61.
[28] C. Rousseau, *Droit International Public* (Paris, 1970) 46 cited in Iona Tudor, *FET in International law of Foreign Investment* at 61; American Law Institute's Restatement (Second) of Foreign Relations Law of the United States 1965 para 165.2.
[29] *USA (George Hopkins) v. United Mexican States,* The Mexican-United States General Claims Commission Award (1926) IV RIAA 41, 50
[30] G, Sacerdoti, Bilateral Treaties and Multilateral Instruments on Investment Protection (1997) 269, 347.
[31] *Neer v Mexico*, Opinion, US-Mexico General claims Commission, 15 October 1926 AJIL 556. See also, *USA (Harry Roberts) v. United Mexican States*, The Mexican-United States General Claims Commission Award 1926 IV RIAA 77 (1927); *USA (George Hopkins) v. United Mexican States* The Mexican-United States General Claims Commission Award (1926) IV RIAA 41, 50
[32] *Neer v Mexico*, Opinion, US-Mexico General claims Commission, 15 October 1926 AJIL 556; This decision influenced the decision in *Glamis Gold v. United States* UNCITRAL Award (2009) 598-627. However, in *Mondev International Ltd. v. United States of America* (ICSID Case No. ARB (AF)/99/2) Award, 11 October 2002 para 117, the tribunal criticised the influence of the *Neers case*, on investment arbitration as surprising.

It is critical to note that though MST is recognised as customary international law, it is not accepted by all States. This is observable in the inability of States to reach an agreement on the International Law Commissions' Draft Law of State Responsibility for Injury to Aliens.[33] Furthermore, UNCTAD notes that in the absence of an express link between the MST and FET in international investment agreements, it can be presumed that the State parties did not intend to consider the MST as FET within the context of their BITs.[34] Finally, MST and FET unless connected by the BIT/Investment Chapter like in NAFTA,[35] or US Model BITs; are separate standards of *lex specialis* in International Law, though closely related to each other.

Fundamentally, MST seemingly applies to incidences of egregious injury to foreigners by State or State agents or procedural issues concerning injury to foreigners, while FET more broadly protects foreign investors and investments with a less stringent threshold, based on the circumstances of each case.[36] Consequently, FET, when viewed from a spectrum is identical and part of the MST[37] on one end as long as they are linked in the BIT/Investment Chapter, and on the other, it is divorced from the MST and exists independently on its own.[38] This Chapter examines FET from all points to determine if host State macroeconomic policies may breach portfolio investors' FET rights.

But before we get into that, it is relevant to examine the concept and content of FET. Modern conceptions of Fair and Equitable Treatment (FET) protection standard can trace its origin to the United States of America's Friendship Commerce and Navigation Treaties.[39] However, it

[33] S. N. Guha Roy, Is the Law of Responsibility of States for Injuries to Aliens a Part of Universal International Law? (1961) AJIL 813; Charter of Economic Rights and Duties 12 December 1974, Article 2(2) (a) which provides that no State shall be compelled to grant preferential treatment to foreign investments. This provision was criticised in Charles Brower & John B Tepe, 'The Charter of Economic Rights and Duties of States: A Reflection or Rejection of International Law?' (1975) 9(2) The International Lawyer 305-306

[34] UNCTAD FET Series on Issues in International Investment Agreement (1999) 40

[35] North American Free Trade Agreement Article 1105 which was repealed and replaced by the United States, Mexico and Canada Agreement Article 14.6.

[36] Iona Tudor, *FET in International law of Foreign Investment* (n 27) 66-67.

[37] Martins Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment* (OUP, 2013) 93: See: Article 1105(1) NAFTA (Notes on Interpretation in respect of Article 1105(1) NAFTA, now replaced by Article 14.6 USMCA; Article 5 of the US Model BIT 2012; Article 6 of the Canada Model FIPA (2014) which all includes FET as part of the customary law MST.

[38] *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1 Award 30 August 2000; *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3 Award 22 May 2007Dolzer & Stevens, 'The US Bilateral Investment Treaty Program' (1995) 21 Stanford Journal of International Law, 23.

[39] R. R. Wilson, *United States Commercial Treaties and International Law* (1960) 120; G Schwarzenberger, 'The Abs-Shawcross Draft Convention on Investment Abroad (1960) 147, 153, 155, 158.

is believed that the term ‘fair and equitable’ existed in pre-WWII State practice.[40] According to Paparinskis, this is observable in the use of ‘fair’, ‘equitable’, ‘just’ and ‘equitable’ in customary rules for treatment of foreigners such as Article 5 of the Treaty between Great Britain and Sweden (1670).[41] Additionally, it has been used within other areas of international law and adjudication;[42] and features in relation to commercial activities in the Covenant of the League of Nations[43] as well as treaties concluded in the 1930s by the US, Canada and the UK.[44] The implication of the latter iteration of ‘fair and equitable’ is that it demonstrated that FET had gained recognition within international economic law prior to WWII, was outside the sphere of customary international law or MST; and possessed identifiable contents.[45]

A contemporary version of FET clauses relating to investment protection can be seen in Article 1 section 1 of the US-Germany FCN agreement 1954[46] which provides that:

> Each Party shall at all times accord fair and equitable treatment to the nationals and companies of the other Party and to their property, enterprise and other interests.

Subsequently, FET provisions have featured in a number of multilateral investment agreements such as the Energy Charter Treaty (ECT);[47] NAFTA;[48] USMCA[49] and a host of international investment Agreements (IIAs).[50]

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[40] Martins Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment* (n 37) 84.
[41] See also; Treaty between Great Britain and Denmark (1670); Decisions in Ambattelos case and Betsey Case in Martins Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment* (n 37) 85-87.
[42] Martins Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment* (n 37) 87 & 88)
[43] League of Nations, Covenant of the League of Nations, 28 April 1919, Article 23.
[44] Martins Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment* (n 37) 88-89
[45] Ibid 89
[46] Treaty of Friendship, Commerce and Navigation, 29 October 1954, US-FRG, 273. See also, Treaty of Friendship, Commerce and Navigation, US-Netherlands; Treaty of Amity, Economic Relations and Consular Rights, 15 August 1955, US-Iran, 284; Abs-Shawcross Draft Convention on Investment Abroad 1959, Article 1; Organisation for Economic Co-operation and Development (OECD) Draft Convention on the Protection of Foreign Property (1967) Article 1. Prior to this, a ‘just and equitable’ treatment standard could be seen in the Havana Charter for an International trade Organisation 1948, Article 11(2), and an ‘equitable treatment’ standard accorded to foreign capital could be found in the Economic Agreement of Bogota, 1948. It is noteworthy that neither of them ever came into force.
[47] The Energy Charter Treaty (ECT) Adopted: 17 December 1994, Entry into force: 16 April 1996, Article 10(1).
[48] North American Free Trade Agreement 1992
[49] United States-Mexico-Canada Agreement, 1 July 2020.
[50] Newcombe & Prandell, Law and Practice 257: R Dolzer & M Stevens, *Bilateral Investment Treaties* (Kluwer, 1995).
From the UNCTAD Investment Policy Hub International Investment Agreement Tracker, about 2,445 IIAs have FET clauses, of which 1985 are drafted as unqualified clauses and about 460 are qualified. https://investmentpolicy.unctad.org/international-investment-agreements/iia-mapping.

FET clauses are not all drafted or phrased in the same way, they exist in multiple variations even though they are quite pervasive in investment agreements.[51] Given their variation in drafting and treaty practice, it is unsurprising that there will be variations in arbitral practice.[52] However, they have to be interpreted based on the international rules of interpretation,[53] and the circumstances of each case.[54]

Fair and Equitable Treatment (FET) standard of protection imposes an obligation on host states not to undertake executive, legislative, and judicial measures that are arbitrary, unreasonable, abusive etc., against foreign investments. As a result, it is the most used basis for investment Arbitration claims by investors. [55] FET cuts across all State conducts and can include host State macroeconomic measures - which can potentially give rise to FET claims. It is a non-contingent standard of treatment, as its applicability is not contingent upon the rules or manner the host State treats domestic investments, or other States' foreign investments such as National Treatment and MFN standards which are contingent standards based on external treatments.[56] Host State's actions are not measured based on how domestic or foreign investments are treated, rather FET provides the basis upon which tribunals may assess host State judicial and/or administrative treatment of foreign investments.[57]

In *Waste Management v. Mexico*[58] which concerned the failure of a sub-national entity to perform certain undertakings, the tribunal describing what constitutes a violation of an FET provision held that:

> the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary,

[51] Rudolf Dolzer & Christoph Schreuer, *Principles of International Investment Law* (n 21) 132.
[52] *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 of the Argentine Republic, 25 September 2007.
[53] United Nations, Vienna Convention on the Law of Treaties, 23 May 1969, United Nations, Treaty Series, vol. 1155 Entry into force: 27 January 1980, Article 31.
[54] *Mondev International Ltd. v. United States of America* (ICSID Case No. ARB (AF)/99/2) Award, 11 October 2002 para 118; *Waste Management, Inc. v. United Mexican States* ("Number 2") (ICSID Case No. ARB (AF)/00/3) Award 30 April 2004 para 99.
[55] United Nations Conference on Trade and Development (UNCTAD), Fair Equitable Treatment: UNCTAD Series on Issues in International Investment Agreement II. A Sequel (2012) p.1; M. Sornarajah, *The International law on Foreign Investments* (n 20) 349.
[56] Marcel Klein Bronfman, 'Fair and Equitable Treatment: An Evolving Standard' (n 26) 621.
[57] C McLachlan et al, International Investment Arbitration Substantive Principles (OUP, 2008) 207 at para 7.1.7-7.1.9
[58] *Waste Management, Inc. v. United Mexican States* ("Number 2") (ICSID Case No. ARB(AF)/00/3) Award 30 April 2004.

> grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety-as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process. In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.[59]

In *Salukha v Czech Republic*,[60] the arbitral tribunal held that: 'foreign investor whose interests are protected under the Treaty is entitled to expect that the [host State] will not act in a way that is manifestly inconsistent, non-transparent, unreasonable (i.e. unrelated to some rational policy), or discriminatory (i.e. based on unjustified distinctions).'[61] Thus, where an investor enjoys BIT protection, any act, conduct or omissions of the host State that is harmful to the investment and deemed to be arbitrary, unjust, or unreasonable could be the basis for a claim of breach of FET standards of treatment.[62]

The implication is that BIT/Investment Chapter protected foreign portfolio investors (which this thesis is strongly against), can challenge host State macroeconomic measures which are harmful to their portfolio investments for breach of FET treatment, where such measures are alleged to be arbitrary, unjust, unreasonable, inconsistent etc., regardless of whether undertaken for prudential purposes. As emphasised in the previous chapters,[63] portfolio investments are highly sensitive to macroeconomic policies.[64] As a result, host State macroeconomic measures are very likely to have a negative consequence on portfolio investments thereby rendering them liable to be challenged for allegedly violating FET standards. Instances of host state macroeconomic measures challenged based on FET by portfolio investors will be discussed in the next part.

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[59] *Waste Management, Inc. v. United Mexican States* ("Number 2") para 98.
[60] *Saluka Investments B.V. v. The Czech Republic*, Partial Award 17 March 2006 under the UNCITRAL Arbitration Rules 1976.
[61] *Saluka Investments B.V. v. The Czech Republic*, Partial Award 17 March 2006 para 309.
[62] *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States* (ICSID Case No. ARB (AF)/00/2 Award 29 May 2003 para 154; *Saluka Investments B.V. v. The Czech Republic*, Partial Award 17 March para 309
[63] See Chapter Two and Three of this Thesis.
[64] William Sharpe, 'Risk, Market Sensitivity and Diversification' (1972) 28(1) Financial Analyst Journal 74. Regional and national economic factors, such as tax and interest rate policies, can significantly contribute to the directional change of the market and greatly influence volatility. For example, in many countries, when a central bank sets the short-term interest rates for overnight borrowing by banks, their stock markets react violently.

Part B

5.2 Host State Macroeconomic Policies Affecting Portfolio Investments Challenged Using FET

As earlier discussed, macroeconomic measures which affects the value/price of foreign portfolio investments may be challenged based on the FET standard. Interestingly, certain macroeconomic measures have been challenged for violating FET standards such as host State decisions refusing to grant bailout/financial assistance to financial institutions[65] or varying foreign exchange policy,[66] or restructuring sovereign debts as could be seen in *Abaclat v. Argentine Republic,*[67] and *Ufficio v Argentine Republic.*[68]

In *Abaclat v. Argentine Republic,* the claimant's contended that the respondent's actions constituted FET treaty violation. They argued that the respondent in defaulting in sovereign bond payment, repudiated its obligation under the bond. That by refusing to negotiate with bondholders, the respondent pursued a unilateral punitive exchange offer, which targeted amongst others, the claimants, and the passage of the law 26.017[69], repudiating all obligations to the claimants, destroyed the value of the investments. These actions amounted to the respondent violating treaty obligations under the Argentina-Italy BIT 1990.[70] Particularly, the respondent's obligation against violation of bondholders Fair and Equitable Treatment standard.[71]

Under the Argentina-Italy BIT 1990, the FET standard is provided under Article 2(2).[72] The claimants in *Abaclat* argued that Argentina fell short of its international obligations because its exercise of sovereign authority with regards to Law 26.017 breached the FET standards in the

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[65] *Saluka Investments B.V. v. The Czech Republic,* Partial Award 17 March 2006 under the UNCITRAL Arbitration Rules 1976.
[66] *CMS Gas Transmission Company v. The Republic of Argentina* (ICSID Case No. ARB/01/8) Award 12 May 2005; *LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc .v. Argentine Republic* (ICSID Case No. ARB/02/1) Award 25 July 2007; *Continental Casualty Company v. The Argentine Republic* (ICSID Case No. ARB/03/9) Award, 5 September 2008 etc.
[67] *Abaclat & Others v. Argentine Republic* ICSID Case No. ARB/07/5 Decision on Jurisdiction and Admissibility (4 August 2011).
[68] *Ambiente Ufficio SPA & Ors v. Argentine Republic* (ICSID Case No. ARB/08/9) Decision on Jurisdiction and Admissibility of 8 February 2013; See also *Poštová banka, a.s. and Istrokapital SE v. Hellenic Republic*, ICSID Case No. ARB/13/8 Award (9 April 2015).
[69] Ley 26.017 of 9 February 2005, Boletín Oficial de la República Argentina, Núm. 30.590, 11 February 2005 (hereinafter "Law No. 26.017"), Articles 1-6.
[70] *Abaclat v. Argentine Republic para 238.*
[71] *Abaclat v. Argentine Republic para 84*
[72] Agreement between the Argentine Republic and the Italian Republic on Investment Promotion and Protection (Argentina – Italy BIT) 1990, Article 2(2).

Argentina-Italy BIT. They contended that Argentina violated its FET obligations when it neglected the concept of proportionality in its response to the 'temporary financial crisis' and continued to impose an excessive burden on claimants even after the ebbing of the crisis.[73] They further contended that the adoption of discriminatory measures which affected the enjoyment of claimants ' investments, by discriminating between the claimants and domestic investors in Argentina, by shielding the domestic investments from the negative impacts of its measures following Argentina's sovereign debt restructuring, amounted to a breach of FET obligations under Article 2(2) of the Argentina-Italy BIT.[74]

In *Ufficio v Argentina*, the claimants claimed in paragraph 90 of their Request[75] that by failing to ensure FET and Full Protection and Security to their investments, the respondent breached its international obligation under the Argentina-Italy BIT, and international law.[76] The Claimants alleged that by eliminating the Italian bondholder rights to their capital and interests through the passage of Law 26.017, and the refusal to restore those rights even after the Argentine economy recovered, Argentina breached their FET obligation, specifically the claimant's **legitimate expectations**, with regards to the stability of the investment environment.

It is relevant to note that both claims stemmed from the Argentina-Italy BIT 1990. However, the Argentina-Italy BIT 1990 is in Spanish and Italian which massively constrains an opportunity to consider it. Nonetheless, relying on UNCTAD's Investment Policy Hub International Investment Navigator database which has mapped most of the IIAs/BIT, it is observable that under the provision on Fair and Equitable Treatment standard (FET) in the BIT, FET was not qualified, i.e., the FET was also not defined in relation to international law, and there was no list of FET elements or categories.[77] Importantly, as mentioned earlier, there was no decision on the merit regarding the respondent's alleged violation of FET obligations in both cases. The claim was eventually settled before an award could be entered on the merits in *Abaclat*. A settlement Award was entered on 15 December 2016.[78]

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[73] *Abaclat v. Argentine Republic* para 312(i) (See footnote 120)
[74] *Abaclat v. Argentine Republic* para 312(ii) & (iii) (see footnote 121).
[75] *Ufficio v Argentine Republic Decision on Jurisdiction para 63*
[76] *Ufficio v Argentine Republic Decision on Jurisdiction para 63 & 529.* It is noteworthy that the provision of the Argentina-Italy BIT on FET is an unqualified one, with no reference to international law. See
[77] The next Part will deal with types and contents of FET clauses.
[78] *Abaclat v. Argentine Republic* ICSID Case No. ARB/07/5 Settlement Decision of 15 December 2016.

From the facts of the claims put forth in both claims, the FET clause in issue is Article 2(2) of the Argentina-Italy BIT 1990, which is an unqualified FET clause. Nevertheless, it was claimed that Argentina's actions were arbitrary, discriminatory, and unjust, as well as in breach of the claimants' legitimate expectation preserved under the FET clause. Consequently, the following sections will consider these elements of FET with a view to demonstrating that foreign portfolio investor FET challenge of macroeconomic measures ordinarily might not to succeed on the merit.

Part C

5.3 Types and Contents of FET Protection Clauses, and their Applicability to Foreign Portfolio Investment Protection

FET clauses may be drafted as qualified or unqualified clauses. A qualified FET clause either clearly limits the legal scope of its content, or expressly lists the category of situations which can give rise to an FET claim. An unqualified FET clause is broad, indefinite and sometimes contains vague provisions on FET.

Unqualified FET clauses essentially adopts words to the effect that the host State has an obligation to accord investments fair and equitable treatment. Examples of unqualified FET clauses include the Argentina-Italy BIT 1990,[79] or the China-Switzerland BIT which provides thus:

> Investments and returns of investors of either Contracting Party shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Contracting Party.[80]

According to UNCTAD, it is unclear if unqualified FET clauses are to encompass the minimum standard of treatment (MST) under Customary International Law (CIL) norm, or they exists separately, independent of that norm, to be determined on a case by case basis.[81] Interestingly, unqualified FET clauses were considered to encompass the MST under CIL norm, in the OECD

[79] Agreement between the Argentine Republic and the Italian Republic on Investment Promotion and Protection (Argentina – Italy BIT) 1990.
[80] Agreement between the Swiss Federal Council and the Government of the People's Republic of China on the Promotion and Reciprocal Protection of Investments, Article 4(1).
[81] United Nations Conference on Trade and Development (UNCTAD), Fair Equitable Treatment: UNCTAD Series on Issues in International Investment Agreement (1999) 40.

Draft Convention on Protection of Foreign Property[82] which was influential on subsequent BIT/Investment Chapter drafting practices adopted by States. However, its influence did not extend to having a binding effect on the interpretation of unqualified FETs[83] since some tribunals have variously considered unqualified FET clauses as being autonomous of the MST norm, and as self-contained provisions.[84] Tribunals consider unqualified FET clauses to go beyond the MST, to provide greater protection than the MST.[85] Focus is on the meaning of 'fair' and 'equitable' which without definition, has the potential to open unqualified FET clauses to wide interpretations and expand the incidents of host state conducts liable to arbitral tribunal review.[86] As a result, the definition of what constitutes FET can include a wide array of categories or elements of FET (such as MST, legitimate expectations etc.,) and can go beyond what the States initially intended.[87]

Conversely, FET can be drafted as a qualified clause by expressly limiting its scope to international law;[88] or minimum standards of treatment of aliens under customary international law (MST);[89] or by explicitly listing elements or categories that constitutes FET such as legitimate expectation, denial of justice[90] etc. According to Stephen Schill, it is now quite

[82] Organisation for Economic Co-operation and Development (OECD), 'Draft Convention on the Protection of Foreign Property and Resolution of the Council of the OECD on the Draft Convention' (1967)13-15; OECD, 'Intergovernmental Agreements Relating to Investment in Developing Countries' (1984); OECD, 'Fair and Equitable Treatment Standard in International Investment Law' (2004) OECD Working Papers on International Investment 2004/03 10. The OECD Draft Convention on the Protection of Foreign Property linked FET to the MST under CIL for aliens.

[83] UNCTAD FET Series on Issues in International Investment Agreement II (2012) p. 21

[84] *PSEG Global, Inc., The North American Coal Corporation, and Konya Ingin Electrik Üretim ve Ticaret Limited Sirketi v. Republic of Turkey* ICSID Case No. ARB/02/5 Award 19 January 2007 para 238; Pope & Talbot

[85] Iona Tudor, *FET in International law of Foreign Investment* (n 27) 66-67.

[86] UNCTAD FET Series on Issues in International Investment Agreement II (2012) p. 21 p. 22.

[87] Eric De Brabandere, 'States' Reassertion of Control Over International Investment Law - (Re)Defining 'Fair and Equitable Treatment' and 'Indirect Expropriation' in Andreas Kulick (ed.), *States Reassertion of Control over International Investment Agreements and International Investment Treaty Dispute Settlement* (Cambridge: Cambridge University Press, 2016) 292.

[88] Here, the FET clause may require that FET treatment be extended in accordance with international law which may include treatment that constitutes FET under international law. See Croatia –Oman BIT (1990) Article 3(2). It could also require that FET treatment should not be less favourable than that required under international law. See Bahrain-US BIT 1999 Article 2(3)(a).

[89] Regarding FET standards qualified by the minimum standard of treatment (MST) under customary international law (CIL), the investor will be tasked with the burden of proving that the host State's conduct was particularly egregious. Here, the host State's macroeconomic policy has to be egregious, shocking etc.. The liability threshold here is quite high.

[90] Prohibition of denial of justice is usually captured in two forms. It could provide that the FET clause includes the requirement of the host State not to deny justice in legal or administrative proceedings. The implication of the word 'includes' is to the effect that FET means more than just the requirement of the host state not to deny justice in legal or administrative proceedings but may include the requirement to accord investment minimum standard of treatment under customary international law which is an extension of the scope. See, Rwanda-US BIT 2008 Article 5(2)(a); ASEAN-Australia/New Zealand FTA 2009, Article 9. On the other hand, denial of justice clauses

common in BITs/Investment Chapters for these substantive contents of FET to be added to make the concept of FET more precise and predictable for interpretative purposes.[91] This is because the more precise the provision, the clearer it becomes.[92] This part will consider the manifestations and contents of the FET standard (such as legitimate expectations;[93] and arbitrary and discriminatory[94] measures) which may be construed from an FET clause; and their applicability to foreign portfolio investors' challenge to host macroeconomic measures.

5.3.1 FET Qualified as Minimum Standard of Treatment under Customary International Law

As discussed earlier, FET qualified as MST under CIL occurs frequently in US and Canadian BITs/Investment Chapters,[95] and has resulted in several NAFTA claims. FET qualified as MST can be seen in Article 1105 of NAFTA which provides that:

> Article 1105 Minimum Standard of Treatment:
>
> 1. Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

In a bid to seemingly bring about clarity to the meaning and scope of FET under Article 1105 of NAFTA, the NAFTA Trade Commission (FTC) established under NAFTA issued interpretative notes on Article 1105 NAFTA in July, 2001[96] where it stated that FET standard does not require treatment in addition to or beyond that which is required by MST.[97] Thus, FET is to be determined based on the MST standard of treatment to be accorded to aliens. The effect of this is that tribunals confronted with claims alleging breach of Article 1105 NAFTA can only interpret it in accordance with the MST standard of treatment of aliens under customary

could be conceived of as narrowly, where it confines the host state's obligation to not deny justice in legal or administrative proceedings. See, ASEAN Comprehensive Investment Agreement, Article 11.

[91] Stephen Schill, 'Fair and Equitable Treatment, the Rule of Law and Comparative Public Law' in Stephen Schill (ed), in *International Investment Law and Comparative Public Law* (2010) 159-170.

[92] UNCTAD FET Series on Issues in International Investment Agreement II (2012) p. 30.

[93] *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States* (ICSID Case No. ARB (AF)/00/2 Award 29 May 2003.

[94] *LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc .v. Argentine Republic* (ICSID Case No. ARB/02/1) Award 25 July 2007.

[95] NAFTA, Article 1105(1) now replaced by USMCA Article 14.6; US Model BIT 2012 Article 5; Canada Model FIPA (2014) Article 6.

[96] NAFTA (Notes on Interpretation in respect of Article 1105(1)

[97] This view is consistent with the original OECD view as captured in the OECD, 'Council Resolution on the Draft Convention for the Protection of Foreign Property' (1967) 7 ILM 117. See also, S. Vasciannie, 'The Fair and Equitable Standard in International Investment Law and Practice' [1999] 70 BYIL 104.

international law which requires the host State conduct to be egregious for there to be a breach.[98] This interpretation has been included in subsequent US BITs, such as the US Model BIT[99] and the Investment Chapter in the USMCA[100]

In relation to foreign portfolio investments, for a portfolio investor to succeed in a claim under US or Canadian BITs, they must show that the host State macroeconomic policy to avert or mitigate a crisis, which affected portfolio investments was egregious, outrageous, and in bad faith. This is a very high threshold to satisfy, which will be quite difficult especially given the potential economic and social consequences such crisis can bring about if nothing is done. Under such circumstances it will be quite difficult for an investor or investors to demonstrate the egregiousness of the host State conduct in altering its macroeconomic policy in the interest of public welfare.

Interestingly, the adoption of this interpretation of FET has been criticised on the basis that it confines tribunals discretion to determine principles that are necessary to achieve the objectives of the treaties such as 'fair' and 'equitable', in order to develop the law on FET.[101] Furthermore, the tribunal in *Pope & Talbot v. Canada*[102] which was decided prior to the FTC notes, but before award on damages was issued, questioned how parties could be considered to have intended to be bound by standards less protective than what is granted under the BIT.[103] The tribunal saw the FTC notes as an amendment rather than an interpretation. It held that the FET standard had gone beyond the principles encapsulated in the *Neers case*, thus it ought to be viewed as a self-contained standard which requires each word to be interpreted independently and autonomously based on its plain meaning.[104]

However, the inclusion of the FTC interpretation note into subsequent US BITs, has made the minimum standard of treatment a requirement under those BITs, thus an interpretation of FET will be based on the MST under customary international law (CIL) principles. It therefore is

[98] Marcel Klein Bronfman, Fair and Equitable Treatment: An Evolving Standard 649; See *Neer v Mexico,* Opinion, US-Mexico General claims Commission, 15 October 1926 AJIL 556
[99] US Model BIT 2012 Article 5.
[100] USMCA Article 14.6
[101] Charles. H Brower, 'Fair and Equitable Treatment under NAFTA's Investment Chapter' (2002) 9 ASIL
[102] *Pope & Talbot Inc v. Canada,* UNCITRAL Case, Final Merits Award 10 April 2001 105-118.
[103] See also, Marcel Klein Bronfman, Fair and Equitable Treatment: An Evolving Standard 675.
[104] F Mann, British Treaties for the Formation and Protection of Investments (1981) 24 BYIL 244. F Mann changed his position in F.A Mann, The *Legal Aspects of Money* (OUP 5th ed, 1992) 427, 526; R Dolzer & M Stevens, *Bilateral Investment Treaties* (1995).

up to the tribunal to interpret it based on the principles encapsulated in the *Neers Case* where such interpretation note is present.

In *Glamis Gold v. United States,*[105] the tribunal held that:

> Given the absence of sufficient evidence to establish a change in the custom, the fundamentals of the Neer standard thus still apply today: to violate the customary international law minimum standard of treatment codified in Article 1105 of the NAFTA, an act must be sufficiently egregious and shocking—a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons—so as to fall below accepted international standards and constitute a breach of Article 1105(1).

It is submitted that portfolio investors will have an uphill task showing the egregiousness of the host State macroeconomic conduct given its necessity in circumstances where it aims to avert or mitigate an economic or financial crisis where FET is tied to the minimum standard of treatment.

5.3.2 Obligation to Refrain from Arbitrary, Unreasonable and Discriminatory Measures as a Constituent of FET

Prohibition of arbitrary, unreasonable, and discriminatory host State measures against foreign investors exists either as a standalone treaty standard, or an expressly provided element of an FET provision, or inferred into the FET provision.[106] In this regard, part of the basic tenets of the FET standard denotes the expectation that host State conduct will not be arbitrary, unreasonable and discriminatory against the foreign investor.[107] Thus, according to Jeswald Salacuse, a plain meaning of the concepts 'fair' and 'equitable' may imply that any arbitrary treatment of investments, including arbitrary discrimination will be a violation of FET.[108]

The issue then will be determining whether a State's action, in this case, a macroeconomic measure is arbitrary and discriminatory in view of its cogency in averting or mitigating an economic crisis. Obviously, both sides will strenuously argue for or against the alleged arbitrariness of the host State macroeconomic policy, as was seen in the *Abaclat case.* The

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[105] *Glamis Gold v. United States* UNCITRAL Award (2009) 627
[106] UNCTAD FET Series on Issues in International Investment Agreement II (2012) p. 31; S. Vaciannie, 'The Fair and Equitable Treatment Standard in International Investment law and Practice' (1999) 70 BYIL 133.
[107] Netherlands-Oman BIT, Article 2(2).
[108] Jeswald Salacuse, *The Law of Investment Treaties* (OUP, 2015) 238

refusal of the host State to negotiate during a sovereign bond default restructuring, including the adoption and implementation of unilateral legal or policy instruments, which erodes foreign portfolio investments may give rise to this kind of claim.

However, a guide to deciding what constitutes arbitrary conduct by the State was laid down in the International Court of Justice decision of *ELSI,*[109] where the ICJ held that arbitrariness 'is not so much something opposed to a rule of law, as something opposed to the rule of law…it is willing disregard of due process of law, an act which shocks, or at least surprises a sense of juridical propriety.'[110] In recognition of this, the arbitration tribunal in *Genin v Estonia,*[111] where the Bank of Estonia withdrew the banking licence of Genin, in construing 'arbitrariness' the tribunal held that 'any procedural irregularity' that may have occurred had to be shown as being done in bad faith, 'a wilful disregard of due process' or an 'extreme insufficiency of action.'[112] The tribunal found none of these to have occurred, it nonetheless took into consideration the economic challenges in Estonia at the time the licence revocation took place, which made close supervision of the banking sector imperative to prevent economic collapse, and then concluded that the withdrawal of the licence was for a legitimate purpose.

Also, in *LG & E v Argentina,* where macroeconomic measures were adopted by Argentina during severe economic crisis which adversely affected LG & E's gas investments, LG & E claimed that the macroeconomic measure were arbitrary and violated Article 11(2)(b) Argentina-US BIT (1994). The tribunal, relying upon the *ELSI case,* in determining the meaning of arbitrary since the BIT had no definition of it, explored the text of the BIT, and construed a provision of the BIT which restrains host States from undertaking measures that could affect the foreign investments without employing a 'rational decision making process'.[113] It held that owing to the balancing of the interests of the stakeholders, and the necessity to avert economic collapse of Argentina, the economic measures adopted by Argentina were not arbitrary, they resulted from reasoned judgment.

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[109] *Elettronica Sicula SpA (ELSI), United States v Italy*, Judgment, Merits, ICJ GL No 76, [1989] ICJ Rep 15, (1989)
[110] *Elettronica Sicula SpA (ELSI), United States v Italy* 73-77.
[111] *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*, ICSID Case No. ARB/99/2 Award 25 June 2001.
[112] *Genin v Estonia para 371.*
[113] *LG & E v. Argentine Republic 158*

From the foregoing, it seems arguable that in times of economic /financial crisis, tribunals may not be inclined to consider a State's macroeconomic measure adopted to avert or mitigate such emergencies as arbitrary, and a breach of an FET standard. This is quite poignant in relation to foreign portfolio investments inevitably adversely affected by a macroeconomic measure owing to its sensitivity to lose/gain based on prevailing macroeconomic variations.[114] It is only logical that tribunals should be disinclined to recognise such macroeconomic measures for prudential purposes as arbitrary and a breach of FET. This is because such measures undertaken to avert or mitigate economic crisis are obviously done in good faith given their objective; and even if done in the absence of due process, were done out of necessity and not in wilful disregard.

It is noteworthy that breach of FET may go beyond a determination of arbitrary, unreasonable, and discriminatory conduct, because, a measure may be considered as unfair and inequitable, but not in breach of the FET standard. In *LG & E v. Argentina,*[115] the tribunal in refusing to hold Argentina's economic measures as arbitrary as discussed above, found that 'the charges imposed by Argentina to Claimants' investment, though unfair and inequitable, were the result of reasoned judgment rather than simple disregard of the rule of law.'[116] The tribunal went on to justify Argentina's economic measures based on their necessity, in accordance with the non-precluded measure clause contained in the IIA.[117]

5.3.3 Obligation to Safeguard Legitimate Expectation as FET

Foreign investor legitimate expectation[118] arises from the host State' legal and regulatory framework as well as specific express or implied representations or commitments of the host State.[119] Generally, where a State creates an expectation through its laws and policies to attract investment, it will be considered unfair when it takes actions that undermines the expectations

[114] William Sharpe, 'Risk, Market Sensitivity and Diversification' (1972) 28(1) Financial Analyst Journal 74
[115] *LG & E v. Argentine Republic,*
[116] *LG& E v. Argentine Republic para 162.*
[117] *LG& E v. Argentine Republic para 239-240.* See Chapter 6 for a complete discussion on non-precluded measures as a justification for a breach of treaty standards.
[118] Jeswald Salacuse, *The Law of Investment Treaties* (n 108) 231. Recognition of legitimate expectations is not unique to international investment law. It can be found within EU law as it is part of the 'general principles of law', which can be the basis for overturning national measures in breach. (See n 103). It is also present in domestic law. For instance, under English administrative law, public institutions that create expectations directed at individuals and groups cannot vary these expectations unless a hearing is granted to the individuals and groups that had the expectation. See, P Craig, *Administrative Law* (5th edn, 2005) 639-56; H Wade & C Forsyth, *Administrative law* (2000) 498.
[119] Robert Dolzer, 'New Foundations of the Law of Expropriation of Alien Property' (1981) 75 AJIL 553.

it creates. The representations and commitments create legitimate expectation on the part of the investor, that any reversal of commitments will be a breach of FET.[120] However, this should not be construed to mean that macroeconomic policies undertaken by host states such as fixed exchange rate, benchmark interest rates, coupon and yield payment guarantees etc, which attracted foreign portfolio investments for instance, but were subsequently varied by the State contrary to foreign portfolio investor's expectation thereby resulting loss, may be considered a breach of FET for undermining investor's legitimate expectations.[121]

In *Tecmed v. Mexico,*[122] the respondent initially issued a licence of unlimited duration to the claimant enabling it to undertake its investment. Subsequently, the respondent replaced the claimant's initial licence with another one of limited duration. The claimant claimed breach of FET arising from the frustration of its legitimate expectation. The tribunal upheld the claimant's claim. The tribunal held that it is the expectation of the investor that the host State will act consistently, and not revoke the permission which was the basis for the planning and establishment of its investment undertaken.[123] In *MTD v Chile*,[124] the claimant's investment was approved by a host State agency but was subsequently revoked by another State agency for violating urban and zoning laws. The claimant claimed breach of FET arising from violation of its legitimate expectation. The tribunal agreed and held that the inconsistency of the State policy was a breach of the claimants FET even though the claimant did not properly perform its due diligence. In *Occidental v. Ecuador,*[125] the tribunal stated that 'stability of the legal and business framework' is part of the requirements of FET.

However, recognition of foreign investor legitimate expectation does not automatically imply absolute stability of host State legal and policy measures or constriction of sovereign regulatory powers.[126] Sornarajah expressed disapproval at the extent of tribunals' construction of

[120] W. M. Reisman & M. H. Arsanjani, 'The Question of Unilateral Governmental Statements as Applicable Law in Investment Disputes' (2004) 19 ICSID Review-FILJ 328; Thomas Walde, 'Energy Charter Treaty-Based Investment Arbitration' (2004) 5 Journal of World Investment 387.
[121] Jeswald Salacuse, *The Law of Investment Treaties* (n 108) 231.
[122] *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States* (ICSID Case No. ARB (AF)/00/2 Award 29 May 2003 para 154.
[123] *Tecmed v Mexico* para 154 & 172.
[124] *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7 Award 25 May 2004.
[125] *Occidental Exploration and Production Company v. The Republic of Ecuador*, LCIA Case No. UN3467 Final Award 1 July 2004 para 183; See also *CMS v. Argentine Republic*
[126] Diego Zannoni, 'The Legitimate Expectation of Regulatory Stability under the Energy Charter Treaty' [2020] 33 International Law and Practice 455.

legitimate expectation, and opined that such interpretation could not have been agreed by the State parties to the treaties.[127] Similarly, Salacuse contends that investor's legitimate expectation does not presuppose the freezing of legal and regulatory environment to the advantage of the investor, because the State cannot be held responsible for every change to conditions that induced investors to invest, (such as the markets) but now adversely affects such investment.[128] In *El Paso v. Argentine Republic*[129] it was held that a measure will violate legitimate expectation where it exceeds the normal regulatory powers and fundamentally alters the investment framework beyond a margin of appreciation.[130] In *Thunderbird Gaming Corp v Mexico,*[131] the claimant sought an official opinion from the respondent's agency on the legality of its intended gaming machines and activities. The respondent replied stating that provided the claimant's activities were in accordance with its laws, the investments will be valid. After a change of government, the new government started closing gaming and gambling facilities, including the claimant's for violating the law. Gambling was prohibited in Mexico. The claimant then brought this claim for breach of FET arising from a frustration of its legitimate expectation created by the respondent's initial response. The tribunal denied the claimant's claim. The tribunal held that the respondent's statement could not have created legitimate expectation because it objectively conveyed the message that claimant's activities enjoy protection provided, they are in accordance with the law. The tribunal further held that the claimant undertook the investment with the knowledge that gambling was illegal in Mexico.

Alleged violation of legitimate expectations is subject to temporal limitation as laws and policies that predates the decision to invest are excluded from evaluation[132] especially if they are general legislations without specific, express stabilisation commitments in favour of investors.[133] However, where there are guarantees and assurances given within host State

[127] M. Sornarajah, *The International law on Foreign Investments* (n 20) 355.
[128] Jeswald Salacuse, *The Law of Investment Treaties* (n 108) 232-233.
[129] *El Paso Energy International Company v. The Argentine Republic* ICSID Case No. ARB/03/15 Award 31 October 2011.
[130] *El Paso Energy International Company v. The Argentine Republic* ICSID Case No. ARB/03/15 Award 31 October 2011 para 402.
[131]*International Thunderbird Gaming Corporation v. The United Mexican States*, UNCITRAL Award 26 January 2006; See also *Ronald Lauder v. The Czech Republic* UNCITRAL Final Award 3 September 2003. Compare with *CME v The Czech Republic*, 14 March 2003 which was based on similar circumstances concerning an alleged reversal of prior express permission which adversely affected the claimant's investment. The tribunal held the reversal to be a violation of the claimant's legitimate expectation.
[132] *Glamis Gold v. United States Award* (2009) 598-627 para 93; *Mondev International Ltd. v. United States of America* (ICSID Case No. ARB (AF)/99/2) Award, 11 October 2002 para 156.
[133] *Total S.A. v. The Argentine Republic* ICSID Case No. ARB/04/01 Decision on Liability 27 December 2010 para 164.

policies which directly influenced investment decisions, any measure varying the initial legal or policy framework may be deemed a violation of legitimate expectation.[134] In *EDF v. Romania*, the tribunal held that:

> Except where specific promises or representations are made by the State to the investor, the latter may not rely on a bilateral investment treaty as a kind of insurance policy against the risk of any danger in the host State's legal and economic framework. Such expectation would be neither legitimate nor reasonable.[135]

Even where there are assurances given within host State policies which influenced investment decisions, tribunals have held a variation of those policies not to be in violation of legitimate expectations in times of necessity.[136] Consequently, the host State's economic conditions can be taken into consideration in determining whether a breach of legitimate expectation had occurred. Thus, if the economic environment of the host State is such that warrants policy flexibility to meet the economic necessities of that time, measures by host States may be adjudged as legitimate and may not be considered as a breach of legitimate expectation. Flowing from this, macroeconomic changes necessary to address economic issues which seemingly violate legitimate expectation, may be justified.

An important question that arises is with respect to investment contracts between the host State and the investor. This is critical regarding sovereign bonds which are debt instruments creating rights and duties between the host State and the bondholders. Does a non-performance of its duties by the host State, such as defaulting in sovereign bond payments violates bondholders' legitimate expectations and breach FET?[137] According to Schreuer, this will depend on whether the investment contract (sovereign bond instrument) is elevated to treaty status based on the effect of an umbrella clause[138] where one exists in the BIT/Investment Chapter.[139] Salacuse

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[134] *CMS Gas Transmission Company v. The Republic of Argentina* (ICSID Case No. ARB/01/8) Award 12 May 2005 para 274-6.
[135] *EDF (Services) Limited v. Romania* ICSID Case No. ARB/05/13 Award 8 October 2009
[136] *Continental Casualty Company v. The Argentine Republic para 261.*
[137] In Mondev v US para 134; and SGS v. Philippines (decision on jurisdiction) it was held that a non-performance of an investment contract can be a violation of FET obligation. See also *CMS v Argentine Republic* and *Siemens v Argentine Republic* where legitimate expectation was used to protect the investors from non-performance of contractual/quasi-contractual obligations.
[138] An 'Umbrella Clause is a provision in investment treaties which guarantees the observance of all obligations undertaken by the host State in relation to the investments of investors. Thus, host State obligations under investment contracts may be guaranteed and protected by the treaty, if it contains an umbrella clause.
[139] Christoph. Schreuer, 'Fair and Equitable Treatment in Arbitral Practice' (2005) 6(3) JWI 379.

considers the question as quite difficult because where the investment contract is elevated to treaty status, non-performance by the host State may violate legitimate expectation. However, it will constitute **a breach of contract which is part of 'ordinary business risk'** within the contemplation of the foreign investor when concluding the investment contract.[140] Taking these outcomes into consideration, and in an attempt to strike a balance, Salacuse suggests distinguishing between:

> simple breaches of contract arising out of a host State's financial difficulties, or legitimate differences between the parties about contractual terms; and wilful refusals by a government authority to abide by its contractual obligations, abuse of government authority to evade agreements with foreign investors, or actions in bad faith in the course of contractual performance.[141]

He concluded that it is only in the latter situation that a finding of violation of legitimate expectation should be made. Echoing this reasoning, In *Waste Management v. Mexico,*[142] the tribunal declined finding a breach of FET because there was no evidence of the municipal authority acting arbitrarily or unfairly in respect to non-payment of debt, rather it was as a result of financial difficulties. The tribunal held that:

> …the persistent non-payment of debts by the municipality is not to be equated with a violation of Article 1105 NAFTA provided that it does not amount to an outright and unjustified repudiation of the transaction, and provided that some remedy is open to the creditor to address the problem.

From the foregoing the suggestion of Salacuse, which is consistent with the prescription in the *Waste management case*, will see to it that it is only circumstances where the host State, wilfully and unjustifiably refuses to repay sovereign bond debts in bad faith, and not situations of financial challenges, that will be considered as violating foreign investors legitimate expectation. Generally, sovereign defaults and restructuring takes place when the State is unable to repay the debt. Therefore, an application of this will see to it that not every default in payment will be considered as a breach of FET.

[140] Jeswald Salacuse, *The Law of Investment Treaties* 236.
[141] Jeswald Salacuse, *The Law of Investment Treaties* 236; Christoph. Schreuer, 'Fair and Equitable Treatment in Arbitral Practice' 379.
[142] *Waste Management, Inc. v. United Mexican States* ("Number 2")

Finally, for the portfolio investor to claim violation of FET based on legitimate expectation, the investor must demonstrate that it was not reasonably foreseeable that the host State will undertake the challenged measure. To put it in context, the investor must demonstrate that it is not reasonably foreseeable in the circumstance that the host State's will restructure their sovereign debt in the event of default, or change their foreign exchange policy, or tariff/subsidy policy in the light of exceptional economic situations.[143] Interestingly, the current form of sovereign bonds/security interests was the consequence of the restructuring of commercial loans into Brady bonds during the Latin American Economic Crisis of the 1980s, which were done through financial policies carried out by the US Treasury, resulting in the Banks taking some hair-cut.[144] Consequently, it will be absurd for the claimants in the *Abaclat* & the *Ufficio* cases or any other foreign portfolio investment claim alleging FET/legitimate expectation violation owing to macroeconomic measures to succeed where there exists an economic crisis, and it becomes necessary to undertake the contested measure to address the crisis, and it is reasonably foreseeable that the contested measure will be adopted to address the crisis.

5.3.4 Obligation to Provide Transparency as a Constituent of FET

Transparency is critical to good governance. It is also fundamental to foreign investors decision-making process. Consequently, governments ought to be transparent about the rules and policies, as well as changes to the rules and policies to aid foreign investors in making, adjusting, and managing their investment plans. A potential claim may be presented by a foreign portfolio investor when the host State is elusive, or secretive, or fails to disclose its macroeconomic policies to prospective investors and as a result, the portfolio investment suffers losses,

Transparency is usually considered in conjunction with legitimate expectation, since governments must make clear their policies, and if such policies or rules induces investments, they create legitimate expectation in favour of the investors.[145] In *Metaclad v.Mexico*, the respondent alongside a subnational government issued licences to the claimant to undertake its investment within a local area, and assured the claimant that it had all the necessary licences. However, the local government where the investment was to be situated, refused to grant the

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[143] *Charanne and Construction Investments v. Spain* SCC Case No. V 062/2012 Award 21 January 2013 para 500; *Electrabel S.A. v. Republic of Hungary* ICSID Case No. ARB/07/19 Award 25 November 2015 para 7.77

[144] IMF Blog, 'The IMF 30 years After Brady' https://blogs.imf.org/2019/04/11/the-imf-30-years-after-brady/ Accessed 30/09/2020.

[145] Thomas Wulde, 'Energy Charter Treaty-Based Investment Arbitration (2004) 5 JWIT 387.

claimant a construction permit, which disrupted the claimant's investment. The tribunal held that the respondent was in breach of FET for its lack of transparency in not disclosing the requirement for the local permit; and violation of legitimate expectation for assuring the claimant that there were no other licence requirements.[146] However, at the request of Mexico, the Supreme Court of British Columbia in Canada, reviewed the Metaclad decision, and concluded that the transparency requirement was not inherent in Article 1105 of NAFTA, but was imported from another Chapter of NAFTA. As a result of this, the tribunal acted outside its jurisdiction when it included a transparency requirement under Article 1105.[147]

This FET requirement will be difficult to apply. States are usually open about their rules and policies, and they tend to publicise changes to their macroeconomic policies. Furthermore, owing to global financial obligations to the IMF under its supervisory role, and other international multilateral finance and development institutions such as the WTO and World Bank, there exists publicly available data on economic and financial policies of host States that are parties to these frameworks. Therefore, the issue of lack of transparency cannot succeed where macroeconomic information is easily accessible.

5.3.5 Prohibition of Denial of Justice as a Constituent of FET

Denial of Justice is another sub-element which may be implied, or expressly provided in State's obligation to extend fair and equitable treatment to foreign investors,[148] particularly foreign portfolio investors in the event they are extended protection. It may be relevant to foreign portfolio investors of covered portfolio investments to challenge host State macroeconomic measures for prudential reasons, where such measures affect the value of the portfolio investment and are deemed not to be in accordance with due process. This can arise in situations where the host State did not take account of portfolio investors interests in the formulation and implementation of measures like sovereign bond restructuring, capital controls, fixing of short-term interest rates etc.

Originally, denial of justice emanated from the customary international law minimum standard of treatment (MST).[149] Denial of justice has broadly been used to cover injuries suffered by

[146] *Metaclad v Mexico* para 99. Award was eventually set aside by the Supreme Court of British Columbia, Canada.
[147] See M. Sornarajah, *The International law on Foreign Investments* (n 20) 350.
[148] US Model BITs include denial of justice as a sub-element of the FET/MST standard.
[149] G, Sacerdoti, Bilateral Treaties and Multilateral Instruments on Investment Protection (1997) 269, 347.

aliens occasioned by the host State,[150] however it is currently narrowly construed as injury or harm in relations to foreigners arising from denial of access to courts, absence of procedural fairness, and due process in judicial proceedings.[151]

Denial of justice claims amounting to a breach of FET could be in the form of a disregard by the State or its agents, or inadequacy of procedural fairness. Deficiencies in the administration of justice system in a State may give rise to a breach of FET claim grounded in denial of justice.[152] Thus, for an FET claim to succeed on the grounds of denial of justice, it must be shown that there was a failure by the host State to extend due process of the law to foreigners, or extant deficiencies in the administration of justice system such as absence of procedural fairness, resulting in injury/harm or loss to the portfolio investments.

Consequently, failure to extend due process of the law to investors resulting in losses may be found to be denial of justice and a breach of FET in circumstances of failure to issue and give proper notices to the portfolio investor, or failure to invite the portfolio investor to appear and participate in an administrative or judicial process affecting investments. In *Metaclad v. Mexico,* the refusal by a local authority to grant permits to Metaclad was found to be a denial of justice and breach of FET because the permit was 'denied' at a meeting in which Metaclad was not invited to nor, given an opportunity to appear and make representations.[153]

In relation to portfolio investments, the implication of this seems to be that where a macroeconomic policy is formulated and adopted, portfolio investors ought to be notified of it, and ought to be given opportunity to be present at the time of formulation, otherwise, it will amount to a denial of justice, and breach of FET obligations where such macroeconomic policies have adverse effects on the portfolio investments (portfolio investments are likely to suffer adversely owing to their sensitivity to host state macroeconomic policies).

In the off chance that the above narrative is advanced, it is respectfully submitted that arriving at such conclusion is bereft of practicality. Firstly, owing to the nature of portfolio investments,

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[150] See, Rwanda-US BIT 2008 Article 5(2)(a); ASEAN-Australia/New Zealand FTA 2009, Article 9

[151] F V Garcia Amador et al., *Recent Codification of the Law of State Responsibility for Injuries to Aliens* (1974) 180; Restatement: Third Restatement of the Foreign Relations Law of the United States S. 711. See also, ASEAN Comprehensive Investment Agreement, Article 11.

[152] I Brownlie, *Principles of Public International Law* (2003) 506.

[153] *Metaclad v Mexico* para 91; See also *Middle East Cement v Egypt* where the seizure and auction of the claimant's ship by Egypt without notice was held not to be in accordance with the due process of the law.

there could technically be hundreds of millions of portfolio investments from numerous home States covered by BITs/IIA with the host State[154] whereby it will be practically impossible to give notice to each one of the portfolio investors, and accommodate their presence during the macroeconomic policy decision making process. Additionally, macroeconomic policy decisions are usually publicised by State's when they intend to change macroeconomic conditions like interest rates, exchange rates or public expenditure decisions etc before they are done where these rates are not subject to market forces.[155] Such publication should suffice. Secondly, it is within a host State's sovereign right to make decisions and adopt policies in the general interest of its people. Thus, any process or procedure which requires the notice and presence of external actors in the decision-making process of State to avoid arbitration claim, will manifestly be an infringement of a State's right to regulate. Finally, in the face of impending economic/financial crisis, or while neck deep in a consuming economic emergency, surely, a State will not be required to go through such a procedure to prevent a potential FET claim on grounds of denial of justice. Tribunals have been known to take economic crisis into consideration when determining breach of FET obligations.[156] In such circumstances, the necessity of the situation served to justify the State actions.[157]

In conclusion, the above analysis demonstrates that FPI FET claims may not succeed against host state's macroeconomic measures on the merit when undertaken to avert or prevent crisis. However, it is critical to consider what the effect will be if FET claims against macroeconomic policies do succeed? This will be discussed in the next part, as well as some investment policy options that may be available.

Part D

5.4 Chilling Effect of Fair and Equitable Treatment Standards of Protection and Policy Considerations for Emerging and Frontier Economies

One of the biggest criticisms of the FET standard is that it possesses the capacity to break through the traditional *domaine reserve* of host States and challenge host State conduct to the

[154] The Abaclat and Ufficio claims were initially instituted by hundreds of thousands of Italian sovereign bond security entitlement holders of Argentinian sovereign bonds.
[155] Short term interest rates are usually decided by the monetary policy committee of Monetary authorities of States usually do deal with inflation and price stability issues. The exchange rates may also be adjusted by the State to deal with situations of balance of payment crisis.
[156] *LG & E v. Argentine Republic; Genin v Estonia; Continental Casualty v Argentine republic etc.*
[157] See Chapter 7 for a complete discussion on non-precluded measures as a justification for breach of treaty standards.

point of constricting its regulatory space, unlike all other standards of protection.[158] Observable in the drafting and interpretation of FET provisions in a way that is restrictive of policy space in the public interest.[159] One of such ways is the use of legitimate expectation as a means of reviewing host State conduct and constraining regulatory autonomy.[160] The effect is usually a regulatory chill, or positive discrimination in favour of foreign portfolio investors' investment, to the detriment of host State's policy for the general benefit of its citizens, and regulatory autonomy. The chilling effect is more considerable and poses an immense challenge when the FET standard is an unqualified clause, thereby imbuing the arbitral tribunal with discretion to determine the boundaries of what constitutes FET, sometimes beyond what parties would have contemplated.

It is in this light, that it is submitted that applying the FET standards to FPI claims against host state macroeconomic measure aimed at addressing an economic or financial challenge may serve to constrict and reduce host State's macroeconomic policy flexibility which can lead to the adoption of only macroeconomic measures favourable to the foreign portfolio investors such as public debt repayment at face value, rather than restructuring public debt, or maintaining currency exchange peg, rather than floating, despite the immense social and economic costs.

To address this issue, some BITs/IIAs have included provisions on right to regulate in their preamble.[161] These provisions essentially affirm host States' right to regulate in the public interest, others limit the scope of the right to regulate to issues of health, public order, and environment.[162] Other ways of dealing with the chilling effect include:

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[158] Rudolf Dolzer, 'Fair and Equitable Treatment: A Key Standard in Investment Treaties (2005) 39(1) *the International Lawyer*; Eric De Brabandere, 'States' Reassertion of Control Over International Investment Law - (Re)Defining 'Fair and Equitable Treatment' and 'Indirect Expropriation' (n 87) 294; Bonnitcha, *Substantive Protection under Investment Treaties* (2014) 113-133*;* Gus Van Harten, 'Investment Treaty Arbitration, Procedural Fairness and Rule of Law; K. Tienhara, Regulatory Chill and the Threat of Arbitration; Gus Van Harten, Sovereign Choices and Sovereign Constraints: Judicial Constraints in Investment Arbitration.
[159] Andrew D. Mitchell & Caroline Henckels, 'Variations on a Theme: Comparing the Concept of "Necessity" in International Investment Law and WTO Law 96
[160] *Metalclad Corporation v. The United Mexican States* ICSID Case No. ARB(AF)/97/1 Award 30 August 2000
[161] So far, only about 45 BITs/IIAs include provisions on the right to regulate in their preamble. Some of which are the Australia-China FTAS (2015); Most Brazilian Investment Facilitation Agreements (CFIA) after 2015; Morocco-Nigeria BIT (2016) etc.
[162] Colombia-UAE BIT (2017).

(i) Construing FET Obligations in Accordance with Level of Development

The introduction of a clause requiring FET to be interpreted based on the level of development of the host State is a flexible means of determining violation of FET in emerging/frontier economies host States. It can be found in the Investment Agreement of the COMESA Common Investment Area.[163] Article 14(3) of the Investment Agreement provides that:

> For greater certainty, Member States understand that different Member States have different forms of administrative, legislative and judicial systems and that Member States at different levels of development may not achieve the same standards at the same time. Paragraphs 1 and 2 of this Article [prohibition of the denial of justice and affirmation of the minimum standard of treatment of aliens] do not establish a single international standard in this context.[164]

This clause is quite relevant to emerging, frontier host States that are attractive to portfolio investors seeking high risks and high reward investments, but who may be concerned that the financial markets and public administration policies of the State are not well developed. In determining if host State measures are in violation of FET standards, the level of public institutional development, and their likelihood to be up to international standards and practices expected of developed host States will be considered.[165] Thus, what can be legitimately expected of such host State's in terms of conduct will be greatly limited.

However, the issue with this approach of incorporating such provision is that it will create a perfect excuse for emerging and frontier economies host States to carry out egregious measures against foreign portfolio investors with zero accountability, to the detriment of the legitimacy of the international investment regime. Bearing this in mind, it is quite doubtful that developed, major capital exporting home states will be willing to negotiate and enter such IIAs.

Nevertheless, the idea behind this clause is consistent with the IMF caveat to emerging/frontier economies on capital liberalisation at the 1997 IMF and World Bank Group meeting in Hong Kong.[166] There, it was cautioned that for liberalisation to take place, host State must have

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[163] Investment Agreement for the COMESA Common Investment Area 2007. See also South Africa Development Commission Model BIT (2012) https://www.iisd.org/itn/en/2018/07/30/making-the-right-to-regulate-in-investment-law-and-policy-work-for-development-reflections-from-the-south-african-and-brazilian-experiences-fabio-morosini/

[164] Investment Agreement for the COMESA Common Investment Area 2007, Article 14(3).

[165] UNCTAD FET Series on Issues in International Investment Agreement II (2012) 34.

[166] World Bank Group-IMF Annual Meeting in Hong Kong 1997

strong and stable financial institutions and strong regulatory framework. Therefore, in the interest of coherence within international economic law, such clauses should be fundamental in emerging/frontier economies BITs and should be upheld by investment arbitration tribunals.

(ii) Exclusion of FET Obligation in IIA/BIT

Another approach to forestall the constricting effects of FET standards when raised by portfolio investments is the outright removal of FET clauses in BITs. Instances of such exists in some BITs concluded by Singapore,[167] Turkey,[168] Egypt,[169] Germany[170] Brazil's CFIA with Angola[171] and Mozambique.[172]

The observable implication of this is that the State parties to such BITs do not intend their conduct to be subject to investment arbitration review. The question then is whether FET claims can be instituted by a portfolio investor against the host State in the absence of an FET clause? The short answer is no. However, since the minimum standards of treatment of aliens is customary international law (CIL),[173] it may be possible for a foreign portfolio investor to produce a claim for breach of MST under CIL before the arbitration tribunal provided that the investment arbitration submission clause in the IIA/BIT extends investment arbitration access, to disputes relating to the covered investments that is, assuming portfolio investments pass the jurisdictional threshold,[174] and are considered as covered investments, and the BIT includes International Law as part of the governing law.

An example is an all-encompassing arbitration clause like the New Zealand-Thailand Closer Economic Partnership Agreement[175] which permits disputes that do not arise specifically from a breach of obligations in the agreement, but with respect to the covered investment. Article 9.16 provides thus:

[167] Australia-Singapore FTA (2003); New Zealand-Singapore FTA (2009); India-Singapore Comprehensive Economic Cooperation Agreement (2005).
[168] Moldova–Turkey BIT (1994); Oman–Turkey BIT (2007); Qatar–Turkey BIT (2007); Turkey–UAE BIT (2005) etc.
[169] Egypt-Georgia BIT (1999); Egypt–Libya BIT (1990); Egypt–Turkey BIT (1996); Egypt–USA BIT (1986) etc.
[170] Germany-Singapore BIT (1973); Germany-Malaysia BIT (1960); Germany–Niger BIT (1964)
[171] Angola–Brazil CFIA (2015)
[172] Brazil -Mozambique CFIA (2015)
[173] Martins Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment* (n 37)
[174] It is contended in this thesis that the portfolio investments have to be shown to be an investment under ICSID i.e. it must be an investment that does not undermine economic development. See, Chapter Three.
[175] New Zealand-Thailand Closer Economic Partnership Agreement, Article 9.16. The clause is wide enough to encompass claims alleging violation of MST under CIL.

> In case of **a dispute with respect to a covered investment** between a Party and an investor of the other Party, consultations shall take place between the parties concerned with a view to solving the case amicably. [Emphasis supplied].

In such circumstances, claims may be presented even though the BIT is silent on FET.[176] It is noteworthy that the MST high liability threshold for succeeding in such a claim still must be surmounted by the foreign portfolio investor.[177]

Nevertheless, where the BIT is silent on FET, and the submission clause allows access to ISDS for only disputes arising from allegations of breach of obligations contained in the BIT or Investment Chapter, claims of disputes emanating from breach of MST clauses will be outside the jurisdiction of the tribunal because no such obligation is contained or imposed under the BIT.[178] For instance, the India-Singapore Investment Chapter[179]; and the UK-Angola BIT[180] grants ISDS access to disputes arising from violation of obligations contained under the BIT.

From the foregoing, it is evident that in situations where the BITs/Investment Chapters are silent on FET, foreign portfolio investors are constrained from presenting FET claims, unless the submission to arbitration clause is broadly drafted to allow ISDS access to any dispute that affects covered investments. Even in such circumstance, foreign portfolio investors will still have to overcome the difficult requirement to prove host State's liability. Consequently, future drafts of BITs/Investment Chapters may choose to exclude FET clauses to ensure their conducts are outside the remit of investment arbitration review. The issue may be whether such agreements will be executed and brought into force.

[176] UNCTAD FET Series on Issues in International Investment Agreement II (2012) 19.
[177] The investor will be tasked with the burden of proving that the host State's conduct was particularly egregious.
[178] UNCTAD FET Series on Issues in International Investment Agreement II (2012) 19.
[179] India-Singapore Comprehensive Economic Co-operation Agreement, Article 6.21
[180] UK-Angola BIT 2000, Article 8.

However, all these efforts could be in vain, owing to the effects of MFN clauses[181], which if broadly interpreted can have the effect of introducing into the BIT/Investment Chapter, FET standards despite the IIA being silent on FET. In *Bayindir v Pakistan*[182]

> It is true that the reference to FET in the preamble together with the absence of a FET clause in the Treaty might suggest that Turkey and Pakistan intended not to include an FET obligation in the Treaty. The Tribunal is, however, not persuaded that this suggestion rules out the possibility of importing an FET obligation through the MFN clause expressly included in the Treaty. The fact that the States parties to the Treaty clearly contemplated the importance of the FET rather suggests the contrary. Indeed, even though it does not establish an operative obligation, the preamble is relevant for the interpretation of the MFN clause in its context and in the light of the Treaty's object and purpose pursuant to Article 31(1) of the VCLT.[183]

Reference to MFN clauses to import FET standards from other BITs, creates the appearance that the standard BIT is filled with landmines at every corner, waiting to ensnare the host State, and compel its every conduct to arbitral review. Nevertheless, a realisation and recognition that portfolio investments should not be investments within the contemplation of ICSID Arbitration because they can constrain economic development, thereby denying them access through the jurisdictional threshold, will render otiose, all substantive issues of the applicability of standards of protection such as, FET, to portfolio investments.[184]

5.5 <u>Conclusion</u>

Financial/economic crises are rare and extreme events with uncertain nexus between the cause and the effect, but with massive economic and social cost implications for the State in question or the global economy. To this end, States acts to try and avert such crisis or mitigate its impact. Research has identified several likely warning signals of impending financial crisis. It is only reasonable therefore that once these signals are identified that timeous macroeconomic and counter-cyclical measures for prudential purposes are undertaken to reduce the likelihood of

[181] Most favoured Nation Treatment is a standard of protection extended to foreign investments to the effect that it would not receive treatment less favourable than what is accorded to another investment.
[182] *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan,* ICSID Case No. ARB/03/29 Award 27 August 2009.
[183] *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan* para 155 See also *Rumeli v Kazakhstan para 575; ATA Construction v Jordan para 125; MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile,* ICSID Case No. ARB/01/7 Decision on Annulment 27 March 2007.
[184] *Societe Generale v. Dominican Republic* para 41.

the crisis or its severity. The sole objective of these macroeconomic measures is purely to avert the crisis or ameliorate its impact.

However, host State macroeconomic measures deployed to avert or mitigate economic and financial crisis such as, sovereign debt crisis, currency crisis etc., incidentally, may adversely affect portfolio investments owing to their sensitivity to macroeconomic and systematic risk conditions. Where such host State macroeconomic countercyclical measures cause loss of value to portfolio investments protected under IIAs/BITs, it can find a claim for breach of FET if the macroeconomic measure is alleged to have been unfair, inequitable, arbitrary, unreasonable or inconsistent with due process in relation to the portfolio investment.

FET is the most widely used protection standard for challenging all facet of host State conduct or omission that affected foreign investors' investments. In the realm of portfolio investments, the contested host State measures are macroeconomic measures. Given the propensity for FET to freeze host State regulatory powers, FET potentially could freeze host State Macroeconomic authority, or result in positive discrimination in favour of portfolio investments. The effect of this outcome may portend negative economic consequences especially in times of economic crisis, where such macroeconomic measures will be necessary to address the economic situation.

Bearing all this in mind foreign portfolio investments, may not be in breach of the Fair and Equitable Treatment (FET) standard of protection. This is because in several cases the circumstances of each case, and context of each situation (including the economic condition of the host State) are usually considered by the tribunals to deny FET protection; on the other, a stricter standard based on the egregiousness of the macroeconomic measure is required where FET is tied to the minimum standard of treatment under customary international law, thereby making it quite difficult for the investor to prove FET violation.

Chapter Six

Assessing Transfer of Funds Clause Standard of Protection for Foreign Portfolio Investment Protection.

6.0 Introduction

Currently most foreign portfolio investment transactions are conducted and concluded outside the host State territory and have no territorial connection with the host State particularly owing to the proliferation of retail investments that may be acquired through online trading platforms which may rely on Payment for Order Flow Practices (PFOFP).[1] Purchase of foreign portfolio investments can be done electronically through mobile brokerage trading platforms,[2] or through direct instructions to brokers. In effect, entire transactions could be conducted offshore, outside the host State territorial jurisdiction.[3] These transactions may be done without the host State directly receiving any part of the transactions especially when the foreign portfolio investments are exchanged outside jurisdiction electronically. Yet, the dividends and yields accruing to such foreign portfolio investments are required to leave the territory of the host State to wherever the investor resides.

Repatriation of proceeds and returns such as capital gains, dividends and yields from foreign portfolio investments within host State could be restricted or limited either through outright prohibitions or the imposition of taxes, such that even holders of foreign portfolio investments acquired through the trading platforms or brokers can be affected. The effect will be a breach of the transfer clause provision, where foreign portfolio investments are protected under BITs. Thus, a host State's macroeconomic measure which prevents dividends, capital gains or yields from leaving the host State or reduces the value of the yields or dividends accruing to foreign portfolio investors may be considered as a breach of the transfer rights of foreign portfolio

[1] Payment for order flow practice is the use of market makers to acquire investments. It essentially is used to direct traffic towards market makers. Retail investors using online trading platforms do not acquire shares, and derivatives directly from exchanges; rather the shares are routed to market makers for the acquisition of shares. See Investopedia. It may be detrimental to retail investors where brokers direct transactions to market makers simply to get commission. This can affect the retail investor's opportunity for price improvement. There is growing need for more regulation of PFOFP.

[2] The proliferation of mobile brokerage trading platforms with its adoption of game interfaces has led to loads of retail investors starting trading including day trading without the requisite knowledge and experience to manage the risk. It is like an addiction. Though the interface is not coercive, it is considered as being capable of influencing decisions. See Madison Darbyshire, 'Traders Phone Up Gambling Helplines as Game-like Broker Apps Spread' *Financial Times* October 6, 2021.

[3] Eichengreen et al, 'Liberalizing Capital Movements: Some Analytical Issues' (1999) IMF Economic Issue No. 17. IT can affect the effectiveness of capital controls because transactions can be concluded outside the jurisdiction of the host State.

investors protected under BITs/Investment Chapters. This is even where the host State did not benefit in any way from the investors acquisition of the investment, and even where such macroeconomic measure was adopted in the face of impending economic/financial crisis.

Host States are concerned about ensuring financial and economic stability. As a result, they undertake measures like maintaining foreign reserves to deal with current account deficits in a bid to avoid economic crisis such as Balance of Payment (BoP) crisis. They are also interested in attracting foreign investments into their territories for economic and financial development.[4] To this end, they adopt capital liberalisation policies for free movement of capital and offer substantive protection standards to incoming capital in BITs/Investment Chapters. However, the protections captured in BITs/Investment Chapters are made at the expense of their policy space autonomy because of the controls that are given up.[5] Consequently, the BITs/Investment Chapters provide investors with guarantees of unrestricted transfer rights in relation to capital gains, dividends, and interest payments. They sometimes also guarantee investors the unrestricted right to transfer in currency of investor's choice. Transfer rate could be required to be at the prevailing market rate, or the rate most recently applied to inward investment, or the conversion rate of the currency into SDR whichever is more favourable (where there is no market rate).

In view of the comprehensive guarantee of unrestricted transfer of funds within BITS (which encompasses both capital and current account liberalisation), the issue then becomes whether there exist safeguards for host States to exercise control within BITs to deal with impending crisis or mitigate existing economic crisis? This is relevant owing to the indisputable fact that there exists a recognition of a nexus between liberalised capital movement and economic/financial crisis.[6] Thus, it is imperative that host States possess the right to intervene to prevent or mitigate crisis by adapting macroeconomic measures such as transfer restrictions. Though harmful to foreign portfolio investments, they are necessary for mitigating or preventing economic/financial crisis. These safeguards could be in the form of exceptions

[4] Jeswald W Salacuse & Nicholas P. Sullivan, 'Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and Their Grand Bargain' (2005) 46(1) Harvard International Law Journal 76

[5] Andrew T Guzman, 'Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties' (1998) 38 Virginia Journal of International Law 643.

[6] Ricardo Hausmann & Eduardo Fernandez Arias, 'Foreign Direct Investment: Good Cholesterol?' (2000) Inter-American Development Bank Research Department Working Paper No. 417 p 3; United Nations Conference on Trade and Development, Trade and Development Report 1999 112-113; C .M Reinhart and Kenneth Rogoff, *This Time is Different: Eight Centuries of Financial Folly* (Princeton: Princeton University Press, 2009).

contained within Transfer of funds clauses in BITs. Some BITs contain exceptions to transfer clauses. These exceptions include specialised exceptions which forms part of the transfer clause.[7]

Where specialised exceptions are contained in transfer of fund clauses in BITs/Investment Chapters, they tend to offer space for host State macroeconomic flexibility in imposing transfer restrictions on capital and current account convertibility, sometimes even better than the International Monetary Fund (IMF). For instance, under Article VIII (2) of the IMF Articles of Agreement, the IMF only allows restrictions on current account transactions where a particular currency is scarce, or the host State is still in transition.[8] Meanwhile, BIT/Investment Chapter safeguards such as Balance of Payment exceptions where available, applies to both capital and current transactions.

Finally, macroeconomic flexibility to restrict transfer may be constrained by the effect of MFN clauses where better protection is offered elsewhere. MFN clauses could even be used to introduce transfer of funds clauses from another BIT/Investment Chapter with stronger protection allowing unrestricted freedom to transfer. Possible solutions include, removing any obligation or penalties on foreign investors if they don't transfer into the host State;[9] or removing MFN completely from BITs/Investment Chapters.

6.1 Transfer of Funds under International Economic Law

It is critical that a foreign investor be able to freely bring in capital into the host State, and freely move it out as well. The aim of bringing capital into the host State is to set up an investment, or to operate or expand an existing investment. In the same vein, the objectives of a foreign investor in taking capital out of the host State may be to obtain raw materials or infrastructure, secure services, make payments, service debts, transfer profits or divest from the host State economy.

Thus, it remains imperative that foreign investors can transfer funds freely without restrictions from the host State to achieve any or all the above objectives. However, while it is important

[7] For instance, see Japan – Kenya BIT (2016), Article 17; Netherlands – Serbia BIT, Article 5.
[8] International Monetary Fund Articles of Agreement, Article VII(3)(b) & Article XIV(2)
[9] Jeswald Salacuse, *The Law of Investment Treaties* (OUP, 2015) p 261, See Canadian Model BIT and Article 1109(3) NAFTA

that foreign investors can freely transfer funds in and out of the host State to attract foreign investments; extending absolute freedom of capital movement to foreign investors especially investors in volatile, short term speculative investments poses risks to the host State.[10] Some of these risks include: reduction of foreign reserves, volatility in exchange rate which can affect a host State's international trade activities and undermine the ability of the host State to meet its global financial obligations, and money laundering activities.[11] As a result, it is considered that the costs of unrestricted fund movements on financial stability and macroeconomic flexibility and independence outweighs the benefit.[12] Furthermore, the impacts of unforeseen situations like Covid-19, which engendered massive movement of funds away from emerging and frontier economies underscores the need for these economies, particularly frontier economies to have the policy space to restrict the outflow of funds from their jurisdictions. The Asian Financial Crisis of 1997 and the Global Financial Crisis of 2007 underscores the necessity for host State policy space to regulate fund movements.[13] Regulating destabilising outflows could be through inflow control.[14]

Consequently, it goes without saying that emerging and frontier economies need to exercise the right to regulate the flow of capital in and out of their economy to prevent or mitigate against the negative externalities associated with free movement of capital.[15] State flexibility to regulate capital flows is critical. Capital flows regulation is viewed as a means of dealing with market instability incidental to highly liberalised capital movements.[16] It is now axiomatic that market failures are the basis for State macroeconomic policy intervention to bring about a more efficient market.[17] This is currently evident in the effect of the COVID-19 global pandemic on the global economy,[18] and the imperative for State intervention and flexibility.[19]

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[10] Jeswald Salacuse, *The Law of Investment Treaties* (n 9) 256

[11] *Ibid.*

[12] D. Filiz Unsal, 'Capital Flows & Financial Stability (2011) IMF Working Paper; F. Lupo-Pasini, Movement of Capital & Trade in Services 582.

[13] During the Asian Financial Crisis, some East Asian States like Malaysia adopted restrictions on capital movement to stem the effects of the BoP crisis that was engulfing the region.

[14] Eichengreen et al, 'Liberalizing Capital Movements: Some Analytical Issues' (n 3); Christopher Neely, 'An Introduction to Capital Controls' (1999) Federal Reserve Bank of St Louis Review.

[15] Barry Johnston & Natalia Tamirisa, 'Why Do Countries Use Capital Controls?' (1998) IMF Working Paper

[16] Anton Korinek, 'The New Economics of Prudential Capital Controls: A Research Agenda' (2011) 59(3) IMF Economic Review 524

[17] Rachel D Thrasher, Sarah Sklar, Kevin P Gallagher, 'Policy Space for Capital Flow Management: An Empirical Investigation' (2021) 24(4) Journal of International Economic Law 780.

[18] Kayvan Bozorgmehr, 'COVID 19 & the Consequences of three Crisis in Europe' *The Lancet* April 1, 2020 https://www.thelancet.com/action/showPdf?pii=S2468-2667%2820%2930078-5. Accessed 11/11/2022. See also https://www.imf.org/en/About/FAQ/sovereign-debt on the effect of COVID 19 on public debt distress

[19] Gallagher & Kozul-Wright, 'Breaking Out of the Double Squeeze: The Need for Fiscal and Policy Space during the Covid-19 Crisis' (2020) Global Policy.

The IMF recognising this imperative, now allows States to engage in pre-emptive capital flow regulation.[20]

However, transfer restrictions have been criticised for incurring administrative costs for its implementation; undermining the flexibility of host State private sector to adapt to the changing international financial market; and can create a negative perception of the host State's financial market, thereby increasing the costs and elevating the challenges for host States in attracting foreign capital[21] especially when they are poorly designed and implemented.[22] Transfer restrictions are also considered to become ineffective overtime as foreign investors search for means to circumvent the restrictions and exploit the system,[23] such as the use of derivatives,[24] or the advancement of financial technology.[25] Transfer restrictions may shelter financial intermediaries from foreign competition and vest extra powers upon bureaucrats who may be even less capable than markets at delivering an efficient allocation of resources.[26] Finally, the successes of transfer restrictions may be difficult to pinpoint unequivocally since they require rigid implementation, and are usually not executed independent of other macroeconomic and prudential policies, which is why generalising their effectiveness poses some risk.[27] Paul Krugman in his famous open letter to the Malaysian Prime Minister following their adoption of Control measures warned that fund restrictions are most egregious when they are used to defend over-valued currencies rather than combat speculation.[28] Recall that Foreign portfolio investments which are short term, speculative and in search of arbitrage are what this thesis seeks to deny protection. Thus, according to Professor Krugman, transfer restrictions can legitimately be used to curtail them.

[20] International Monetary Fund, Review of the Institutional View on the Liberalisation and Management of Capital Flows 2022.
[21] Age F.P Bakker, The Liberalization of Capital Movements in Europe (Kluwer Academic Publishers, 1996); IMF Cap Control 4.
[22] 'The Perils of Global Capital' *Economist* April 9, 1998; Christopher Neely, 'An Introduction to Capital Controls' (n 14) 27-28.
[23] Akira Ariyoshi et al., 'Capital Controls: Country Experiences with Their Use and Liberalization' (2000) IMF Occasional Paper 190, 15.
[24] Christopher Neely, 'An Introduction to Capital Controls' (n 14) 27; Peter Garber, 'Derivatives in International Capital Flow' (1998) NBER Working Paper 6623.
[25] Eichengreen et al, 'Liberalizing Capital Movements: Some Analytical Issues' (n 3).
[26] Barry Eichengreen, 'Capital Account Liberalisation: What Do Cross Country Studies Tell Us?' (2001) 15(3) The World Bank Economic Review 342.
[27] Maurice Obstfeld & Alan M. Taylor. 'The Great Depression as a Watershed: International Capital Mobility over the Long Run' in Michael D. Bordo, Claudia D. Goldin, and Eugene N. White, eds., *The Defining Moment: The Great Depression and the American Economy in the Twentieth Century* (University of Chicago Press, 1998) pp. 353-402
[28] Paul Krugman, An Open Letter to Prime Minister Mahathir

The objectives for imposing fund transfer restrictions includes not just the preservation of the macroeconomic sovereign prerogative of host States, but for the purpose of reducing pressure on the host State's exchange rate, credit allocation domestically,[29] maintaining currency and monetary stability in view of sporadic and volatile capital flows, dealing with unsustainable capital flows[30] and insulating the economy from international financial market volatility.[31] It is noteworthy that not long ago, developed countries owing to their faith in capital account liberalisation were opposed to funds transfer restrictions. However, they seem to have changed their tune, and now allow transfer restrictions, particularly capital controls under exceptional circumstances such as economic crisis etc.[32] A no less obvious reflection of this can be seen in the European Court of Justice decision directing Sweden and Austria to renegotiate BITs without transfer restriction safeguards in *Commission v Sweden & Commission v. Austria*.[33] As well as the letter signed by 250 global economists on the effectiveness of fund restrictions.[34] Finally, even the IMF has changed its view on capital control[35] as mentioned earlier.

Consequently, host States' can restrict transfer, and impose controls by prohibiting, or placing a limit on the quantity or volume of funds that can come in and leave the host State;[36] making it more expensive to transfer funds through the creation of multiple exchange rate systems to apply to different sectors, industries and transactions or restricting the trade in currencies[37]; or imposing taxes on inflows and outflows to discourage flows in either direction.[38]

[29] Developing countries may impose controls on outflows to make credit available domestically and manage the capital flight. See Barry Johnston & Natalia Tamirisa, 'Why Do Countries Use Capital Controls?' (n 15)
[30] Akira Ariyoshi et al., 'Capital Controls: Country Experiences with Their Use and Liberalization' (n 23)1 & 3.
[31] Ibid 20.
[32] Jeswald Salacuse, *The Law of Investment Treaties* (n 9) 269. In the decisions of, the ECJ recognised the legitimacy of capital controls after considering the provisions of Articles 57, 59 and 60 of the EU treaties. The ECJ in both cases found BITs entered by Sweden & Austria as incompatible with their EU obligations because they guaranteed investors unrestricted rights to transfer funds.
[33] Commission of the European Communities v Sweden, Lithuania (intervening) and ors (intervening), Final judgment, Case C-249/06, ILEC 020 (CJEU 2009), 3rd March 2009; Commission of the European Communities v. Republic of Austria, European Court of Justice Case C-205/06, 3rd March 2009.
[34] Global Development and Environment Institute 2011.
[35] International Monetary Fund, 'Institutional View on the Liberalisation and Management of Capital Flow' (2012); International Monetary Fund, 'Review of Institutional View on the Liberalisation and Management of Capital Flows' (March 2022) IMF Policy Paper.
[36] Quantity Control.
[37] Exchange Control
[38] Price Control. Such as the Brazilian Entrance tax; or the proposed Tobin Tax in the US by Nobel Laureate James Tobin which was meant to tax a little percentage of currency exchange transactions to reduce exchange market volatility. Germany and France championed the introduction of the Financial Transaction Tax (FTT) despite the opposition from businesses. See James Wilson, German Companies Weigh in Against Tobin Tax (2013) *Financial Times https://www.ft.com/content/5cb60a60-b7d2-11e2-bd62-00144feabdc0*

Fund transfer restrictions may be restrictions on capital movement i.e., restrictions on capital account[39] transactions, or restrictions on both capital account and current transactions[40] movement. Investment treaties do not always make this distinction between capital and current transactions. BITs usually, create an obligation on host States to allow transfer of funds generally i.e., capital inflows and outflows[41] as well as in relation to capital and current transactions, often times **<u>'payments'</u> or <u>'investments and returns'</u> or <u>'transfers'</u> are used generally, and they encompass both capital and current transactions** in transfer clauses**;** and where exceptions are provided for, they usually do not distinguish between capital and current accounts unlike the IMF Articles of Agreement & WTO General Agreement on Trade in Services (GATS) which have separate requirements for capital account restrictions, and current account restrictions.[42]

Sequel to this, BIT/Investment Chapter exceptions usually allow restrictions on transfer of both capital and current transactions, unless otherwise expressly provided, or expressly made subject to the provisions of the IMF Articles of Agreement. In such circumstance, the IMF provisions apply, and current transactions will enjoy unfettered movement and convertibility unless economy is under transitional arrangements, or the relevant currency is scarce. Consequently, current account transfers (profits, interests, dividends etc) enjoy BIT protection & IMF protections[43] permitting free transfer where exceptions are subject to IMF Articles. In such situation host States are not permitted to restrict transfer for current transactions unless in the manner prescribed by the IMF.

Article VI(3) of the IMF allows member states to impose capital flow restrictions necessary to regulate international capital movements. The restrictions are not permitted to be imposed on

[39] Capital Account is the part of a Country's Balance of Payment where trade in goods, services and capital are recorded.
[40] Current Account is the other part of a Country's Balance of Payments where payments to foreign holders of investments and capital are recorded.
[41] Rachel D Thrasher, Sarah Sklar, Kevin P Gallagher, 'Policy Space for Capital Flow Management: An Empirical Investigation' (n 17) 784. Capital inflows regulation affects the acquisition of host State assets by foreign investors, while outflows control affects the purchase of foreign currency within the host State. The latter affects foreign portfolio investments more because they obstruct foreign portfolio investors from repatriating the proceeds of the sale of investments.
[42] For instance, the IMF allows for Capital Controls in Article VI(3) but does not allow current account transaction restrictions unless in accordance with Article VIII (2). While the GATS allows for restrictions based on satisfying the conditions therein. See, General Agreement on Trade in Services (GATS), Article XI (1) & Article XI (2).
[43] Abba Kolo, 'Transfer of Funds: The Interaction between the IMF Articles of Agreement and Modern Investment Treaties: A Comparative Law Perspective' in Stephen Schill (*ed) International Investment Law and Comparative Public Law* (2010) 4.

current transactions unless in the manner provided under Article VII(3)(b) & Article XIV(2).[44] Article VII(3)(b) provides for the limited justification for current transaction restriction where a particular currency is scarce, and after consultation with the IMF.[45] In such circumstance, State members can impose current account restrictions on the exchange of such scarce currency. Additionally, current transactions restrictions may also be imposed where member states choose to avail themselves of transitional arrangements in view of changing circumstances, under Article XIV(2).[46] Here, only members in transition (frontier economies) can rely on the option of transitional arrangements to maintain or change restrictions on current transactions existing at the date they became members of IMF, and are obliged to withdraw restrictions immediately after they can settle their BoP.

The WTO GATT and GATS recognizes rights to freely transfer fund and restrictions to the right of transfer.[47] Article XI GATS imposes an obligation on members to allow free movement of current transactions unless under circumstances of serious BOP and financial crisis or a threat of such crisis in accordance with Article XII GATS.[48] It also imposes an obligation on members not to restrict capital transactions unless under a threat of, or existing serious BOP and financial crisis, provided control measures are not discriminatory, or excessive, but are temporary, and at the request of the IMF.[49] According to Gallagher, it is uncertain if this provision allows host State policy space for preventive control measures against BOP.[50] The inclusion of 'under threat of' suggests subjectivity in the decision, which therefore seemingly allows for preventive policy space since there is no definition or interpretation of what would constitute a threat of serious BoP crisis. However, the inclusion of the requirement of requesting the adoption of control measures from IMF, clearly denies host State policy space.

[44] International Monetary Fund Articles of Agreement.
[45] See International Monetary Fund Articles of Agreement, Article VIII (2)
[46] International Monetary Fund Articles of Agreement, Article XIV (2)
[47] General Agreement on Tariffs and Trade (GATT), Art XV. Few BITs/Investment Chapters allow for the transfer of funds with some limitations. However, the majority permits unrestricted guarantees. Those with unrestricted access will conflict with the host State's economic sovereignty. See Adaeze Agatha Aniodoh, 'Host States' Monetary Sovereignty Within the Construct of Bilateral Investment Treaties' (2021) 65 (1) Journal of African Law 5-6.
[48] General Agreement on Trade in Services (GATS), Article XI (1)
[49] General Agreement on Trade in Services (GATS), Article XI (2)
[50] Kevin Gallagher, *Ruling Capital: Emerging Markets and the Reregulation of Cross-Border Finance* (Cornell University Press, 2014) 176.

Additionally, transfer restrictions may be permitted for prudential reasons, such as to ensure the stability of the host States financial system.[51] However, such restrictions should not be used to avoid obligations under GATS where they do not conform with the provisions of GATS.[52]

The effect of the interplay of all these international economic law frameworks is that where host States imposes transfer restrictions based on economic sovereignty, or inuring rights under the IMF Articles or WTO GATS, it can result in ISDS claims against the host State for breaching BIT transfer provisions where safeguard provisions are absent. This is owing to the potential conflict that could arise between host States BIT obligations to allow free transfer with no space for restriction, and host State sovereign economic rights recognised under the WTO GATS, and provisions of IMF Articles' and recommendations.[53] Essentially it becomes a conflict of international economic law rights and obligation. An alignment of safeguards will be the best way to deal with the fragmentation. Unfortunately, most transfer of funds provisions in BITs do not contain safeguards.

Where such claims of breach arise, host states can have recourse to general exceptions within the BIT if available, and if not, host state can advocate for a proportional analysis review of the conflicting rights by balancing both objectives to see if imposing a transfer restriction amidst economic and financial crisis is worth denying the foreign portfolio investor the right to free transfer of funds.

6.2 Transfer of Funds in International Investment Law.

Among the over 2000 BITs that have been mapped by the UNCTAD Investment Policy Hub Mapping of IIA's platform, about 2000 BITs contain provisions on Transfer of Funds with no safeguards or exceptions.[54] What this means is that a vast majority of IIAs contain almost absolute rights of foreign portfolio investors to move in and transfer funds outside the host State with no restrictions. Of particular interest are some of the international investment treaty practices of capital exporting countries such as Netherlands, the United States, the United Kingdom, Germany etc which mostly provides for unrestricted transfer of fund obligations

[51] Marrakesh Agreement Establishing the World Trade Organisation General Agreement on Trade in Services (GATS) Annex on Financial Services (Annex 1B), paragraph 2(a).
[52] Ibid,
[53] Kevin Gallagher, *Ruling Capital: Emerging Markets and the Reregulation of Cross-Border Finance* (n 50) 124.
[54] https://investmentpolicy.unctad.org/international-investment-agreements/iia-mapping

without including exceptional safeguard circumstances, except in few instances. For instance, see the Netherland – Nigeria BIT which provides for prohibition against transfer of funds in Article 5 that:

> 'The Contracting Parties shall guarantee that payments relating to an investment may be transferred. The transfers shall be made in a freely convertible currency, without undue restriction or delay. Such transfers include in particular though not exclusively:
> (a) profits, interest, dividends and other income;
> (b) funds necessary
> i. for the acquisition of raw or auxiliary materials, semi-fabricated or finished products; or
> ii. to replace capital assets in order to safeguard the continuity of an investment; or
> iii. for expansion and/or improvement of an investment;
> (c) funds in repayment of loans;
> (d) royalties or fees;
> (e) earnings of natural persons;
> (f) the proceeds of sale or liquidation of the investment'.[55]

Similarly, the United Kingdom – Serbia BIT (2002) in Article 6 provides that:

> 'Each Contracting Party shall guarantee to the investors of the other Contracting Party, free transfer of payments related to their investments including in particular, though not exclusively:
> a) capital and additional amounts to maintain or increase investments;
> b) unspent earnings of investors' employees working in connection with the investment in the territory of the Contracting Party;
> c) returns;
> d) repayment of loans;
> e) proceeds from total or partial liquidation or sale of the investment,
> f) compensation according to Articles 4 and 5 of this Agreement,
> g) payments arising out of a settlement of a dispute, according to Article 8 of this Agreement…'

[55] See also, Netherlands-Nicaragua BIT (2000); Netherlands-Oman (2009); Netherlands – Serbia BIT (2002); Netherlands – Sri Lanka (1984); Netherlands – Vietnam BIT (1994)

The implications of the above provisions, and others like these are that where a host State takes measures such as:

(i) prohibiting the quantity of inflow[56] of portfolio investments[57] (like fixed income assets) into the host State to deal with the volatility of such capital:[58] or

(ii) the prohibition of the transfer of the proceeds of sale of investment for a period[59]; or

(iii) requiring the conversion of the proceeds of sale to be in accordance with an exchange rate, to reduce depreciation of foreign reserves and mitigate or prevent economic crises such as Balance of Payment (BOP) crisis as was done by Malaysia;

such measures can be considered as a breach of the right to freely transfer funds under the BIT/Investment Chapter.

In *Gruslin v. Malaysia,* which arose in reaction to the Asian Financial Crisis, the claimant invested in securities in the Kuala Lumpur Stock Exchange (KLSE) through a mutual fund (EAMEC Portfolio) managed by Citiportfolio S.A. At the direction of Citiportfolio, the EAMEC portfolio fund was invested in KLSE listed securities by and in the name of Citibank S.A. Owing to capital controls imposed by the respondent in September 1998, in the wake of the Asian Financial Crisis,[60] the claimant claimed to have suffered loss in his entire investment in the KLSE listed securities. The claimant then instituted this claim before ICSID against the respondent for loss of value of his investments arising from the breach of the Intergovernmental Agreement (IGA) entered between the respondent and the Belgo-Luxemburg economic union in 1979. The Claimant's claim against the respondent relates to the respondent's imposition of

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[56] Chile between 1991-1998 restricted the quantity of inflows of capital, to reduce the possible volume of capital that can leave the country during crisis for the purpose of macroeconomic stability. See Christopher Neely, 'An Introduction to Capital Controls' 25.

[57] The short-term inflows usually come in search of high interest rates. Though considered less risky, they can be speculative and destabilizing at the aggregate level. See IMF Cap Control 4. For the purposes of this thesis, portfolio investments are short term investments and traditionally long-term investments, but which comes in for capital gains and arbitrage.

[58] Such as the case in Malaysia.

[59] In Malaysia, the government adopted restrictions in September 1998, and prohibited the repatriation of foreign portfolio investment capital, for a period to deal with the Balance of Payments crisis facing Malaysia at that time. Subsequently, it imposed exit taxes on of the transfer of foreign portfolio capital, which was progressively reduced depending on how long the investment was resident in Malaysia. They further limited the transfer of dividends from portfolio investments by amending their Company Act to avoid breaching Article VIII of the IMF's Articles. of Agreement which does not allow restrictions on current account transactions without permission. The restriction on transfer of portfolio capital aided in containing the exit of capital from Malaysia, and the inclusion of other macroeconomic policies helped in stabilising the exchange rate and the economy. See IMF Cap Control 22.

[60] Factbox: Malaysia After Capital Controls FACTBOX: Malaysia after capital controls | Reuters

exchange controls in 1998, which was deemed a breach of its obligation under the IGA. The claimant claimed that the proportion of his investment in the EAMEC portfolio, invested in the KLSE listed securities amounted to an investment under Art 1(3) of the IGA. In response, the respondent raised an objection challenging the jurisdiction of the claim before ICSID on the basis that claimant was not the investor, and the fund invested in the KLSE was not an investment under Article 1(3) of the IGA for not satisfying the requirement of proviso (i) to Article 1(3) which mandates the listed investments to be tied to an approved project.

The Claimant argued that the term 'project' was used in the sense of an activity, and acquiring securities is an investment activity within the contemplation of the project requirement. Furthermore, an approval from the respondent's Capital Issues Committee (CIC) for listing of securities on the KLSE for investment activities is an approved project. Thus, CIC approval for the listing of securities, which were then the subject of the funds' investment, satisfied the requirement of Article 1(3) proviso (i). However, the tribunal rejected the claimant's submission.[61] The tribunal held that what is contemplated under proviso (i) is a regulatory approval of a project. Thus, the CIC approval for share listing does not suffice to satisfy the requirement of approved projects under proviso (i). Tribunal went on to add that mere investments in shares, in stock markets that are easily tradeable, and unconnected to an approved project are not covered by the IGA. Owing to the decision of the tribunal denying jurisdiction, the substantive claim challenging Malaysia's exchange controls during the Asian Financial Crisis was never determined. However, this case illustrates how transfer restrictions that affects foreign portfolio investments can give rise to investment arbitration claims.

In *Air Canada v. Venezuela,*[62] which concerned dispute over the repatriation of claimant's returns arising from aviation services rendered within the respondent's territory, while construing the substantive provisions of the Canada-Venezuela BIT[63], the tribunal held that transfer restriction measures[64] will be a violation of the transfer of funds provisions in a BIT where: (i) it is impossible to transfer funds from the host State owing to the measures; or (ii) the measures effectively prevent investors from freely transferring funds contrary to the extant

[61] *Gruslin v. Malaysia* para 24-26,
[62] *Air Canada v. Venezuela* para 373.
[63] Canada-Venezuela BIT (1996) Article VIII.
[64] Restrictive measures such as: prohibiting the quantity of inflow of short-term portfolio investments into the host State or the prohibition of the transfer of the proceeds of the sale of investment for a period; or requiring the conversion of the proceeds of sale to be in accordance with an exchange rate.

system or procedure. Here, the tribunal found that the respondent's failure to process the claimants' transfer requests without any justification under the BIT, effectively prevented the claimant from freely transferring their funds in accordance with the existing process of transfer.

6.2.1 **Analysing Contents of Transfer of Funds Provisions in International Investment Law**

The investor's right to unrestricted transfer of funds in BITs/Investment Chapters are usually expressed in different ways. It could be captured as a requirement of the host State to guarantee the free transfer of capital and current transactions payments to and from the host State.[65] For instance, the Netherlands-Oman BIT, Article 3 provides that: 'the Contracting Parties shall guarantee the transfer of payment related to an investment'.[66] It does not define what constitutes payments but provides an inexhaustive list of payments which could be freely transferred without restriction.[67]

It could also be presented as a duty of the host State to allow unrestricted fund mobility 'in connection with an investment' such as in the Germany-Oman BIT Article 6(1) which provides that: 'Each Contracting State shall guarantee to investors of the other Contracting State the *free transfer of payments in connection with an investment made in its territory…*' (italics provided).[68]

This raises an interesting question of what is meant by 'in connection with an investment' or 'related to an investment'? Could it be interpreted as permitting transfers in relation to economic activities that falls within the scope of what constitutes an investment as applicable to the BIT/Investment Chapter? If that is the case, what it suggests is that only economic activities recognised as investments can benefit from this right to freely transfer. Thus, to take advantage of this provision, the FPI investor must first show that its investment falls within the meaning of an investment within the contemplation of ICSID convention where applicable. It becomes a threshold issue to be determined before the substantive scope of the right to

[65] Bangladesh-US BIT (1986) Article V.
[66] Japan -Korea BIT Article 12.
[67] See Netherlands-Oman BIT (2009), Article 3 (a-g). See also the Netherlands-Bangladesh BIT (1994), Article 5; Netherlands-Vietnam BIT (1994), Article 5, Netherlands-Nigeria BIT (1992), Article 5 etc.
[68] Germany-Oman BIT 2007, Article 6(1); Germany-Nigeria BIT (2000); Germany-Pakistan BIT 2009, Article 591) used 'relating to an investment'. So also does the Netherlands-Bangladesh BIT (1994), Article 5; Netherlands-Vietnam BIT (1994), Article 5, Netherlands-Nigeria BIT (1992), Article 5

unrestricted transfer. As has been vigorously argued in Chapter Four[69] of this thesis, foreign portfolio investments seemingly protected under BITS/Investment Chapters, are not investments because they are volatile and can be harmful to the economy, and their protection can undermine macroeconomic policies directed at dealing with economic challenges thus consequentially affecting economic development.

BITs/Investment Chapters may also include the nature of the payments which can be transferred. These kinds of funds maybe expressed generically, just like in the UK-Vietnam BIT (2002).[70] The kind of funds which may be transferred can be expressed by permitting the transfer of 'investment and returns. For instance, Article 6 of the UK-Vietnam BIT provides that:

> Each Contracting Party shall in respect of investments guarantee to nationals or companies of the other Contracting Party the unrestricted transfer of their investments and returns. Transfers shall be effected without delay in the convertible currency in which the capital was originally invested or in any other convertible currency agreed by the investor and the Contracting Party concerned. Unless otherwise agreed by the investor transfers shall be made at the rate of exchange applicable on the date of transfer pursuant to the exchange regulations in force.

Transfers could also be expressed through a list which could either be an inexhaustive (open) list, or an exhaustive (closed) list. Where the transfer restriction provision provides a list, the challenge of interpretation would be whether it is an exhaustive, or inexhaustive list. This is especially so where the provision is unclear.[71] An instance of an exhaustive list of transferrable payments can be seen in the Oman-US FTA (2006), Article 10.7(1) which provides that:[72]

[69] To rely on the transfer of funds provision, there must exist a nexus between the capital and returns to be transferred and an investment. Such investment must be one that passes the jurisdictional test. Chapter Four of this Thesis argues that foreign portfolio investments should not be considered as 'investments' for investment law protection. This is because their recognition and protection can be an obstacle to economic growth and development contrary to the objectives of ICSID and most BITS. Foreign portfolio investments can have this effect owing to their sensitivity to macroeconomic measures. Protecting them will fundamentally place host State macroeconomic policy rights to the review of investment arbitration. Additionally, since it is unclear whether host States, particularly developing and frontier economies intended to protect foreign portfolio investments, records from the making of ICSID, and current treaty practice suggests otherwise, subsequent State practice can be used to determine whether host States intended to extend protection to foreign portfolio investments. For a detailed discussion of this, see Chapter Four of this Thesis.

[70] UK-Vietnam BIT (2002), Article 6 which guarantees unrestricted transfer of investments and returns. See also UK-Bangladesh BIT (1980) Article 6; UK-Pakistan BIT (1994), Article 6; UK-Nigeria BIT (1990), Article 6.

[71] Annamaria Viterbo, *International Economic Law and Monetary Measures: Limitations to States' Sovereignty and Dispute Settlement* (Edward Elgar, 2012) 245.

[72] Oman-US FTA (2006), Article 10.71; Bangladesh-US BIT (1986) Article V; Netherlands-Oman BIT (2009) Article 3; Netherlands-Nigeria BIT (1992) Article 5.

> Each Party shall permit all transfers relating to a covered investment to be made freely and without delay into and out of its territory. Such transfers include:
> (a) contributions to capital;
> (b) profits, dividends, capital gains, and proceeds from the sale of all or any part of the covered investment or from the partial or complete liquidation of the covered investment;
> (c) interest, royalty payments, management fees, and technical assistance and other fees;
> (d) payments made under a contract, including a loan agreement;
> (e) payments made pursuant to Article 10.5.4 and 10.5.5 and Article 10.6; and
> (f) payments arising out of a dispute

While an inexhaustive (open) list approach can be seen in Article 3 of the Netherlands-Oman BIT (2009) which provides that:[73]

> The Contracting Parties shall guarantee the transfer of payments related to an investment. The transfers shall be made in a freely convertible currency, without undue restriction and delay. Such transfers include in particular though not exclusively:
> (a) profits, interests, dividends and other current income;
> (b) funds necessary
>
> i. for the acquisition of raw or auxiliary materials, semi-fabricated or finished products; or
>
> ii. to replace capital assets in order to safeguard the continuity of an investment;
>
> (c) additional funds necessary for the development of an investment;
> (d) funds in repayment of loans;
> (e) royalties or fees;
> (f) earnings of natural persons;
> (g) the proceeds of sale or liquidation of the investment.

Furthermore, the BITs may require the transfer to be done in a 'freely convertible currency,'[74] and as well require the transfer to be in the same currency in which the initial transfer was made,[75] or in a currency agreed upon by the investor and the host State,[76] however in the absence of such agreement, transfer of funds is permitted in the currency in which the investment was made. The latter part raises the question of the possibility of the foreign portfolio investor and host State reaching an agreement on currency in which transfer is to be

[73] See also, the UK-Serbia BIT (2002), Article 6, and Dutch and Danish BITs generally.
[74] Bangladesh-US BIT (1986) Article V; Morocco-US BIT (1985) Article IV
[75] UK-Vietnam BIT (2002), Article 6; UK-Pakistan BIT (1994) Article 6; UK-Oman BIT 1995.
[76] UK-Vietnam BIT (2002), Article 6; Canada-Peru BIT.

made, given their conflicting interests of managing economic crisis on one hand, and profit making on the other.[77] Furthermore, reaching an agreement on currency of transfer can also bring about MFN claims against the host State where the host State agrees to a favourable currency with foreign portfolio investors from one State, as against those of another.[78] Interestingly, the Bangladesh-US BIT gives the foreign portfolio investor the overriding right to select the currency of transfer where parties do not have an agreement on currency of transfer. Bangladesh-US BIT, Article V(2) provides thus:

> To the extent that a national or company of either Party has not made another arrangement with the appropriate authorities of the other Party in whose territory the investment of such national or company is situated, **currency transfers made pursuant to Paragraph 1 of this Article shall be permitted in a currency or currencies to be selected by such national or company.** (Emphasis supplied).

Additionally, BITs/Investment Chapters may also include the means of determining the applicable rate of exchange in the transfer clause. Some BITs/Investment Chapters requires the rate of currency exchange to be the prevailing rate on the date of transfer according to the extant exchange regulation.[79] Where no prevailing rate exists or is unascertainable, some BITs requires that the IMF's conversion to SDR rate should be applicable.[80] In the event where the IMF SDR conversion rate is not applicable, a 'just and reasonable'[81] or 'fair and equitable'[82] rate should be applied by the host State. There are usually no definitions or interpretations of what constitutes just and reasonable or fair and equitable, nor is there an objective parameter. What may seem fair and just to the host State may seem otherwise to the foreign portfolio investor.

Transfer provisions may also require that fund transfers be executed without undue delay. It is uncertain what may constitute undue delay. However, the Austria-Philippines BIT construes 'without undue delay' to mean that the delay should not exceed two (2) months.[83] Does that mean that transfer restrictions beyond two (2) months may constitute a breach of this provision?

[77] UK-Vietnam BIT (2002), Article 6; UK-Pakistan BIT (1994) Article 6; UK-Oman BIT 1995
[78] Most Favoured Nation (MFN) clauses provides protection against offering better investment protection to investors of a 3rd State.
[79] See UK-Vietnam BIT; UK-Oman BIT.
[80] Germany-Oman BIT (2007) Article 6(3); Germany-Nigeria BIT (2000).
[81] Germany-Pakistan BIT (1959) Article 6(3).
[82] Germany-Bangladesh BIT (1981) Article 4(3).
[83] Austria-Philippines BIT Article 6; Germany-Oman BIT (2007) Article 6(2)

In *Air Canada v. Venezuela*, the tribunal held that the time element of transfer of funds clauses must be determined based on the specific facts of each case. Where no consideration is given in the BIT to determining the timeframe of transfer peculiar to the extant exchange rate regime, the time frame should reflect the normal time it takes to complete such transfer within the host State.[84] The issue with this analysis is that it is silent on circumstances during times of crisis where host State's imposes restrictions in exchange regime, and these restrictions may be necessary to last provided the crisis subsists. For instance, the Asian Financial Crisis lasted for more than one year, the Global Financial Crisis lasted for about 2 years. Currently, we are still feeling the economic effects of Covid-19 with high inflation and supply chain crisis. In the end, each case must be dealt with according to its circumstances, but a timeframe of about 1-2 years seems reasonable when transfer restrictions are imposed to manage crisis situations.

The effect of all the above provisions on emerging and frontier markets is that where they (experiencing BOP crisis which) proceed to impose transfer restriction measures such as exchange controls[85] to address an impending or existing crisis, such measures will be considered as being in breach of foreign portfolio investor's right to unrestricted transfer of funds. Thus, imbuing foreign portfolio investors with the vires to present investment claims against the host State. Allowing investors to challenge the host State's transfer restriction measures before investment arbitration can exacerbate impending or existing financial crisis, and stifle host State's economic sovereignty.

However, if the transfer clause provisions subject transfer rights to the host State's laws and regulations, or IMF guidelines,[86] the implication will be upholding host State's discretion over monetary/exchange policies and insulating host States from potential ISDS claims. Interestingly, as attractive a prospect as it seems, extant BITs which subject transfer rights to host State laws and policies, have been criticised for not striking a 'fair balance between the interest of the host State and those of the foreign portfolio investors, thereby depriving the free transfer standard of their effectiveness'.[87] Admittedly, such provisions may erode the free

[84] *Air Canada v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/17/1 Award 13 September 2021 para 362-364

[85] This could be done either by the creation of multiple exchange rate systems to apply to different sectors, industries and transactions; or restricting the trade in currencies- Exchange controls.

[86] IMF allows for capital transfer restrictions and current account transactions transfer restrictions in exceptional circumstances.

[87] Annamaria Viterbo, *International Economic Law and Monetary Measures: Limitations to States' Sovereignty and Dispute Settlement* (n 71) 247.

transfer standard of its effectiveness, but it reinforces the economic sovereignty of the parties by recognising that each party in their capacity as a host State can exercise discretion in respect to transfers especially during times of economic necessities. It is submitted that such host State discretion ought to be qualified in terms of preventing or mitigating economic/financial crisis to achieve symmetry between host State and foreign portfolio investor interests. Unfortunately, aside for a few frontier economies' BITs under review[88] which permits host State discretion in the form of exceptions, all the others provide for absolute rights to free transfer of funds. It is noteworthy that in a bid to achieve symmetry between the expedience of preventing/ mitigating financial crisis or protecting creditors, and the need to offer investment protection to attract foreign investments, some BITs[89] have included limitations and exceptions to their provisions on transfer to find a balance between these competing objectives.[90]

6.2.2 Exceptions to Transfer of Funds Obligation in International Investment Law

To avoid the negative externalities of the unrestricted freedom of movement of capital such as reduction of foreign reserves, and currency volatility which can affect a host State's international and domestic economic activities, few countries including emerging and frontier economies have successfully included safeguards and exceptions to foreign portfolio investors' right to unrestricted capital mobility in BITs entered with other countries. Consequentially preserving their rights and expanding their space for funds transfer restriction, owing to the existence of consensus on the correlation between free unregulated capital movement and economic/financial crisis.[91] Thus, it is imperative that States, particularly emerging and frontier economies are conferred with rights to undertake measures though may be harmful to foreign portfolio investments but are necessary for preventing or mitigating crisis. These rights can be in the form of exceptions, limitations, or qualifications.[92]

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[88] UK-Morocco BIT (1990) Article 7 provides for financial/economic/BOP exceptions. Bangladesh-UK BIT (1980) Article 6 also provides for financial/economic exceptional circumstances. Bangladesh-US BIT (1986) Article X; and Morocco-US BIT (1985) Article IX provides for NPM necessity justification on security and public order grounds.

[89] There about only 368 Mapped BITs which contain general exceptions to transfer of funds clauses. See UNCTAD's Investment Policy Hub.

[90] United Nations Conference on Trade and Development (UNCTAD), Trends in Investment Rulemaking (2007) 63.

[91] Ricardo Hausmann & Eduardo Fernandez Arias, 'Foreign Direct Investment: Good Cholesterol?' (n 6) 3; United Nations Conference on Trade and Development, Trade and Development Report (n 6) 112-113.

[92] Andrew Mitchell et al., 'Dear Prudence: Allowance under International Trade Law and Investment Law for Prudential Regulations' (2016) 19(4) Journal of International Economic Law.

BITs may contain qualifications and exceptions inserted by the State parties to ensure that foreign portfolio investors do not have unrestricted rights to move capital.[93] Exceptions to the foreign portfolio investor's right of unrestricted transfer of funds could be in the event of economic crisis. Some BITs/Investment Chapters goes further to qualify the exception by requiring the exception to be applicable where it is done 'equitably and in good faith.[94] No definition of equitably and in good faith are usually provided.

It is quite remarkable that since transfer of funds clauses do not usually distinguish between capital and current transactions as mentioned earlier but covers both, preserving regulatory space for capital restrictions through exceptions is more encompassing compared to the limited regulatory space found under IMF. Particularly where an exception clause exists as part of the transfer clause. Since such exceptions where provided, may justify the restrictions on both capital and current transactions.

These exceptions and qualifications include crisis exceptions such as economic and financial crisis (such as Balance of Payment) exceptions[95] and other exceptions such as good governance exceptions etc. According to Salacuse, economic and financial crisis as an exception was influenced primarily as a result of the experiences from the Asian financial crisis and the Argentine economic crisis which underscored the need for host State economic flexibility.[96] However, without contesting the necessity for host State economic flexibility, economic crisis exceptions have been included in some early UK BITs long before the Asian and Argentinian economic crisis.[97] Most of these UK BITs were signed in the 1980s and early 1990s.[98]

In addition to crisis exceptions, good governance exceptions are also included in some BITs to justify transfer restrictions. It is commonly included for the protection of creditors, to prevent financial crimes and terrorism, and to prevent tax evasion.[99]

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[93] About 300 Mapped BITs contain exceptions to the transfer of funds clause. See UNCTAD's Investment Policy Hub.
[94] For instance, see UK-Bangladesh BIT (1980), Article 6.
[95] For instance, see UK-Bangladesh BIT (198) Article 6; Morocco – UK BIT (1990) Article 7.
[96] Jeswald Salacuse, *The Law of Investment Treaties* (n 9) 267. Korea-Japan BIT influenced by the Asian Financial Crisis.
[97] See UK-Morocco BIT (1990); UK-Bangladesh BIT (1980); UK-Yemen BIT (1982); UK-Turkey (1991); Senegal-UK BIT (1980) etc.
[98] See UK-Morocco BIT (1990); UK-Bangladesh BIT (1980); UK-Yemen BIT (1982). However, the most recent of which is the Rwanda-UK BIT (2008).
[99] US-Uruguay BIT Article 7

6.2.2.1 **Economic and Financial Crisis including Balance of Payment Exceptions**.

Balance of Payment exception clauses allows host States to temporarily prevent transfer of funds to protect currency reserves. Most BITs do not provide for this exception. For instance, the US BITs do not contain BOP exceptions.[100] Research reveals that economic and financial exceptions which are provided for in few US BITs are prudential carve-outs which do not permit transfer restrictions.[101] Some of these carve-outs can be found in the Tunisia-US BIT (1990) and Rwanda-US BIT[102] In contrast, several other developed countries such as Germany and the UK as earlier mentioned sometimes include BoP or other financial/economic crisis exceptions in their BITs.[103] Other developed States with BoP/economic crisis exceptions to free transfer include Japan,[104] Netherlands[105] etc.

Remarkably, the OECD included BoP exceptions to the OECD Code on Liberalisation of Capital Movement. The provision permits transfer restrictions in respect to BoP challenges.[106] Also, under the GATS, restrictions are permitted to both capital and current transactions as safeguards during serious BoP crisis. Ordinarily, current transactions (payments) are not to be restricted,[107] however they can be restricted during circumstances of serious BoP or threats thereof to developing and transition states provided the restrictions are non-discriminatory and consistent with IMFs Articles of Agreement.[108] Article VI (3) IMF Articles of Agreement permits member States the flexibility to impose restrictions on capital account transactions, necessary to regulate international capital movement. Article VIII (2) excludes restrictions on current transactions[109] except in circumstances of currency scarcity and upon consultation with the IMF,[110] or where member State is an economy in transition.[111]

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[100] Efforts to include BoP clauses in US model BITs failed. For more details see Annamaria Viterbo, *International Economic Law and Monetary Measures: Limitations to States' Sovereignty and Dispute Settlement* (n 71) 251-252.
[101] Annamaria Viterbo, *International Economic Law and Monetary Measures: Limitations to States' Sovereignty and Dispute Settlement* (n 71) 251.
[102] Rwanda – US BIT Article 20
[103] UK-Bangladesh BIT Article 6, Mexico – UK BIT, Article 8(4) ; Morocco – UK BIT Article 7.
[104] Japan – Kenya BIT, Article 17.
[105] Netherlands – Serbia BIT, Article 5.
[106] OECD Code on the Liberalisation of Capital Movement, Art. 7
[107] General Agreement on Trade in Services (GATS), Article XI GATS
[108] General Agreement on Trade in Services (GATS), Article XII GATS
[109] International Monetary Fund Articles of Agreement, Article VIII (2).
[110] International Monetary Fund Articles of Agreement, Article VII(3)(b).
[111] International Monetary Fund Articles of Agreement, Article XIV (2).

BoP exceptions in BITs may provide for the situation under which temporary transfer restrictions may be introduced,[112] and/or it could also permit the maintenance of already existing restrictions.[113] The former allows the introduction of new transfer restrictions, where free movement of funds can result in crisis or accentuate same, while the latter permits host States to maintain pre-existing transfer restrictions in a bid to deal with economic or financial crisis including BOP crisis.

The effect of these exceptions to the right to free transfer of funds is that they represent a recognition of the right of host States to exercise macroeconomic independence and flexibility in terms of transfer restrictions and serve as justification for transfer restrictions in the event of an actual or imminent BoP crisis. For instance, Article 6 of the UK- Bangladesh BIT recognises the right of host States to restrict transfers pursuant to powers conferred by its laws during exceptional economic and financial circumstances, provided it is done equitably and in good faith.[114] The terms 'equitably; and 'good faith' are not defined in the BIT. However, it is submitted that provided the restrictive measure is non-discriminatory and non-arbitrary it ought to be justified.

Consequently, if transfer restriction measures which are adopted or maintained by host States to deal with economic crisis are not arbitrary, non-discriminatory, and not excessive they ought not to be in breach of free transfer clauses. Thus, host State's measures restricting the free transfer of capital and payments which affects foreign portfolio investment will not amount to a breach since by their nature and objective they are hardly discriminatory since they usually affect all foreign investors, and are not arbitrary, since they are based on established and tested economic principles. However, this is only applicable to BITs with such exceptions.

Furthermore, economic/financial exception clauses may allow restrictions in the event of BoP crisis, or other exceptional crisis situations where permitting transfer will be detrimental to host State macroeconomic management like in Article 17 of the Japan – Kenya BIT.[115] Here, the BIT requires the restriction measures to conform to the IMF standards, and such measures

[112] For instance, the Mexico-UK BIT 2006, Article 8(4) allows for temporary restriction of transfers during serious Balance of payment crisis.
[113] Japan-Kenya BIT, Article 17 allows a contracting State to adopt or maintain transfer restrictions.
[114] See also Senegal – UK BIT, Article 6; Netherlands – Serbia BIT, Article 5.
[115] Japan – Kenya BIT (2016), Article 17(1); Japan – Vietnam BIT (2003), Article 16(1).

ought not to exceed what is needed to deal with the crises.[116] In essence, it demands that the applicable standard is that of the IMF, thus capital transfers may be permitted to deal with economic crisis, but current transactions are not permitted unless in accordance with IMF Articles of Agreement.

The poignant question will then be what then happens to BITs without economic crisis exceptions since there are almost 2000 BITs without an economic/financial crisis exception? To answer this, we will have to consider other provisions within Transfer of Funds clauses to see if they may offer justification for restrictions when interpreting transfer clauses.

6.2.2.2 **Other Exceptions contained in Transfer Clauses (Credit etc.).**

(i) Restrictions Based on Controlled Entry Clauses:

This could be by subjecting the investor's right of transfer to domestic law. For instance, the China-Djibouti BIT in Article 3 provides that:

> 1, Each Contracting Party shall, subject to its laws and regulations, guarantee to the investors of the other Contracting Party the transfer of their investments and returns held in its territory…:[117]

Furthermore, Annex 11-G of the US – Korea FTA[118] provides that nothing in the chapters on investment, trade in services, and finance should be considered as depriving South Korea the right to apply measures pursuant to Article 6 of Korean Foreign Exchange Transaction Act provided the measures do not exceed one year, are progressively phased out, are published by the Ministry of Finance or Bank of Korea etc. The effect of this provision is that if the host State adopts a macroeconomic policy restricting transfer to mitigate or avert a crisis, or for whatever reason based on existing law, such as the currency exchange law[119], it will be permissible as long it is not inconsistent with the domestic law of the host State. It places

[116] Japan – Kenya BIT (2016), Article 17 (2); Japan – Vietnam BIT (2003), Article 16(2).
[117] China-Djibouti BIT Article 3. See also, China – Germany BIT; Canada – Colombia FTA.
[118] US – Korea FTA 2014, Annex 11.G; Contra with US – Chile FTA, Annex 10.F. It is noteworthy that the US-Chile FTA provides for a 'cooling off' period during which a State is allowed breathing space to address a financial crisis without being subject to ISDS claims by US investors. Afterwards, claims may be brought for damages. However, in a flagrant display of asymmetry in the FTA arrangement, it is only Chile that is subject to such claims by US investors.
[119] If the Argentina – US BIT Transfer clause was drafted in this manner, it would have excused the pesofication law that gave rise to *CMS v. Argentina*, Continental Casualty v. Argentina etc.

discretion on the host State and upholds the right of the host State to regulate economic matters. Salacuse considers this a more balanced perspective but holds that it may create uncertainty regarding how the treaty will be interpreted. It is unclear how this will be the case. This is because the provision subjects the investor's right to free funds transfer to host State's laws and regulations, and as is contended above, free capital movement can only be permissible where the right does not conflict with domestic law and policy. In interpreting the above provisions or similar ones, this must be satisfied before the right to free capital movement can apply. It is suggested that emerging and frontier economies adopts provisions like Annex 11-G of the US – Korea FTA. However, the challenge remains whether capital exporting countries will be willing to be bound by such provisions.[120]

(ii) Issuing, Trading and Dealing in Securities:

Some BITs provide for derogation from guaranteeing free transfer of funds to comply with domestic securities law on issuing, trading and dealing in securities. [121] For instance, the Italy – Mexico BIT in Article 6(3):

> Notwithstanding paragraphs 1 and 2 above, each Contracting Party may prevent a transfer through the equitable, non-discriminatory and in good faith application of measures to protect the rights of creditors, **relating to or ensuring compliance with laws and regulations on the issuing, trading and dealing in securities, futures and derivatives**, reports or records of transfers, or in connection with criminal offences and orders or judgements in administrative and adjudicatory proceedings, provided that such measures and their application shall not be used as a means of avoiding the Contracting Party's commitments or obligations under this Agreement.

The implication of this limitation provision is that where host State's domestic securities law provides for limitations on repatriation of capital and returns such as capital gains, dividends, interests etc., emanating from securities, these limitations will be effective in justifying transfer restrictions. Sometimes, the exceptions are subject to the qualification that the restriction must be applied equitably, non-discriminatorily and in good faith.[122]

[120] US – Chile FTA negotiators tried to include a similar type of provision but failed in the process.
[121] Mexico – Germany BIT, Article 6(3)
[122] See also, Canada-Venezuela BIT (1996), Article VIII.

The issues with these other exceptions are that firstly, what are their effect in relation to the IMF Articles of Agreements which allows capital controls, but limits current transactions (payments) restrictions, unless in very limited circumstances.[123] It is submitted that for the purposes of investment arbitration, where domestic securities law safeguards host State capital and current restrictions based on BIT/Investment Chapter, then such safeguards ought to be upheld because such safeguard within the BIT/Investment chapter constitutes *lex specialis*, and upholds broader policy space for emerging and frontier economies.[124]

Furthermore, and as has been discussed earlier, there are usually no definitions or interpretation of what the terms 'equitably, non-discriminatorily and in good faith' may mean. However, it is submitted that where BITs contain such words qualifying the application of the exceptions, provided the host State's actions restricting transfer to prevent or mitigate crisis was not done arbitrarily and discriminatingly, such restrictive measure based on domestic securities law or controlled entry clauses should not be deemed to be in violation of Transfer of Funds clause. Consequently, foreign portfolio investments affected by host State transfer restriction measures based on domestic laws cannot claim breach of transfer protection where BIT permits such exceptions, and the restrictive measure was not arbitrarily exercised.[125] In these few instances, transfer of fund clauses within BITs may provide better macroeconomic policy independence and flexibility.

Aside exceptions contained within transfer of funds clauses, some BITs contain general exception clauses which provide even broader policy space. This will be considered in depth in the next chapter.

6.3 The Problem of MFN and Transfer of Funds Obligations

Where exceptions and limitations exist, or where an unrestricted right to capital mobility is not available, MFN clauses if available within a BIT/Investment Chapter could be used to import and impose an unrestricted right to capital movement from the host State's BIT with a different 3rd party home State.

[123] International Monetary Fund Articles of Agreement, Article VII(3)(b) & Article XIV(2)
[124] *Gabčikovo-Nagymaros Project, Hungary v Slovakia* [1997] ICJ Rep 3, ICGJ 65 (ICJ 1997), 5th February 1997, United Nations [UN] para 132. Rules governing specific subject matters will take precedence over rules regulating general matters.
[125] Mexico – Germany BIT, Article 6(3)

Most Favoured Nation Treatment standards are contingent standards i.e., the determination of a breach of MFN will be based on the existing rules and manner domestic investors, or other foreign investors are treated. MFN standards are mutable if their reference points (rules and treatment of other foreign investors) changes. For instance, if the host State accords more favourable treatment to a 3rd party foreign investor in another BIT, that favourable standard of treatment of the 3rd party foreign investor will be expected to be accorded to an instant foreign investor. However, a foreign investor cannot claim breach of MFN if the 3rd part foreign investor is treated the same way. Extending more favourable investment protection to a 3rd party foreign investor, may result in foreign portfolio investors relying on MFN clauses to import alleged favourable investment protection conditions to a BIT without such investment protection. This will be permissible on the basis that better protection was extended to the investment of a 3rd party home State than the foreign portfolio investment home State, thereby breaching the MFN clause.

MFN clauses can be used to replace an existing substantive standard of protection with another which contains more favourable provisions. In *CME v, Czech Republic,*[126] the tribunal agreed to rely on the MFN clause in the Czech-Netherland BIT[127] to replace a compensation requirement in the expropriation clause of the same Czech-Netherland BIT[128], with the compensation requirement for expropriation in the Czech-US BIT[129] which was considered as more favourable.[130] Consequently, a foreign portfolio investor can potentially rely on an MFN clause to import a very broad transfer clause with no exceptions from another BIT executed by the host State with a 3rd party State.

Furthermore, MFN clauses could also be used to import non-existent substantive standards in a BIT under review, from another 3rd party BIT. In *Bayindir v. Pakistan,*[131] the tribunal imported an FET clause from another BIT. The tribunal however reached this decision upon consideration of the BIT in dispute including the preamble. Since the BIT preamble referred to FET, and the MFN clause was vague enough to permit the importation.[132] What this means is

[126] *CME Czech Republic B.V. v. The Czech Republic*, UNCITRAL Award 14 March 2003.
[127] Czech-Netherland BIT (1991) Article 3(3)
[128] Czech-Netherland BIT (1991) Article 5(c).
[129] Czech-US BIT (1991) Article III (1).
[130] *CME Czech Republic B.V. v. The Czech Republic* para 500.
[131] *Bayindir .v. Pakistan* ICSID Case No. ARB/03/29 Decision on Jurisdiction (14 November 2005)
[132] *Bayindir v. Pakistan* see para 207; 228-232. See also, *MTD Equity v. Chile* para 104. Here the tribunal justified the importation since the imported provision was consistent with the object and purpose of the BIT under review as contained in its preamble.

that even in situations where a transfer clause is absent in a BIT,[133] claimants can rely on an MFN clause to import wholistically a Transfer Clause from another treaty between the host State and a 3rd party, provided the Claimant finds a way of construing unrestricted movement of capital in the preamble to justify resort to MFN. However, it may be possible where the preamble expresses the desire of both parties to create favourable conditions for investments, just like in some UK BITs.[134]

A potential solution may be to adopt what is provided in the Canadian BITs[135] which is like Article 1109(3) NAFTA[136] that removes any obligation on foreign investors or excuses them from any penalties if they don't transfer funds into their home State.[137] However, the reason behind foreign portfolio investors' need for unrestricted transfer is probably not down to home State pressure, rather as mentioned earlier, the objectives may be to obtain raw materials or infrastructure, secure services, make payments, service debts, transfer profits or divest from the host State economy. Therefore, this provision may not go a long way in dealing with MFN clauses, primarily because the foreign investor may proceed to import a significantly more favourable transfer clause.

Non-inclusion of MFN clauses in BITs/Investment Chapters like the SADC Model Treaty[138] and the Indian Model BIT[139] could be another solution. Here, the foreign portfolio investor will have no recourse to MFN, therefore will be unable to invoke unrestricted transfer from 3rd party BIT when the instant BIT contains limitations to unrestricted funds transfer. This appears to be the most effective means of dealing with MFN clauses. However, it is of no value to extant BITs containing MFN clauses.

Nevertheless, denying foreign portfolio investments jurisdictional access through the realisation and recognition that portfolio investments ought not to be investments within the

133 There are only 12 treaties without Transfer of Fund Clauses and only 9 of them are still in force. See https://investmentpolicy.unctad.org/international-investment-agreements/iia-mapping Accessed 28/6/2022.
134 See Bangladesh – UK BIT 1980, Preamble; Egypt – UK BIT 1975, Preamble; Bosnia – UK BIT, Preamble.
135 See Article VIII (3) of Canada-Venezuela BIT (1996); Canada – Nigeria BIT 2014, Article 11(4).
136 Now Article 14.9 (3) USMCA
137 Jeswald Salacuse, *The Law of Investment Treaties* (n 9) 261.
138 SADC Model Treaty 2012 https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2875/download
139 https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/3560/download

contemplation of ICSID Arbitration since they can constrain macroeconomic flexibility[140] which is detrimental to economic growth, will render otiose, all substantive issues of the applicability of Transfer of Funds standard of protection or its importation through the back door using MFN clauses. In *Societe Generale v. Dominican Republic,* [141] the tribunal held that MFN does not apply to definition of investments, but to treatments accorded to 'defined investments.'[142] What this means is that expansion of jurisdiction *rationae materia* by claimant through MFN is not permitted.[143] Thus, before a foreign portfolio investor can take advantage of an MFN clause, the investor ought to have made an investment as defined and covered by the BIT. It has been demonstrated in Chapter Four[144] that provided the BIT refers the dispute to ICSID, ICSID's definition of an investment will be determined first before resorting to the BIT. Thus, under ICSID, it has been submitted that foreign portfolio investments ought not to be considered as investments. Consequently, portfolio investors will be unable to rely on MFN clauses to replace or expand seemingly favourable transfer of funds clauses because of the jurisdictional threshold that needs to be crossed.

6.4 **Conclusion**

Consensus exists to the effect that there is a correlation between liberalised capital movement and economic/financial crisis.[145] Consequently host States must have the right to intervene by adapting macroeconomic measures such as transfer restrictions which may be harmful to foreign portfolio investments but are necessary for mitigating or preventing economic/financial crisis. These safeguards could be in the form of exceptions contained within Transfer of funds clauses in BITs.[146] Some BITs contain exceptions to transfer clauses. These exceptions include specialised exceptions which forms part of the transfer clause.[147]

[140] As strenuously contended in Chapter 3 of this Thesis, the host State measures/treatment which are the complaints of foreign portfolio investors are usually macroeconomic policies. Seeking to review such measures with ISDS is a threat to macroeconomic flexibility, and potentially economic growth.

[141] *Société Générale In respect of DR Energy Holdings Limited and Empresa Distribuidora de Electricidad del Este, S.A. v. The Dominican Republic*, UNCITRAL, LCIA Case No. UN 7927 Award on Jurisdiction 19 September 2008.

[142] *Société Générale In respect of DR Energy Holdings Limited and Empresa Distribuidora de Electricidad del Este, S.A. v. The Dominican Republic* para 41

[143] Ibid

[144] For a detailed discussion on Jurisdiction *Rationae Materia* of Foreign portfolio investments see Chapter Four of this Thesis.

[145] Ricardo Hausmann & Eduardo Fernandez Arias, 'Foreign Direct Investment: Good Cholesterol?' (n 6) 3; United Nations Conference on Trade and Development, *Trade and Development Report* (n 6)112-113.

[146] For instance, see UK-Bangladesh BIT (1980) Article 6; Morocco – UK BIT (1990) Article 7.

[147] For instance, the Mexico-UK BIT (2006), Article 8(4) allows for temporary restriction of transfers during serious Balance of payment crisis.

This Chapter argued that where specialised exceptions are included in transfer of fund clauses in BITs/Investment Chapters, they tend to offer space for host State macroeconomic flexibility in imposing transfer restrictions, sometimes even better than the International Monetary Fund, and the World Trade Organisation. However, autonomy and flexibility to restrict transfer may be constrained by the effect of MFN clauses. However, possible solutions include, removing any obligation or penalties on foreign investors if they don't transfer into the host State;[148] or removing MFN completely from BITs/Investment Chapters.

[148] Jeswald Salacuse, *The Law of Investment Treaties* (n 9) 261, See Canadian Model BIT and Article 1109(3) NAFTA

Chapter Seven

Emergencies Exceptions and a Proportionality Analysis of Foreign Investment Protection of Foreign Portfolio Investment Protection.

7.0 Introduction

98% of BITS offers recognition and protection for foreign portfolio investments. 95% of BITs provides for ISDS enforcement. 14% offers exceptions in times of macroeconomic crises, and 4% provides for 'prudential carve-outs'[1]. The effect of this is that there exists limited flexibility for host State interventions in the face of impending crisis or existing crisis. Interestingly, most BITs with host State flexibilities are treaties amongst emerging and frontier economies themselves.[2] Developed countries tend not to provide for these safeguards in their investment treaty practice. As a result, BITs between developed economies and emerging/frontier economies tend to reflect the preferences of the developed economy because of the socialising effect and power asymmetry existing between both parties.[3]

Consequently, it is fundamental that other means and options for flexibility are considered, all of which must be relevant and applicable under ISDS. The options considered under this Chapter include the customary international law plea of necessity; plea of fundamental change of circumstances codified under Article 62 of the Vienna Convention on the Law of Treaties[4]; non precluded measure clauses in BITs/Investment Chapters and proportionality analysis.

The issue with the customary international law plea of necessity and plea of fundamental change of circumstances codified under Article 62 of the Vienna Convention on the Law of Treaties options is that they could present obstacles for host States. However, where safeguards exist in the form of general and/or specialised exceptions within BITs/Investment Chapter, macroeconomic measures affecting foreign portfolio investments can be justified. Analysis of general and specialised exceptions (non-precluded measures clauses) with necessity requirements will be done in reliance on the 'Least Restrictive Means' approach within proportionality analysis framework to review emerging and frontier economies'

[1] Rachel D Thrasher, Sarah Sklar, Kevin P Gallagher, 'Policy Space for Capital Flow Management: An Empirical Investigation' (2021) 24(4) Journal of International Economic Law 780. See also UNCTAD Mapping Investment Treaties in UNCTAD Investment Policy Hub.

[2] These are treaties recognising host States' right to regulate, and with safeguard/exception provisions.

[3] Zachary Elkins, A Guzman & B Simmons, 'Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960 – 2000' (2006) Berkley Program in Law and Economics Annual Papers.

[4] United Nations, Vienna Convention on the Law of Treaties, 23 May 1969, United Nations, Treaty Series, vol. 1155 Entry into force: 27 January 1980, Article 62(1).

macroeconomic measures based on their necessity and the extent of their restrictiveness on the foreign portfolio investor's rights. This is to determine whether a contested host State macroeconomic measure is the most objectively necessary means to effectively achieving its objective, or whether an equally effective but lesser restrictive alternative is available.[5] A State macroeconomic measure will not be deemed necessary and justifiable where an alternative measure consistent with investment protection, is available to the State, and could reasonably be adopted.[6] However, alternative measures which are theoretical, ineffective towards the covered objectives, or would place undue burden on the State in terms of cost and technical difficulties are excluded.[7] Consequently, in the absence of an equally effective and less-restrictive alternative measure, or where present, but affected by the afore-mentioned limitations, the State macroeconomic measure will be considered to be necessary even though detrimental to the protected right or interest under the treaty.[8]

Where no exception is contained in BITs/Investment Chapters, which happens to be the case in most BITs as previously stated above, it is submitted that a general proportionality analysis approach should be adopted. Proportionality analysis will require a consideration of the objectives and purpose of the macroeconomic measure in issue towards a balancing of private rights with public welfare. A simple logic will be applied to wit; what are the likely consequences for economic growth and social welfare if host State do not exercise their rights to intervene especially in the face of present or imminent crisis? Given that the basic idea of the 'grand bargain' in IIAs is that foreign investments will contribute to economic growth, protection standards should only apply to investments whose protection will not constrain State economic flexibility and endanger economic growth and social welfare. Additionally, foreign portfolio investors do not bear the negative externalised costs attendant to extending investment protection to foreign portfolio investments. Rather the negative externalities in such circumstance are internalised by the host State citizens who will be affected by investment

[5] Andrew D. Mitchell & Caroline Henckels, 'Variations on a Theme: Comparing the Concept of "Necessity" in International Investment Law and WTO Law (2013) 14(1) Chicago Journal of International Law 98; Manu Misra, 'Necessity Defence & Continental Casualty: Importation of WTO Principles at the ICSID [2015-2016] 2 McGill Journal of Dispute Resolution 133.

[6] *Continental Casualty Company v. The Argentine Republic* (ICSID Case No. ARB/03/9) Award, 5 September 2008 para 195.

[7] World Trade Organisation Report of the Appellate Body, *United States-Measures Affecting the Cross Border Supply Gambling and Betting Services* WT/DS285/AB/R (7 April 2005) para 308; World Trade Organisation Report of the Appellate Body, *European Communities-Measures Affecting Asbestos-Containing Products* WT/DS135/AB/R (12 March 2001) para 172-174.

[8] *Continental Casualty Company v. The Argentine Republic para 198*

protection induced macroeconomic policy chill, where flexibility and independence are necessary to deal with a crisis.

On that note, this Chapter is divided into five (5) parts. Part I introduces the chapter. Part II explores the applicability of substantive standards of protection clauses to host State macroeconomic measures affecting portfolio investments in the face of the customary plea of necessity, and the doctrine of fundamental change of circumstances under Article 62 VCLT. Part III examines general and specific NPM clauses in BITs and argues among other things that where NPM clauses contains necessity requirements, an LRM approach provides the most objective option of preserving host State regulatory space for macroeconomic measures in times of economic crisis without breaching substantive protection clauses. Part IV contends that where emerging and frontier economies BITs/Investment Chapters do not contain any exception clauses, proportionality analysis should be resorted to ensure an objective balancing of the conflicting rights since such review will result in preserving host State regulatory space for macroeconomic measures in times of economic crisis without breaching substantive protection clauses. Part V concludes the Chapter.

PART II

7.1 Applicability of Substantive Standards of Protection to Portfolio Investments: A Review of Necessity under Customary International Law codified in Article 25 ILC RSIWA

The defence of necessity is used to distinguish permissible measures from prohibited measures which violates substantive protected rights such as FET over covered investments.[9] The defence of necessity could be invoked based on a customary plea of necessity arising from Customary International Law codified under Article 25 Responsibility of States for International Wrongful Acts (RSIWA) for the determination of permissible measures that could limit protected rights or interests such as free trade or investment protection.

The customary plea of necessity is provided in Article 25 RSIWA. It states that:

Article 25[10]: Necessity

[9] Tacissio Gazzini et al, 'Necessity across International Law: An Introduction' (2010) 41 Netherlands YB International Law p. 3.
[10] Responsibility of States for International Wrongful Acts (RSIWA) (2001), Article 25(1) & (2).

> 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.

Article 25 RSIWA operates as a secondary rule under international law. It is applied to determine whether a State's measure such as a macroeconomic measure in violation of an international obligation is excused.[11] Article 25 permits under exceptional situations, for a State to undertake measures that may be detrimental to a protected right or interest. It serves as an excuse for host State measures deemed as wrongful or considered as being in breach of an international instrument, (in this case: an investment agreement) if the state measure is consistent with its provisions. It acknowledges the relevance of according regulatory autonomy to States over their interests under exceptional circumstances, to the detriment of investment protection provided the State measure undertaken is the 'only way' of addressing the situation, and the State did not contribute to the creation of the situation.[12] Though, it may serve to preserve regulatory autonomy, it imposes a stringent requirement in terms of mandating the measure to being the 'only way' of addressing the exceptional circumstance. Bringing it home to this thesis in terms of host State macroeconomic measures directed at economic crisis or imminent economic crisis, application of the customary plea of necessity will be quite challenging,[13] given the preponderance of macroeconomic policies that could be adopted during a crisis, or to avert a crisis. Furthermore, there exists a likelihood that the economic crisis was created by or set in motion by the State under a previous administration.

However, where there exist specific rules for the determination of State liability under international law, Article 25 RSIWA will be inapplicable.[14] Article 55 RSIWA provides that:

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[11] August Reinisch, 'Necessity in Investment Arbitration' (2010) 41 Netherlands YB International Law 156.
[12] Article 25 RSIWA; ILC DARSIWA p. 80.
[13] Stephen Schill, International Investment Law & Host State's Power to Handle Economic Crisis (2007) 280-281. Owing to the stringency of the 'only way' requirement under a customary plea of necessity, especially as it relates to economic measures, reliance is best had to NPM clauses.
[14] Responsibility of States for International Wrongful Acts (RSIWA) (2001), Article 55.

> These articles do not apply where and to the extent that the conditions for the existence of an internationally wrongful act or the content or implementation of the international responsibility of a State are governed by special rules of international law.

The above provision is aptly consistent with the principle of '*lex specialis'* which holds that rules governing specific subject matters will take precedence over rules regulating general matters.[15] In *Gabcikovo-Nagymaros,[16]* the ICJ refused to recognise a customary law defence, but it held that the parties' relationship was regulated by the 'applicable rules of the…Treaty as *lex specialis.* In the same vein, in *Continental Casualty,* the arbitral tribunal held that Article 25 RSIWA did not apply, rather, the non-precluded measure (NPM) clause established under Article XI of the Argentina-US BIT did.[17] Thus, where international legal regimes contains their own provisions on necessity as an excuse, which determines what constitutes permissible measures that could interfere with protected rights, such regime will be applicable.[18] Consequently, where there are more than one possible macroeconomic measures for managing crisis, and BIT provides for general exceptions, an emerging/frontier economy is likely to fall short of the customary plea of necessity.

7.2 Applicability of Substantive Standards of Protection to Portfolio Investments: An Analysis of the Fundamental Change of Circumstances Doctrine under Article 62 VCLT.

It has been argued that the doctrine of fundamental change of circumstances can also operate as a justification for economic measures undertaken by Host States and alleged to be in violation of investment treaty standards.[19] The doctrine of fundamental change of circumstances is provided under Article 62 of the Vienna Convention on the Law of Treaty.[20] It states that:

> 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

[15] Hugh Thirlway, 'The Sources of International Law' *in* Malcolm D. Evans (ed) *International Law* (OUP, 4th edn 2014).
[16] *Gabčikovo-Nagymaros Project, Hungary v Slovakia* [1997] ICJ Rep 3, ICGJ 65 (ICJ 1997), 5th February 1997, United Nations [UN] para 132.
[17] *Continental Casualty Company v. The Argentine Republic para* 162-167.
[18] Responsibility of States for International Wrongful Acts (RSIWA) (2001), Article 55
[19] Orhan Bayrak, 'Economic Crises and the Fundamental Change of Circumstances in Investment Arbitration' (2020) 35(1) ICSID Review 132-133.
[20] United Nations, Vienna Convention on the Law of Treaties, 23 May 1969, United Nations, Treaty Series, vol. 1155 Entry into force: 27 January 1980, (VCLT) Article 62.

> (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.

Where there has been a fundamental change in circumstances between parties to a treaty, it could be a basis for the withdrawal, termination or suspension of the operation of the parties' obligations if the change in circumstance was not foreseen; the existence of the circumstance was the essential basis for the parties to consent to be bound by the treaty; and the effect of the change has fundamentally altered the performance of obligations under the treaty. It will not apply where the fundamental change was the consequence of a breach of the treaty or any international obligation, by the party seeking to rely on it; or the treaty establishes a boundary.

Accordingly, given the applicable law within investment arbitration is international law as decided by the parties[21] or by tribunal discretion[22], and the doctrine of fundamental change of circumstances is part of public international law.[23] Bayrak, rightly pointed out that the presence of exception clauses clause within BITs/Investment Chapters if available renders the doctrine under Article 62 VCLT inapplicable where the exception clause has foreseen the likelihood for change in circumstance such as host State measures necessary in the public interest, and expressly justifies it within the BIT/Investment Chapter.[24]

However, Bayrak was unable to reconcile the procedural requirement for reliance on the doctrine of fundamental change in circumstance contained in Article 65 and 67 of the VCLT,

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[21] Party autonomy as contained in BITs and other plurilateral and multilateral treaties.

[22] ICSID Convention, Article 42(1).

[23] Article 38(1) ICJ Statutes provides for the sources of international law which are: international conventions; customary international law; and general principles of law recognised by civilised States. Orhan Bayak makes the case that the doctrine of fundamental change of circumstances checks all the boxes since it is codified under Article 62 VCLT; it constitutes customary international law owing to historical evidence of State Practice of reliance on it to excuse performance, and its considerable acceptance as can be seen in the *Fisheries Jurisdiction case (United Kingdom v. Iceland),* Judgment on Jurisdiction [1973] ICJ Rep 3, 18 para 36; and the fact that it is a recognised principle of law among nations akin to the doctrine of frustration. See Ohran Bayrak, 'Economic Crises and the Fundamental Change of Circumstances in Investment Arbitration' p. 135-143.

[24] Ohran Bayrak, 'Economic Crises and the Fundamental Change of Circumstances in Investment Arbitration' (n 19) 145; Thomas Giegerich in Oliver Dorr and Kirsten Schmalenbach (eds), *The Vienna Convention on the Law of Treaties: A Commentary* (Springer 2nd Edn, 2018).

and the recourse to investor-State arbitration. Under Article 65, a party seeking to withdraw from a treaty, or suspend the operation of a treaty in accordance with the VCLT, must notify the other parties of its intention, and the reasons for it.[25] It goes on to provide that after the expiration of a period not less than three months from the date of the notification, and no party objects, the party seeking to withdraw or suspend the operation of the treaty, may withdraw or suspend the operation of the treaty[26] by an instrument signed by the Head of State.[27] Where a party objects, the ensuing dispute may be settled by negotiation, mediation, arbitration, regional agencies or arrangements.[28] This is without prejudice to the right or obligation of parties under a provision in the treaty relating to settlement of disputes.[29]

Article 65 imposes a condition precedent upon which a party can invoke the provisions of Article 62 to suspend the operation of a treaty. Within this procedure, it is only when the other party objects to the withdrawal or suspension, that resort can be had to dispute settlement regimes. To contextualise this within international investment law, a host State that wish to rely on Article 62 VCLT to suspend the operation of a substantive standard, must notify the foreign portfolio investor home State of its intention, and it is only where the home State does not object that the host State can issue an instrument suspending the operation of the treaty. However, where the home State objects, the parties can settle the emerging dispute based on the consensual mechanism within the treaty (investment arbitration), or through other mechanisms provided in Article 33 UN Charter.[30]

This presents a couple of issues. Firstly, the home State and the host State must have ratified the VCLT, because it applies to only signatories.[31] Furthermore, there is no guarantee that the home State will not object to the withdrawal or suspension. Also, it is not clear whether, the host State is expected to make the notification before the foreign portfolio investor commences the claim, or during the claim, before, or after it files its counter-memorial.[32] Finally, given that

[25] VCLT (1969), Article 65(1).
[26] VCLT (1969), Article 65(2).
[27] VCLT (1969), Article 67
[28] VCLT (1969), Article 62(3); United Nations Charter, Article 33
[29] VCLT (1969), Article 62(4).
[30] VCLT (1969), Article 62(3).
[31] VCLT (1969), Article 34; Jonathan Charney, 'Universal International Law' (1993) 87 AJIL 534.
[32] Counter-memorial is the pleadings filed by the respondent in response to the claimant's memorial. See Convention on the Settlement of Investment Disputes between States and Nationals of other States 1965 Arbitration Rules, Rule 31.

host States have only duties and no rights in most BITs/Investment Chapters,[33] it is doubtful if the host State can institute a separate claim, or a counter-claim[34] in investment arbitration against the investor or home State, if the home State objects to the withdrawal or suspension of the IIA. At best, it could result in a separate State-State arbitration dispute whose outcome may not be accorded weight by the investor-State arbitration claim between the portfolio investor and the host State, if determined before the final award of the investor-State arbitration claim.

Substantively, Article 62 VCLT requires that '*the existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty'*[35]. It will be quite a challenge to demonstrate that the macroeconomic conditions present within the State parties was the fundamental basis for the State parties to enter the BIT, particularly where the BITs where entered a while ago, and the host State has experienced several macroeconomic changes. More so, since the *travaux*, and other negotiation documents are difficult to find or are even non-existent,[36] to illuminate on what the essential basis for the BIT/Investment Chapter was. Interestingly, where the preamble to a BIT indicates for instance economic development as a fundamental basis for parties' consent, a radical change in economic conditions which affects the ability of the host State to abide by the foreign portfolio investor's protected right, might suffice. Though reliance may get caught up by the procedural requirements.

Constructively, having identified the above potential challenges, reliance on Article 62 VCLT may not be an effective justification for host State macroeconomic measures that affected portfolio investors protected rights.

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[33] United Nations Conference on Trade and Development (UNCTAD), World Investment Report 2015: Reforming International Investment Governance 130; Ted Gleason, 'Examining host-State counterclaims for environmental damage in investor-State dispute settlement from human rights and transnational public policy perspectives' (2020) International Environmental Agreements; Y Kryvoi, 'Counterclaims in Investor-State Arbitration. (2012) 21(2) Minnesota Journal of International Law 216–252

[34] Host States may institute counterclaims under ICSID. See Convention on the Settlement of Investment Disputes between States and Nationals of Other States 1965, Article 46.

[35] VCLT (1969), Article 62(1)(a).

[36] Esme Shirlow & Michael Waibel, 'A Sliding Scale Approach to Travaux in Treaty Interpretation: The Case of Investment Treaties' (2021) The British Yearbook of International Law 5

Part III

7.3 Applicability of Substantive Standards of Protection Portfolio Investments: Non-Precluded Measures (NPM) Clauses in International Investment Agreements.

Certain international treaty-based regimes contain provisions which highlights State regulatory objectives that gives rise to legitimate and permissible measures necessary for achieving such regulatory objectives, though they may affect protected rights. Instances of these regimes include Article XX of the GATT[37]; Article XIV GATS[38]; Article 36 EU Treaty[39]; and Non-Precluded Measure clauses (NPM) in international investment agreements (IIAs).[40]

Within these regimes, the consistent mode of determining whether a measure is necessary is generally through a 'least restrictive means' approach akin to proportionality analysis.[41] Under this regime, for a State's measure to be adjudged as necessary, it has to achieve the regulatory objective of the State, as well as be the least restrictive macroeconomic measure on the rights or interest of the claimant under the regime.[42] What this means is that the State measure has to be geared towards achieving legitimate regulatory objectives under the regime such as public peace and security, public morality etc., and where there are alternative measures capable of achieving the same objectives, the State measure must have the least restrictive effect on the foreign portfolio investor's right - for the measure to be justified. That is, in the context of the investment regime, it must be the least constraining to foreign portfolio investor's right to substantive protection,[43] such as FET and Transfer of Funds standards. Therefore, if there exists an alternative measure capable of achieving the same results, and which would affect investor's right to a lesser degree, the challenged measure will not be deemed to be necessary. The treaty-based regime relevant for the application of the least restrictive means approach are non-precluded measures clauses (NPM) under the international investment law regime which will be discussed subsequently below.

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[37] General Agreement on Tariffs and Trade, Article XX.
[38] General Agreement on Trade in Services, Article XIV.
[39] Treaty on European Union, Article 36, 2002 (EU Treaty) It enumerates permissible reasons for derogation of free movement of goods which includes public morality, public policy, public security, protection of health and life of humans etc.
[40] Argentina-US BIT Article XI;
[41] Proportionality analysis is "a decision-making procedure and an 'analytical structure' that judges employ to deal with tensions between two pleaded constitutional 'values' or 'interests' See A. Stone Sweet and J. Matthews, "Proportionality Balancing and Global Constitutionalism", Columbia Journal of Transnational Law 2008-09, (72) 75
[42] Aharon Barak, *Proportionality: Constitutional Rights and Their Limitations* (CUP, 2012) 317.
[43] *Op.cit.* 317, 321-323.

NPM clauses in BITs/Investment Chapters such as Article XI Argentina-US BIT functions as a primary norm under international law because they recognize and establish objectives upon which State measures may be permissible.[44] They create exceptions to State obligations to standards of treatment, thereby expanding the host State regulatory space,[45] and reversing the 'general allocation of risks of state measures impacting investments from the State to the investors.'[46]

NPM clauses can be found in some international investment agreements,[47] including some treaties entered into by the United States of America (US),[48] Canada,[49] Germany,[50] India etc.[51] Permissible/legitimate objectives under general NPM clauses include: peace and security;[52] public order;[53] public health and environmental and natural resources conservation[54]; prudential/financial measures[55] etc.

7.3.1 Analysis of Specific Financial/Economic Sector NPM Clauses in International Investment Agreements.

Where there are specific non-precluded measures such as prudential or financial measures carve-out clauses in IIAs, host States may rely on such clauses to justify macroeconomic measures for prudential purposes taken by the host State to depart from substantive standard obligations, to achieve the desired objective. Out of the 2500 IIAs that have been mapped by the United Nations Conference on Trade and Development's (UNCTAD) IIA mapping

[44] Manu Misra, 'Necessity Defence & Continental Casualty: Importation of WTO Principles at the ICSID (n 5) 13.
[45] *Continental Casualty Company v. The Argentine Republic para 162-167.*
[46] William W. Burke-White & Anor, 'Investment Protection in Extraordinary Times: The Interpretation of NPM Provisions in BIT' (2008) 401-402.
[47] Kenneth Vandevelde, 'Rebalancing through Exceptions' (2013) Lewis & Clarke 454 He makes the point that the effect of the exceptions in NPM clauses does not just weaken the obligations, they extinguish them. In essence, over-balancing the regime. Thus, exceptions should be adopted carefully.
[48] For instance, See, Albania-US BIT (1995).
[49] For Instance, See, Armenia-Canada BIT (1997).
[50] For instance, See, Argentina-Germany BIT (1991)
[51] UNCTAD, Trends in Investment Rulemaking (2007) 172; Suzanne A. Spears, 'The Quest for Policy Space in a New Generation of IIAs (2010) 1043-1044.
[52] Albania-US BIT (1995); Argentina-US BIT (1991); Belarus-India BIT (2002); Canada-Nigeria BIT (2014) etc.
[53] Argentina-Germany BIT (1991); Canada-Senegal BIT (2014); Germany-Nigeria BIT (2000) etc.
[54] Argentina-New Zealand BIT (1999); Canada-Nigeria BIT (2014); Germany-Nigeria BIT (2000) etc
[55] Armenia-Canada BIT (1997); Canada-Czech Republic BIT (2009); India-Japan EPA (2011); Japan-Ukraine BIT (2015); US-Uruguay BIT (2005), Article 20(2)(a) etc. However, it is noteworthy that Prudential carve-outs in US BITs are considered not to excuse transfer restrictions.

project,[56] only 112 IIAs[57] contain specific financial and economic NPM carve out.[58] Thus, it is only available to less than 10% of extant BITs/Investment Chapters operating within the international investment regime. For instance, the General Agreement on Trade in Services (GATS) Annex on Financial Services which has been adopted by some BITs[59] provides that:

> Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement.[60]

Categories of specialised NPM clauses could justify host State economic/financial measures aimed at prudential reasons[61] just like the Armenia-Canada BIT;[62] or be aimed at dealing with purely macroeconomic issues such as serious balance of payment difficulties or threats; or monetary and exchange rate challenges like in the Australia-Japan BIT;[63] or combine a bit of both like in the Azerbaijan-Hungary BIT (2007).[64] In some situations, the measures will only be permitted temporarily until the situation improves;[65] or the clause becomes inapplicable where the measure is inconsistent with provisions of the BIT to prevent abuse.[66] Where the measure is required to be temporary, it may be difficult determining the exact point where the

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[56] UNCTAD IIA Mapping Project is a collaboration between UNCTAD and various universities around the world to outline the contents of IIAs in a database for policymakers, researchers, and other stakeholders to be abreast with IIA policy, practice and trends. See UNCTAD University Mapping Project https://worldinvestmentforum.unctad.org/programme2016/international-investment-agreements-conference-2016/unctad-iia-mapping-project/

[57] See Armenia-Canada BIT (1997) Article XI; ASEAN-India BIT (2014), Article 21(2); Australia-Japan EPA (2014); Benin-Canada BIT (2013); Canada-Czech Republic BIT (2009); Colombia-Japan BIT (2012); Denmark-Nicaragua BIT (1995) etc.

[58] https://investmentpolicy.unctad.org/international-investment-agreements/iia-mapping

[59] ASEAN-India BIT (2014), Article 21(2).

[60] Marrakesh Agreement Establishing the World Trade Organisation General Agreement on Trade in Services (GATS) Annex on Financial Services (Annex 1B), paragraph 2(a).

[61] Rwanda-US BIT (2008), Article 20 describes prudential reasons to include: 'maintenance of the safety, soundness, integrity, or financial responsibility of individual financial institutions, as well as the maintenance of the safety and financial and operational integrity of payment and clearing systems.'

[62] Armenia-Canada BIT (1997) Article XI (1); Burkina Faso-Canada BIT (2015) Article 18(2); Chile-Hong Kong, China SAR BIT (2016) Article 18 (2);

[63] Australia-Japan EPA (2014) Article 14.16(1) & (2).

[64] Azerbaijan-Hungary BIT (2007) Article 13 (1) & (2); Rwanda-US BIT (2008) Article 20 (1) & (2).

[65] Iran-Japan BIT (2016) Article 16(1) & (2); Australia-Japan EPA (2014) Article 14.16(1) & (2); Azerbaijan-Hungary BIT (2007) Article 13(2)(b).

[66] Rwanda-US BIT (2008) Article 20 (1); ASEAN-India BIT (2014), Article 21(2); etc.

situation improves. Will it be where the situation returns to pre-crisis position, or will it be determined in degrees and percentages?

Furthermore, in situations where an anti-abuse safeguard is contained in the clause, (i.e., the applicability of the NPM clause depends on the conformity of the measure with treaty provisions), Andrew Mitchell contends that they be construed as imposing a requirement of 'reasonableness' to determine if the measures conflicts with treaty obligations, to prevent the abuse of the NPM clause.[67] From the perspective of Trade Law, the anti-abuse safeguard contained in Article 2(a) (GATS) Annex on Financial Services, which is similarly worded in some BITs is deemed as self-cancelling because of its alleged limited usefulness.[68]

However, the view of Andrew Mitchell that anti-abuse safeguards be construed as imposing a requirement for reasonableness is consistent with the tribunal decision in *Fireman's Fund Insurance Company v. The United Mexican States,*[69] where the Mexican government undertook prudential measures to support financial institutions to avoid collapse during the 1994 Mexican financial crisis. The claimant contended that the decision of the government to facilitate peso denominated debentures in financial institutions without extending same to dollar denominated debentures amounted to expropriation under NAFTA.[70] The government relied on the prudential NPM clause in Article 1410 of NAFTA to justify its action. In interpreting Article 1410 NAFTA, the tribunal observed that it permitted a measure if the measure is reasonable for prudential reasons.[71] Though it was silent on what could constitute prudential reasons. Interestingly, the US do not consider prudential carve-outs as justification for restrictions on movement of funds even where transfer restrictions was undertaken for prudential purposes.[72]

[67] Andrew Mitchell et al., 'Dear Prudence: Allowances under International Trade and Investment Law for Prudential Regulation in the Financial Services Sector' [2016] 16 JIEL 813.
[68] Kevin Gallagher, *Ruling Capital: Emerging Markets and the Reregulation of Cross-Border Finance* (Cornell University Press, 2014) 175-176. See also, Tucker, Todd, and Lori Wallach, 'No Meaningful Safeguards for Prudential Measures in WTO Financial Service Deregulation Agreements' (2009) Public Citizen: Special Pittsburgh G-20 Report 1.
[69] *Fireman's Fund Insurance Company v. The United Mexican States*, Award ICSID Case No. ARB(AF)/02/1
[70] North American Free Trade Agreement (NAFTA) signed 17 December 1992, and effective 01 January 1994. Now repealed and replaced by the Agreement between the United States of America, United Mexican States and Canada (USMCA) signed 30 November 2018, and effective 1 July 2020.
[71] *Fireman's Fund Insurance Company .v. The United Mexican States* para 159.
[72] John B. Taylor, Testimony before the Subcommittee on Domestic and International Monetary Policy, Trade and Technology 7-8 (2003).

Consequently, host State's may rely on these specific financial/economic NPM clauses where available in BITs, when the measures are directed at the specific objectives for which the clause is meant to justify. Clauses exempting measures for prudential reasons,[73] or macroeconomic management[74] will be interpreted to justify measures aimed at such reasons only; and in situations where an anti-abuse safeguard is part of the specialised NPM clause. In the latter situation, the reasonableness of the measure will be considered to determine its permissibility.[75]

As mentioned earlier, these category of NPM clauses are quite uncommon and will be of no use to host State's whose BITs do not provide for these specialised NPM clauses when their macroeconomic measures for prudential or other macroeconomic reasons are being challenged for violating portfolio investors protected rights. However, tribunals may choose to follow the reasoning in *Renee Rose Levy de Levi v. Peru*[76] and justify macroeconomic measures for prudential reasons purportedly in violation of FET, based on their reasonableness. This will be in the form of a proportionality analysis.

Finally, where BITs have no such financial or economic exceptions, but provide for general exceptions, host States can justify their macroeconomic measures taken in times of crisis which allegedly breached foreign portfolio investors' rights. The justification can be based on essential security reasons[77] but will require the application of a least restrictive means approach where a necessity nexus requirement exists.[78] Otherwise, the exception clause must be interpreted in good faith.[79]

7.3.2 Analysis of General NPM Clauses in International Investment Agreements

To escape liability under the NPM clause, the host State must demonstrate that its state measure was necessary, appropriate, or important for the purpose of realising any of the covered objectives. It requires arbitral tribunals in determining whether a State measure is necessary, or appropriate for the applicability of the NPM clause, to consider the right of the investor to investment protection, and the right of the host State to carry out actions towards legitimate

[73] Armenia-Canada BIT (1997) Article XI; ASEAN-India BIT (2014), Article 21(2)
[74] Australia-Japan EPA (2014) Article 14.16(1) & (2).
[75] Andrew Mitchell et al., 'Dear Prudence: Allowances under International Trade and Investment Law for Prudential Regulation in the Financial Services Sector' (n 67) 813.
[76] *Renée Rose Levy de Levi v. Republic of Peru*, Award 26 February 2014, ICSID Case No. ARB/10/17
[77] *LG&E v. Argentine Republic* para 226.
[78] *Continental Casualty Company v. The Argentine Republic para 196-197*
[79] UNCTAD Series on International Investment Policies for Development (2009) Protection of National Security in IIA p. 94-95

objectives covered in the clause.[80] Thus, the wider the scope of host State's permissible objectives, the greater the flexibility for host States to regulate in the public interest.[81]

NPM clauses envisages a 'nexus requirement' for its application to the effect that a nexus must exist between the host State's measure and its desired objective as contained in the clause.[82] There is no mandatory form which it must take. The NPM clause may require the measure to be 'necessary for',[83] or 'necessary to' achieve the host State's permissible objective, 'in 'pursuance of'[84] or 'for'[85] etc. According to Andrew Mitchell and Caroline Henckels, the nexus requirement does not only determine the relationship between the host State measure and the permissible objective, but also indicates the degree of scrutiny to be adopted by the tribunal.[86] Thus, a nexus requirement of 'necessary to' or 'necessary for' may require an adoption of the least restrictive means analytical approach, when compared to other representations in an NPM clause such as 'for' or 'in pursuance of' which may require a more flexible nexus requirement.[87] Where the NPM clause makes no reference to 'necessary' or 'necessity' but requires the measure to be 'for' or appropriate for etc., it provides a wide ambit for regulatory autonomy, and allows parties the leeway to adopt measures which they consider appropriate to achieving the objective.[88]

Consequently, the representation of the nexus requirement will determine the mode of analysis to be adopted by the tribunal. What this means is that where an NPM clause makes no reference to necessity, host State macroeconomic measures affecting portfolio investors substantive protection rights may be excused, provided the measures were deemed appropriate. It operates somewhat as a self-judging clause. Here, the host State is allowed to exercise discretion within the scope of the clause to decide the measure, and its appropriateness for preventing or

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[80] Suzanne A. Spears, 'The Quest for Policy Space in in a New Generation of IIAs' (n 51) 1059-1060.
[81] William Burke-White & Andreas von Staden, 'Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties' (2008) 48 Virginia Journal of International Law 329-340.
[82] Manu Misra, 'Necessity Defence & Continental Casualty' (n 5) 132-133.
[83] Albania-US BIT (1995), Article XIV; Argentina-US BIT (1991), Article XI.
[84] US-Uruguay BIT (2005), Article 20(2)(a)
[85] India-Croatia BIT (2001), Article 12(2).
[86] Andrew D. Mitchell & Caroline Henckels, 'Variations on a Theme: Comparing the Concept of "Necessity" in International Investment Law and WTO Law (n 5) 107.
[87] UNCTAD Series on International Investment Policies for Development (2009) Protection of National Security in IIA p. 94-95.
[88] UNCTAD Series on International Investment Policies for Development (2009) Protection of National Security in IIA p. 94-95. See, for example, the Hungary-India BIT (2003) Article 12; Peru-Singapore BIT (2003) Article 11.

mitigating financial/economic crisis. However, it must be applied in good faith.[89] This will require a consideration of whether the State followed the proper procedure in adopting the macroeconomic measure, and whether the measure is consistent with the object and purpose of the BIT.[90]

7.3.2.1 General NPM Clauses with Necessity Requirements

The first ever, and most contested NPM clause to be considered in investment arbitration is Article XI of the Argentina-US BIT, which was done in a series of arbitration claims against Argentina, following macroeconomic measures it carried out in response to its economic crisis. Given that there was no separate NPM carve out for financial and economic measures,[91] Argentina relied on the provisions of Article XI Argentina-US BIT.

Article XI of the Argentina –US BIT provides that:

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> This Treaty shall **not preclude the application by either Party of measures necessary for** the maintenance of public order, the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.[92]

Article X of the Bangladesh – US BIT similarly provides thus:

> This Treaty shall **not preclude the application by either Party of measures necessary for** the maintenance of public order, the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.[93]

Construing the necessary/necessity nexus requirement in NPM clauses by arbitral tribunals have given rise to inconsistent and ambiguous interpretations which is observable from

[89] Article 26 VCLT 1969; *Djibouti v France.*
[90] Judge Keith, *Djibouti v France*; S. Schill, 'Self-Judging Clauses in International Dispute Settlement'
[91] Certain International Investment Agreements/BITs have separate non-precluded financial/prudential measure clauses to justify economic and financial actions taken by the host State which may impair the investors' substantive protection rights. There are currently about 112 IIAs/BITs with non-precluded financial/prudential measure clauses. The implication of these specific NPM clauses on contested macroeconomic measures by portfolio investors will be considered a section below.
[92] Argentina-US BIT Article XI.
[93] Bangladesh – US BIT, Article X.

decisions of tribunals on Article XI of the Argentina-US BIT.[94] In the initial three claims instituted against Argentina,[95] the arbitral tribunals interpreted Article XI Argentina-US BIT in the light of the customary plea of necessity.[96] In *CMS v. Argentine Republic* the arbitral tribunal held that Article XI was consistent with its interpretation of the customary plea of necessity, and that Argentina did not meet the requirements under Article XI, therefore it could not rely on the customary plea of necessity.[97] In *Enron v. Argentine Republic*, the arbitral tribunal held that Article XI could not be divorced from the customary plea of necessity.[98] In *Sempra v. Argentine Republic*, the tribunal also agreed that Article XI is to be construed in the light of the customary plea of necessity.[99] The decisions of these tribunals were criticised for its potential to render Article XI, and other NPM clauses redundant, especially given that the customary plea is still available to be relied upon.[100]

Annulment proceedings were filed against all three awards by Argentina.[101] While *Sempra v. Argentina* & *Enron v. Argentina* were both annulled, *CMS v. Argentina* was not annulled. *Enron v. Argentina*, was annulled for failing to provide a legal test for applying the customary plea of necessity, as well as Article XI Argentina-US BIT.[102] The annulment committee held that under Article XI, States have the flexibility to adopt measures which may be detrimental to investors, but are likely to effectively achieve the legitimate objectives; as against alternative measures which have little impact on investments, but also less effective in achieving legitimate objectives.[103] Interestingly though, in *CMS v Argentina*, while the annulment committee declined to annul the award, it recognised the error in the reasoning of the

[94] Dilini Pathirana & Mark MacLaughlin, 'Non-Precluded Measures Clauses: Regime, Trends and Practice' (2020) Handbook of International Investment Law and Practice 26.
[95] *CMS Gas Transmission Company v The Argentine Republic* ICSID, Case No ARB/01/8 Award (12 May 2005); *Enron Corporation Ponderosa Assets LP v Argentine Republic* ICSID, Case No ARB/01/3 Award (22 May 2007); *Sempra Energy International v Argentine Republic* ICSID, Case No ARB/02/16 Award (28 September 2007),
[96] *CMS Gas Transmission Company v The Argentine Republic* para. 320; *Sempra Energy International v Argentine Republic* para 376; *Enron Corporation Ponderosa Assets LP v Argentine Republic* para 334
[97] *CMS Gas Transmission Company v The Argentine Republic* para. 320, 323, 324.
[98] *Enron Corporation Ponderosa Assets LP v Argentine Republic* para 334
[99] *Sempra Energy International v Argentine Republic* para 376
[100] Jurgen Kurtz, 'Adjudging the Exceptional at International Investment Law: Security, Public Order and Financial Crisis (2010) 59 International Comparative Law 342, 344, & 355.
[101] *CMS Gas Transmission Company v Argentine Republic* ICSID, Case No ARB/01/8 Decision of the Ad Hoc Committee on the Application for Annulment of the Argentine Republic (25 September 2007); *Enron Creditors Recovery Corp Ponderosa Assets LP v The Argentine Republic* ICSID Case No ARB/01/3 Decision on the Application for Annulment of the Argentine Republic (30 July 2010); *Sempra Energy International v. Argentine Republic* ICSID, Case No ARB/02/16 Decision on the Argentine Republic's Application for Annulment of the Award (29 June 2010)..
[102] *Enron Creditors Recovery Corp Ponderosa Assets LP v The Argentine Republic* Decision on the Application for Annulment of the Argentine Republic (30 July 2010) para 376-377.
[103] *Enron v. Argentina* Annulment para 371.

tribunal.[104] The committee pointed out that the customary plea of necessity and Article XI ought to be dealt with separately given that reliance on NPM clauses implies the absence of treaty violation or unlawfulness in the first instance, but the customary plea suggests a breach of the substantive standards of protection.[105] It is submitted that the annulment committee's reasoning may have influenced subsequent tribunal decisions on the construction of Article XI.[106]

LG & E v. Argentina,[107] is the first tribunal that considered Article XI as an independent framework for analysing permissible measures.[108] In *LG & E v. Argentina* the tribunal held that in exceptional situations which poses a threat to a State's essential security interest, it is necessary for the State to intervene.[109] Upon consideration of Article XI, the tribunal held that though alternative means of addressing the situation existed, the challenged State measure was necessary and legitimate within the context of the NPM clause.[110] In arriving at this conclusion the tribunal considered the urgency of the measures, the speed within which the measures were drafted, and the fact that the investors' interests were considered.[111] The tribunal however placed a time caveat that after the passage of the economic crisis, the measures will no longer be justified under the NPM clause because the measures will be disproportionate to the objective of dealing with the threat of national security.[112] The decision was criticised for being cursory, that finding the measures to be legitimate was arbitrary without any explanations, and that the decision conflated a least restrictive means approach with a review of good faith.[113] It was also said by August Reinisch, to have the effect of rendering measures permissible even where they are inadequate to achieve the legitimate objectives.[114]

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[104] *CMS v. Argentina* Annulment 129-136.
[105] *CMS v. Argentina* Annulment 129; August Reinisch, 'Necessity in Investment Arbitration' (2010) Netherlands Yearbook of International Law 148-149.
[106] August Reinisch, 'Necessity in Investment Arbitration' (n 11) 156.
[107] *LG& E v. Argentine Republic*
[108] Andrew D. Mitchell & Caroline Henckels, 'Variations on a Theme: Comparing the Concept of "Necessity" in International Investment Law and WTO Law p. 156.
[109] *LG&E v. Argentine Republic* para 226.
[110] *LG&E v. Argentine Republic* para 239-240; 242.
[111] *LG&E v. Argentine Republic* para 240
[112] *LG&E v. Argentine Republic* para 195.
[113] Jurgen Kurtz, 'Adjudging the Exceptional at International Investment:' 355.
[114] August Reinisch, 'Necessity in International Investment Arbitration: An Unnecessary Split of Opinion in Recent ICSID Cases' (2007) 8 Journal of World Investment and Trade. This was said to be disputable from a consideration of the award. See Andrew D. Mitchell & Caroline Henckels, 'Variations on a Theme: Comparing the Concept of "Necessity" in International Investment Law and WTO Law at (n 5) 113.

Article XI Argentina-US BIT was also interpreted independently of the customary plea of necessity in *Continental Casualty v. Argentina.* The decision is unique because the tribunal was chaired by a former Chairperson[115] of the World Trade Organisation's (WTO) Appellate Body. Thus, the construction of Article XI was significantly influenced by WTO jurisprudence on necessity under Article XX GATT[116] and Article XIV GATS.[117]

The tribunal adopted this analytical framework because the exceptions under the WTO agreements, and BIT/Investment Chapters NPM clauses such as Article XI can trace their origins to the US Friendship Commerce and Navigation (FCN) treaties created by the US in the early 20th century,[118] thus making WTO jurisprudence on necessity in general exceptions clauses apt for a comparative construction of necessity of economic measures in international investment law [119] NPM clauses.[120]

As a result, the tribunal in *Continental Casualty*, referred to WTO Dispute Settlement Body (DSB) and Appellate Body [121] decisions in determining the concept of necessity. The arbitral tribunal relied on the WTO Appellate Body decision in *Korea-Beef*[122] which laid out an approach for determining necessity under Article XX GATT. Here, the Appellate Body held that the concept of necessity can have multiple connotations on a spectrum ranging from 'indispensable' to making a 'contribution to,' however the meaning under Article XX is nearer to indispensable.[123] In further reliance on WTO jurisprudence, the tribunal held that a weighing and balancing of factors which include: the importance of the objective, contribution of the

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[115] Giorgio Sacerdoti, 'BIT Protections and Economic Crises: Limits to Their Coverage, the Impact of Multilateral Financial Regulation and the Defence of Necessity' (2013) 28(2) ICSID Review p. 382.
[116] General Agreement on Tariffs and Trade Article XX
[117] General Agreement on Trade in Services Article XIV.
[118] *Continental Casualty Company v. The Argentine Republic para 176.*
[119] It is noteworthy that although international trade law and international investment law have a common heritage and perform similar functions in terms of reviewing governmental conduct with impact on business and commercial activities, they remain separate streams within international law. See Gus Van Harten, *Investment Treaty Arbitration and Public Law* (OUP 2007) 78-79.
[120] *Continental Casualty Company v. The Argentine Republic para 192.* Interestingly, Giorgio Sacerdoti was criticised for not adopting the same framework when deciding *Total v. Argentina*, rather, the tribunal adopted a balancing test to conclude that the host State measure was permissible and did not breach FET standard in para 164. See, José E Alvarez & Tegan Brink, "Revisiting the Necessity Defense: Continental Casualty v Argentina" in Karl P Sauvant, ed, Yearbook on International Investment Law & Policy 2010-2011 (OUP, 2012) 338.
[121] In international trade law, the dispute settlement mechanism is composed of the Dispute Settlement Body which is like a Court of first instance, and the Appellate Body, which hears appeals from the Dispute Settlement Body.
[122] World Trade Organisation Report of the Appellate Body, *Korea – Measures Affecting Imports of Fresh Chilled and Frozen Beef* WT/DS161/AB/R/WT/DS169/AB/R 11 December 2000
[123] *Korea – Measures Affecting Imports of Fresh Chilled and Frozen Beef* para 161.

measure towards the objective, and the restrictive effect of the measure on protected rights, are significant in construing necessity in general exception clauses.[124] This framework embodies a least restrictive means approach for determining necessity.[125]

The tribunal held that where an **alternative measure** exists which is less restrictive to the complainant's rights/interests i.e. it impairs the complainant/investor's substantive rights to a lesser degree compared to the contested measure; and can achieve the legitimate objectives, the contested measure will not be deemed permissible, unless the alternative measure is theoretical, or burdensome in terms of cost or technical difficulties.[126] Thus, where the alternative measure is theoretical or burdensome to implement, it will be considered not to be reasonably available.[127] An alternative measure will also not be reasonably available where it would not bring about the same outcome in terms of the legitimate objectives as the contested measure, or does not materially contribute to achieving the legitimate objectives of the State.[128] Consequently, a contested measure which impairs an investor's substantive right such as FET, but is apt to achieve the legitimate objectives will be found to be necessary and justified where an existing alternative measure is not reasonably available.[129]

Applying these principles, the tribunal held that the claimant's proposed alternative measures were ineffective and impractical in achieving the same outcome as the contested measure because they could not have been issued without success.[130] However, all but one of the contested measures had a 'genuine relationship of 'ends & means' with the legitimate objective dealing with the economic crisis.[131] The tribunal held that:

> In general terms, within the economic and financial situation of Argentina towards the end of 2001, the Measures at issue (the Corralito, the Corralon, the pesification, the default and the subsequent restructuring of those debt instruments involved here) were in part inevitable, or unavoidable, in part

[124] *Continental Casualty Company v. The Argentine Republic para 194: Korea – Measures Affecting Imports of Fresh Chilled and Frozen Beef* para 164; *European Communities-Measures Affecting Asbestos-Containing Products* para 172.
[125] *Korea – Measures Affecting Imports of Fresh Chilled and Frozen Beef* para 165-166.
[126] *Continental Casualty Company v. The Argentine Republic para 195; United States-Measures Affecting the Cross Border Supply Gambling and Betting Services 308.*
[127] *Continental Casualty Company v. The Argentine Republic para 195*
[128] *Continental Casualty Company v. The Argentine Republic para 195para 196 & 198.*
[129] *Continental Casualty Company v. The Argentine Republic para 195; Brazil-Retreaded Tyres II* para 154,
[130] *Continental Casualty Company v. The Argentine Republic para 195 para 208.*
[131] *Continental Casualty Company v. The Argentine Republic para 195 para 196-197*

> indispensable and in any case material or decisive in order to react positively to the crisis, to prevent the complete break-down of the financial system, the implosion of the economy and the growing threat to the fabric of Argentinean society and generally to assist in overcoming the crisis[132]

Finally, like *CMS v Argentina*, the tribunal held that where host States are responsible for the exceptional situations which they require the measure to address, Article XI may be inapplicable.[133] Argentina was held not to be affected by this. It was eventually held that Argentina's measures were necessary and permissible under the BIT to deal with the economic crisis and to prevent the breakdown of the financial system.[134]

Reliance on WTO jurisprudence to determine the mechanics of necessity in BIT NPM clauses was criticised by Jose Alvarez & Brink for not giving consideration to the differences between WTO agreements and investment agreements.[135] Furthermore, that the tribunal ought to have relied on Article 31(3)(c) Vienna Convention on the Law of Treaties (VCLT)[136] in justifying reference to WTO jurisprudence.[137] Towing a similar path, William Burke White & Von Staden agreed that the arbitral tribunal ought to have utilised international rules of treaty interpretation to justify considering WTO case law.[138] However, it was pointed out that other international law regimes interpret necessity in NPM/exception clauses in the same manner.[139]

Jose Alvarez and Brink further argued that the tribunal ignored the textual differences between Article XX GATT & Article XI Argentina-US BIT in respect to the chapeau which they contend is the basis upon which measures ought to be assessed against to ensure they are not arbitrary and discriminatory.[140] In response, Giorgio Sacerdoti, contended that the concept of necessity under WTO jurisprudence is unconnected to the chapeau of Article XX GATT. He argued that the Chapeau to Article XX GATT requires the application of Article XX in good faith, in a non-arbitrary and discriminatory manner.[141] Andrew Mitchell & Caroline Henckels

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[132] *Continental Casualty Company v. The Argentine Republic para 195 para 197, 205, 210, 213, 219.*
[133] *Continental Casualty Company v. The Argentine Republic para 195 para 234.*
[134] *Continental Casualty Company v. The Argentine Republic para 195 para 197.*
[135] José E Alvarez & Tegan Brink, "Revisiting the Necessity Defense:' 338
[136] Vienna Convention Law of Treaties, Article 31(3)(c).
[137] José E Alvarez & Tegan Brink, "Revisiting the Necessity Defense: 335-338
[138] William Burke-White & Andreas von Staden, 'Investment Protection in Extraordinary Times' (n 46) 299
[139] Andrew D. Mitchell & Caroline Henckels, 'Variations on a Theme: Comparing the Concept of "Necessity" in International Investment Law and WTO Law (n 5) 158.
[140] José E Alvarez & Tegan Brink, 'Revisiting the Necessity Defense:' 319 & 346.
[141] See Chapeau to Article XX GATT & Article XVI GATS. See also Giorgio Sacerdoti, 'BIT Protections and Economic Crises' (n 115) 382.

also argued that the absence of a chapeau in a BIT NPM clause ought not to be the reason to prevent investment arbitration tribunals from deriving inspiration from WTO jurisprudence on necessity because the influence of the chapeau in determining necessity under GATT is 'no more than a hypothesis.'[142] Also that other WTO agreements like the SPS[143] and the TBT[144] do not contain a chapeau, yet they follow a similar test for determining necessity within WTO jurisprudence.[145]

It is noteworthy that LRM proportionality analysis can also be adopted for measures where the nexus requirement is framed as 'necessary to' or 'necessary for' in specific NPM clauses like Prudential/Fiduciary clause which we discussed above.

7.3.2.1 Applying LRM Approach to NPM Clauses as a Justification for Host State Macroeconomic Measures Affecting Portfolio Investments.

Where there are no specific non-precluded prudential or financial measures carve-out clauses[146] in emerging/frontier economies BITs but a general NPM clause is contained in their BITs, they may rely on the general NPM clause as a justification if macroeconomic measures must be taken in times of necessity, and the NPM clause requires measures to be 'necessary for' or 'necessary to' achieve the desired objective.

In this regard, it is submitted that the LRM approach of proportionality analysis adopted in *Continental Casualty v. Argentina,* should be adopted for the interpretation of general NPM clauses. This is to determine if they can offer derogation from substantive protection standards claims against necessary host State macroeconomic measures affecting portfolio investments, and for a more consistent and coherent approach to NPM necessity interpretation within the international investment regime.[147]

Consequently, to determine whether a macroeconomic measure is necessary, and thus permissible requires a weighing and balancing of factors such as the importance of the

[142] There was no further clarification on what this meant.
[143] The WTO Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement)
[144] The WTO Agreement on Technical Barriers to Trade.
[145] Andrew D. Mitchell & Caroline Henckels, 'Variations on a Theme: Comparing the Concept of "Necessity" in International Investment Law and WTO Law' (n 5) 158; See also US-Tuna II.
[146] Armenia-Canada BIT (1997). There are about 112 IIAs with Prudential/Financial NPM carve outs such as Canada-Czech Republic BIT (2009); India-Japan EPA (2011); Japan-Ukraine BIT (2015); US-Uruguay BIT (2005) for the purposes of justifying host State macroeconomic measures aimed at legitimate economic objectives.
[147] Manu Misra, 'Necessity Defence & Continental Casualty' (n 5) 141.

objective; the contribution of the macroeconomic measure to the objective; and the restrictive effect of the macroeconomic measure on the foreign portfolio investor's right to substantive standards protection.[148]

(a) Importance of the Objective

The importance of the objective the measure intends to achieve is a fundamental consideration for necessity analysis.[149] In *Continental Casualty v. Argentina,* the tribunal identified the protection of Argentina's national interest,[150] as the importance of the contested measure's objective,[151] however there was no evaluation of the importance of the contested measures' objective against its restrictiveness to the investors' interest. Similarly, in *LG & E v. Argentina,* the tribunal mentioned the importance of the objective as protecting the social and economic system of Argentina.[152]

In the WTO decision of *US-Gasoline,* the Dispute Settlement Body (DSB) held that in assessing the importance of the objective, it is not the necessity of the objective that should be considered, rather it is whether the **contested measure is necessary to achieve the objective**.[153] What this entails is an assessment of the necessity of the contested measure, and not the necessity of the objective. This is to preserve the regulatory autonomy of the State to carry out its desired policies, free from prying tribunals reviewing the legitimacy of host State's objectives.[154] Arbitral tribunals in conducting this assessment, could decline to scrutinise host State objectives,[155] and affirm the objectives as legitimate,[156] but must review the importance of the measure to achieve the objectives against the investor's interest.

To this end, an evaluation of the importance of the objective will be limited to the suitability of the macroeconomic measure for achieving economic/financial goals for public order, public security, or other national interest objectives. Putting it in perspective, the question before the

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[148] *Continental Casualty Company v. The Argentine Republic para 194: Korea – Measures Affecting Imports of Fresh Chilled and Frozen Beef* para 164, 165-166; *European Communities-Measures Affecting Asbestos-Containing Products* para 172
[149] *Korea – Measures Affecting Imports of Fresh Chilled and Frozen Beef 164; US-Tuna II para 323.*
[150] *Continental Casualty Company v. The Argentine Republic para 168*
[151] *Continental Casualty Company v. The Argentine Republic para 194*
[152] *LG&E v. Argentine Republic para 239.*
[153] *US-Gasoline para* 6.22.
[154] Andrew D. Mitchell & Caroline Henckels, 'Variations on a Theme: Comparing the Concept of "Necessity" in International Investment Law and WTO Law (n 5) 146.
[155] *Glamis Gold v. United States* Award para *803 & 805*
[156] *EDF v. Romania para 293-294*

tribunal will be whether the sovereign debt restructuring, or a foreign exchange variation detrimental to foreign portfolio investors substantive rights is critical for curtailing a sovereign debt crisis or a Balance of Payment crisis which is a threat to public security? The answer is an easy yes.

(b) Contribution to Objective

This factor requires that a contested measure has to be shown to be apt to, or did make a material or decisive contribution to the achievement of the objective.[157] In *Continental Casualty v. Argentine Republic,* the tribunal applied an aptness test, and held that all but one measure demonstrated a genuine ends and means relationship with the objective[158] without actually assessing the actual contribution of the measures to the objective, and weighing and balancing the contribution of the measure to its objective against its restrictiveness of the investors rights. In *Brazil-Retreaded Tyres II*[159] the WTO appellate body held that assessing contribution to the objective goes beyond an end and means relationship between the measure and the objective but includes weighing and balancing the contribution of the measure against its restrictiveness.

Where the host State objective is to curtail an economic crisis in the public interest to prevent it from spiralling into a catastrophe, a macroeconomic measure which is capable of, and contributes to achieving this objective, but breaches substantive protection standards will be deemed to be necessary where the impact of the macroeconomic measure in achieving the objective outweighs the impact of the substantive violation. Putting it in context, it is largely agreed that transfer restrictions are apt in dealing with economic crisis like BoP crisis[160] and have been adopted by numerous countries particularly during the Asian financial Crisis,[161] and Icelandic Economic Crisis. It is also widely accepted that economic crisis can lead to a breakdown of public order and even overthrow of governments.[162] Foreign portfolio investments enter the host states knowing of the risks involved, and voluntarily assuming those risks particularly when they enter for arbitrage and speculation.

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[157] *Brazil-Retreaded Tyres II Para 151*
[158] *Continental Casualty Company v. The Argentine Republic para 196-197*
[159] *Brazil-Retreaded Tyres* para 156; *China-Audiovisuals* para 240-241
[160] Barry Johnston & Natalia Tamirisa, 'Why Do Countries Use Capital Controls?' (1998) IMF Working Paper
[161] Christopher Neely, 'An Introduction to Capital Controls' (1999) Federal Reserve Bank of St Louis Review; Akira Ariyoshi et al., 'Capital Controls: Country Experiences with Their Use and Liberalization' (2000) IMF Occasional Paper 190.
[162] See French revolution. For a more current effect of economic crisis on public order and security, see what is going on in Sri Lanka currently.

Consequently, the host State must demonstrate that the macroeconomic measure contributed to achieving the objective or did make a material or decisive contribution to achieving the objective. Afterwards the tribunal must weigh and balance the contribution of the measure to achieving the objective against its restrictiveness of the protected right[163]. This means weighing the impact of the macroeconomic measure on achieving the objective against the impact of impairing the substantive rights on the investment. If the impact of the measure on the objective outweighs the impact of the substantive violation on the portfolio investor, the measure may be deemed necessary.

(c) Least Restrictive Effect of the Measure on the Protected Right

After the measure has been deemed necessary based on the above factorial assessments, the final analysis is to determine how restrictive the contested measure on the protected right is. This entails determining if a less restrictive alternative measure is reasonably available.[164] The alternative measure must attain the level of protection the host State desires, i.e the outcome the host State desires to achieve while not imposing undue burden in the manner of prohibitive cost and technical difficulty and must not be theoretical.

However, in the event that adopting an alternative less restrictive measure may result in negative externalities with consequences for other of the host State's interests such as financial burdens or environmental issues, arbitral tribunals may adopt a 'reasonable necessary' approach which requires the State to demonstrate a reasonable justification for the measure, even if there exists a least restrictive alternative measure.[165] This approach is critical where there could be other objectives or interests which may be affected if an alternative less restrictive approach is adopted. It enables the State to exercise flexibility to undertake a measure which is free from negative consequences for the State in terms of financial burden, administrative challenges, environmental consequences etc., which may ensue if the alternative least restrictive measure is adopted.[166]

[163] Ming Du, 'The Necessity Test in World Trade Law: What Now?' [2016] 15 Chinese Journal of International Law 828.
[164] *Continental Casualty Company v. The Argentine Republic* para 195
[165] Mark Elliot, 'Proportionality and Deference: The Importance of a Structured Approach' in Christopher Forsyth, et al eds *Efficient Judicial Review: A Cornerstone of Good Governance* (OUP, 2010) 278.
[166] *United States-Measures Affecting the Cross Border Supply Gambling and Betting Services* para 308; *Pope & Talbot v. Canada* Award (2000) para 123, 125, 128, 155.

Finally, a contested macroeconomic measure affecting portfolio investment interests may be deemed permissible where an alternative measure will not be less restrictive, or even if it is, adopting it may impose financial or technical burdens on the State, or result in negative externalities on other State objectives or interests. Given that in complex economic situations for instance between honouring sovereign debt obligations and restructuring the debt to free up resources for other pressing areas to prevent economic crisis which may lead to break down of public peace and security, it may be difficult to assess whether other alternative measures exist[167] because they could be theoretical, or burdensome, or with consequences for other sectors of society.

Part IV

7.4 Applicability of Substantive Standards of Protection to Foreign portfolio investments: Where There are no Safeguards Preserving Regulatory Autonomy.

As earlier mentioned, only about 14% of BITs/IIAs contain exceptions/safeguards for the preservation of host State regulatory autonomy[168] in the form of specialised or general NPM clauses. The pertinent question becomes what happens to emerging and frontier economies that fall within the 86% of state parties to BITs/IIAs without any policy or regulatory space? The simple answer is that their macroeconomic independence and flexibility are in danger of being challenged where the BITs/IIAs they signed allow for foreign portfolio investment protection. This is because in the absence of safeguards even in times of, or threat of crises, foreign portfolio investors have absolute protection rights.

What then are emerging, and frontier economies expected to do in such circumstances when faced with an almost absolute obligation of foreign portfolio investment protection, without the BITs/Investment Chapters containing a corresponding right, safeguard, exception etc, for regulatory space necessary to exercise macroeconomic flexibility and independence in this context. Consequently, it is submitted that a proportionality analysis be done to decide on which of the conflicting interests should prevail.

[167] Julian Rivers, 'Proportionality, Discretion and the Second Law of Balancing' in George Pavlakos, ed, *Law Rights and Discourses: The Legal Philosophy of Robert Alexy* (OUP, 2007) p. 185; See also *LG&E v. Argentine Republic para* 195 on economic crisis and essential security.
[168] Rachel D Thrasher, Sarah Sklar, Kevin P Gallagher, 'Policy Space for Capital Flow Management: An Empirical Investigation' (n 7) 780. See also UNCTAD Mapping Investment Treaties.

Proportionality analysis developed from the vertical relationships between individuals and the State. Where State actions have consequences on individuals. Proportionality analysis though is rooted in German Administrative Law jurisprudence[169] is not alien to Public International Law generally,[170] and International Economic Law particularly.[171] The least restrictive means (LRM) analytical approach adopted in the previous section as a tool for analysing BIT NPM clauses with necessity requirements is influenced by WTO jurisprudence,[172] and was applied in the *Continental Casualty v Argentina,*[173] case is based on proportionality analysis. In view of the acceptability of the use of proportionality analysis in assessing the lawfulness of a violation of international rights, it is submitted that it is apt in application to investment treaty analysis. The rationale behind this is that the international investment regime provides for the recognition and enforcement of foreign property rights. It is with a view to protecting through enforcement that investors institute investment claims against host States for State actions purportedly in violation of the substantive protection guarantees.

Clearly, there are two conflicting interests at stake here. The right of the foreign investor guaranteed under the BIT and under customary international law, and the right of the host State guaranteed under customary international law, UN Charter and the BIT. While the investor seeks to protect property rights and interests, the State seeks to exercise economic rights in the interest of its nationals.

These competing rights are usually subjected to review before international investment law Investor-Stated Dispute settlement (ISDS) mechanism. ISDS is an institution that has been used to assess the vertical relationship between host State action and individual/corporate rights. It is basically empowered to review State conduct/actions in relation to investment protection standards guaranteed under BITs. Consequently, it is both a procedural and institutional framework for host State international administrative law.[174] Within domestic

[169] Cohen-Eliya and Porat, 'American Balancing and German Proportionality: The Historical Origins' (2010) 8 International Journal of Constitutional Law 263.
[170] Has been applied in International Human Rights Law, EU Law, International Maritime Law, and International Trade Law. See *Duales Systems Case* 2001.
[171] Proportionality Analysis has been applied in WTO jurisprudence as well as in Investment Arbitration.
[172] Giorgio Sacerdoti, 'BIT Protections and Economic Crises: Limits to Their Coverage, the Impact of Multilateral Financial Regulation and the Defence of Necessity' (n 115).
[173] *Continental Casualty Company v. The Argentine Republic* (ICSID Case No. ARB/03/9) Award, 5 September 2008.
[174] Gus Van Harten and Loughlin, 'Investment Treaty Arbitration as a Species of Global Administrative Law' (2006) 17 European Journal of International Law 121

administrative laws, proportionality analysis is adopted as a means of assessing/reviewing host State actions in relation to competing individual rights.[175] Proportionality analysis is generally used to assess the lawfulness of the State or Agency actions in relation to a competing individual right.

Given the existence of these conflicts of interests, it is sensible that proportionality analysis be adopted in reviewing these rights. Proportionality analysis must be consistent with the objects and purpose of the agreements. It should not import external and extrinsic considerations. For instance, in the context of this thesis, the purport of BITs is for cooperation for economic growth in exchange of investment protection.[176] Thus, a proportionality assessment of a state measure which affects foreign portfolio investor's rights must weigh and balance the State measure in view of the objective of economic growth to determine if the objective of economic growth should override investment protection. Where protection will undermine economic growth with severe consequences, then protection should be sacrificed.

An advantage of proportionality analysis is that it can bring coherence and consistency in investment law jurisprudence. Proportionality analysis is a significant comparator. It emanates from domestic administrative law and is adaptable to the international investment law regime' ISDS because ISDS essentially functions as a tribunal for judicial review of State actions. However, proportionality analysis has been criticised as potentially being an instrument to justify breaches of international economic law instruments since there is a high chance that tribunals/courts will consider a State action as necessary and proportionate.

Following the multiple international law regime adoption of proportionality analysis, consensus has been built around the requirement of satisfying the underlisted subtests to conduct an effective proportionality analysis to wit:[177]

(a) Suitability of the macroeconomic measure to achieve the objective
(b) Necessity of the macroeconomic measure in relation to the absence of other less restrictive macroeconomic measures to achieve the objective.

[175] Alec Stone Sweet, 'Proportionality, General Principles of Law and Investor-State Arbitration: A Response to Jose Alvarez' (2014) Yale Faculty Scholarship Series 916
[176] See Preamble to most BITs & Investment Chapters.
[177] Alec Stone Sweet & Jud Mathews, Proportionality Balancing and Global Constitutionalism (2008) 47 Colum. J. Transnational Law 106-108.

(c) Proportionality *strictu sensu* (in the strict sense)/Balancing in relation to whether the measure in achieving the objective places undue burden on the foreign portfolio investor.

The issue of suitability (Importance and Contribution of the measure to achieving the objective) and necessity (least restrictive means test) of the macroeconomic measure has been dealt with in the LRM analysis of NPM clauses in Part III above. Repetition will only result in redundancy, Consequently, this thesis will focus on the last subtest i.e., proportionality *strictu sensu.*

7.4.1 Proportionality Analysis *strictu sensu*/Balancing

Proportionality *srictu sensus*/Balancing involves weighing the importance of achieving the State's objective, against the importance of upholding the protected right.[178] Here the tribunal has to decide whether the benefit of upholding the protected right outweighs the importance of achieving the objective to determine if the State measure is disproportionate.[179] What should agitate the minds of the tribunal adopting the balancing test is whether achieving the objective is worth restricting the rights of the holder, in this case, the protection rights of foreign portfolio investors. Clearly, this will confer immense powers on the tribunal since it will confer them with inordinate leeway to scrutinise the importance of the host State's objective to decide if achieving such objective is worth restricting a protected right. This is one of the biggest criticisms of the proportionality *strictu sensu* test.[180]

Contextually, balancing will require a weighing and balancing of investment law protected rights, against the promotion of social welfare through measures such as macroeconomic measures directed at mitigating and preventing economic and financial crisis. From the perspective of the foreign portfolio investor, the importance of upholding the investment law protected rights is to compensate foreign portfolio investors for losses occasioned by host State macroeconomic measures that adversely affected their foreign portfolio investments by enforcing the doctrine of *pacta sunt servanda.*[181] However, from the perspective of host States,

[178] Barak, Proportionality (2) 8 (n. 35).
[179] Caroline Henckels, Proportionality and Deference in Investor-State Arbitration: Balancing Investment Protection and Regulatory Autonomy (Cambridge: Cambridge University Press, 2015) 62.
[180] Andrew D. Mitchell & Caroline Henckels, 'Variations on a Theme: Comparing the Concept of "Necessity" in International Investment Law and WTO Law (n 5) 156.
[181] I Lukashuk, 'The Principle Pacta Sunt Servanda and the Nature of Obligation Under International Law' (1989) 83(3) The American Journal of International Law 513.

the importance of achieving the objective is the growth and social welfare of the entire economy, as well as maintaining public peace and security. This is because, the prevention or mitigation of economic/financial crisis is in the overwhelming public interest, and the prevention of economic collapse and spread of contagion.

As mentioned in previous Chapters, allowing foreign portfolio investment protection, would open host State macroeconomic policies to challenge. Macroeconomic policies are complex economic policies that affect the entire economy and creates risks that can affect everyone within the economy, including domestic and foreign investments, which makes them hardly discriminatory, and quite difficult to be done in bad faith. Interestingly, the European Court of Human Rights (ECtHR) in applying proportionality *strictu sensu* has held State measures to be proportionate where they are complex and broadly affects holders of property rights (comparable in this instance to foreign portfolio investors).[182] Caroline Henckels points out that the ECtHR seems to demonstrate a willingness to hold host State economic policy changes that creates risks for commercial entities as legitimate since ruling otherwise will amount to host States insuring these ventures for commercial risks they had undertaken to internalise[183] The implication is that macroeconomic measures which affects property rights can enjoy a wide margin of appreciation if done in the public interest. However, the ECtHR will not spare any margin to economic policies in the public interest where the effect of the policy on property rights is manifestly disproportionate.[184]

Investment arbitration has not been left out in applying the proportionality *strictu sensu* test directly or indirectly. Investment Arbitration recognises and have adopted this test. In *EDF(Romania)*[185] the host State adopted a legislation that revoked the licences to duty free stores in airports, to deal with the problem of smuggling and corruption rife at the customs & airport border security. The claimant challenged this legislation for breaching FET. The tribunal held that the legislation would be disproportionate if the claimant 'bore individual and

[182] De Sena, 'Economic & Non-Economic Values in the Case Law of the European Court of Human Rights' in Dupuy, Petersmann & Francioni (eds) *Human Rights in International Investment Law & arbitration;* Henckels book 64

[183] Caroline Henckels, *Proportionality and Deference in Investor-State Arbitration: Balancing Investment Protection and Regulatory Autonomy* (n 179) 64-65; See also *John v Germany* (2006) 42 EHRR 1084 para 93-117 where economic reform policy was considered proportionate.

[184] *Lithgow and Others v. The United Kingdom*, Council of Europe: European Court of Human Rights, 24 June 1986; para 122; Caroline Henckels, *Proportionality and Deference in Investor-State Arbitration: Balancing Investment Protection and Regulatory Autonomy* (179) 65.

[185] *EDF (Services) Limited v Romania* ICSID Case No ARB/05/13 Award, 8 October 2009

excessive burden,'[186] The tribunal went on to hold that the measure was legitimate because the importance of dealing with corruption outweighed the effect of the claimant's losses since it was only a part of the claimant's business that was affected.[187]

Also, in *Total v Argentina,* the claimant brought claims against Argentina's emergency *pesofication* measure which was adopted to deal with the economic crisis that was plaguing the country back then and to prevent economic collapse. The tribunal adopted a proportionality *strictu sensu* test and held that Argentina's measure had a legitimate objective and that the adoption of the measure is consistent with Argentina's monetary sovereignty.[188] It is noteworthy that the claimant succeeded in their FET claims.[189] In deciding the *pesofication* measure and its objective as legitimate, the *Total* decision referred to *Salukha v Czech Republic.* In *Salukha,* the tribunal referred to proportionality when it found that Czech Republic's prudential regulations which affected the claimant's investment were legitimate because it was required to reform its Prudential and Financial regulations before they can be admitted into the EU. Consequently, no breach of legitimate expectation was found since there was no right to legitimate expectation.[190] In the decision, the proportionality test was only applied to the analysis of legitimate expectation, but not to other claims relating to other standards of protection.[191] The lack of methodological consistency was criticised by Caroline Henckels.[192]

Putting it in context, it has been variously stated that scholars have argued that the definition of investment where they are broadly provided should be broadly interpreted.[193] The consequence of this is that it will open the door for foreign portfolio investments to be considered as investments, and liable to be protected. Protecting foreign portfolio investments

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[186] *EDF (Services) Limited v Romania* para 293. See also Para 217-220.
[187] *EDF (Services) Limited v Romania* para 179, 293-294.
[188] *Total SA v Argentine Republic*, ICSID Case No ARB/04/1Decision on Liability 27 December 2010 para 122-123, 162-165, 309, 197, 429.
[189] *Total SA v Argentine Republic* para 166-175, 325-335, 336-338.
[190] *Saluka Investments BV (The Netherlands) v The Czech Republic*, Partial Award (Perm Ct Arb 2006) *para 306-360.*
[191] Caroline Henckels, *Proportionality and Deference in Investor-State Arbitration: Balancing Investment Protection and Regulatory Autonomy* (n 179) 112-113.
[192] Caroline Henckels, *Proportionality and Deference in Investor-State Arbitration: Balancing Investment Protection and Regulatory Autonomy* (n 179) 113.
[193] Michail Dekastros, 'Portfolio Investment: Reconceptualising the Notion of Investment under the ICSID Convention' (2013) The Journal of World Investment and Trade 286; Julian Mortenson, 'The Meaning of "Investment": ICSID's Travaux and the Domain of International Investment Law [2010] 51 Harvard International Law Journal p 257-298.

with the international investment regime has the profound effect of subjecting host State monetary and fiscal policies to ISDS review. Thus, to undertake a proper balancing of the investors and host State conflicting interests, it is important to understand the nature, and incentives of foreign portfolio investment activities.

While the conversation is usually around whether foreign portfolio investments should be considered as investments for their protection against host State measures, little to nothing is said about the nature of foreign portfolio investments. Little is said about the foreign portfolio investors and their incentives to invest, and nothing is said about their risk tolerance, or the actions they are expected to undertake to ensure risk mitigation. It is hardly enquired if they ought to undertake proper risk management. Finally, their volatility and proclivity for causing crisis is largely ignored.[194]

Investing in an emerging/frontier economy is a high risk/high reward venture.[195] Such action suggests the acceptance of the market risks present in such economies. Also, such market risks are accounted for in the price/value of the foreign portfolio investment following the Efficient Market Hypothesis.[196] Thus, it is strongly contended that the acceptance of the risks involved in investing in an emerging/frontier economy should deprive foreign portfolio investors of the right to complain given their risk seeking behaviour in investing in emerging and frontier economies which are known for their high volatility/high risks. The decision to invest in emerging/frontier markets demonstrates a tolerance of risks in high risk/high reward ventures which may be reflected in an independent, rational, and analytical behaviour; or an indifference towards risks in high risks/high reward ventures reflected in herd mentality behaviour. In a study conducted by Woochan Kim and Shang Jin Wei on investor behaviour before and during crisis, they found out that both individual and institutional foreign portfolio investors herd,

[194] See the above papers.
[195] Livia Yap & Courcoulas, 'What Are Frontier Markets and Why Invest in Them' Bloomberg 8 July 2020 https://www.bloomberg.com/news/articles/2020-07-08/what-are-frontier-markets-and-why-invest-in-them-quicktake. Accessed 30/09/ 2020.
[196] This is consistent with the efficient market hypothesis which holds that all information relevant to securities prices is freely and widely available and shared among investors. Given the preponderance of buyers and sellers within the financial market price movement occurs efficiently to ensure that securities prices are always trading at their current market value. What is the Efficient Market Hypothesis https://corporatefinanceinstitute.com/resources/knowledge/trading-investing/efficient-markets-hypothesis/#:~:text=The%20Efficient%20Markets%20Hypothesis%20(EMH,impossible%20to%20consistently%20%E2%80%9Cbeat%20the; See also, Eugene F Fama, 'Efficient Capital Markets: A Review of Theory and Empirical Work' (1970) 25(2) The Journal of Finance.

though individual retail investors herd more than institutions.[197] Thus, they invest, or pull-out based on imitation arising from perception of available information. Essentially the risk tolerance for investing in emerging/frontier economies is hardly risk aversion, given the propensity for loss or high reward. Though their decision to selloff is characteristic of risk aversion.[198] Usually, foreign portfolio investors owing to their risk neutrality and sometimes risk seeking behaviour are willing to undertake losses because of the potential higher returns. Therefore, they undertake a voluntary assumption of market and macroeconomic risks, which should not be insured by the State through the international investment law regime.

Imagine the consequence of providing extra layer of compensation for potential losses occasioned by macroeconomic measures which foreign portfolio investors are ordinarily meant to have factored, when making their decision to invest. Echoing the ECtHR's sound logic that offering protection against economic changes will amount to insurance against commercial risks,[199] it is submitted that protecting foreign portfolio investments against macroeconomic policies changes will result in compensation for macroeconomic risks which are systematic and non-diversifiable, and can create a moral hazard problem.[200] Thereby incentivising more, and potentially reckless foreign portfolio investment movements owing to the reinforcement of the risk-taking behaviour, and a situation of *fait accompli* on host States.

Consequently, foreign portfolio investment market risk-tolerance behaviour in investing in emerging/frontier markets is fundamental to a consideration in proportionality *strictu sensu.* Critically, from a cost perspective, the costs to the foreign portfolio investors if protection rights are denied will be ridiculously less than the social welfare and economic costs to the emerging/frontier economies if macroeconomic independence and flexibility rights are not upheld. Especially since most of these economies do not have financial market and institutional depth, as well as adequate safety nets for supporting their citizens should crisis deteriorate.[201]

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[197] Woochan Kim & Shang Jin Wei, 'Foreign Portfolio Investors Before and During a Crisis (1999) OECD Economics Department Working Paper No. 210 pp 11-13.
[198] Yilmaz Akyuz, 'Capital Flows to Developing Countries in a Historical Perspective: Will the Current Boom end with a Bust?' (2011) South Centre Research Paper 37, 2.
[199] Caroline Henckels, *Proportionality and Deference in Investor-State Arbitration: Balancing Investment Protection and Regulatory Autonomy* (n 179) 64-65; See also *John v Germany* (2006) 42 EHRR 1084 para 93-117 where economic reform policy was considered proportionate.
[200] Moral Hazard problem occurs when one party in a transaction is more comfortable taking financial risks because they are aware that they will not bear any negative consequences. As a result, they tend to act more recklessly.
[201] Barry Eichengreen & Michael Mussa, 'Capital Account Liberalisation and the IMF' Finance & Development December 1998 35(4) https://www.imf.org/external/pubs/ft/fandd/1998/12/eichen.htm.

Furthermore, in deciding to invest in emerging and frontier economies, foreign portfolio investors accept the risk of losses occasioned by non-diversifiable market risks, but host States in entering BITs/Investment Chapters do not accept the risks of macroeconomic confinement with costs to economic growth and development. Instead, emerging/frontier economies enter BITs for the benefits of economic cooperation for development.[202] Denying these economies macroeconomic flexibility by upholding portfolio investment protection in the face of economic crisis or threat thereof, would be at a grave cost to the host State's economic growth and social welfare.

Similarly, from a benefit perspective, it goes without saying that ensuring emerging/frontier economies macroeconomic flexibility amidst crisis or threat thereof, is worth the restriction of the substantive protection rights of foreign portfolio investors. This is in view of the fact foreign portfolio investors voluntarily choose to invest within emerging/frontier economies knowing their risk profiles, which were factored in their decisions to invest. This idea is consistent with IMF's current Institutional View on Capital Movement.[203] Bearing this is mind, investment arbitration tribunals confronted by claims challenging macroeconomic policies under BITs without any safeguards, ought to adopt a proportionality analysis of the conflicting rights, taking into consideration the costs and benefits of upholding host States rights to macroeconomic independence and flexibility.

In sum, as has been demonstrated in this Chapter, Proportionality analysis in international investment law requires balancing the rights of investors against the interests of the host State. However, there exists absence of clarity on how to implement proportionality analysis. Rather, what you have are tribunals discretionarily adopting *ad hoc* systems for implementation.[204]

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[202] The motivation for developing countries particularly emerging and frontier countries was to attract foreign capital to accelerate development by offering foreign investment protection, while for the developed countries; it was for a robust protection of investment and market liberalisation based on neoliberal prescriptions. Essentially, BITs were considered as offering a 'Grand Bargain' where for a promise of protection of investment; there is a corresponding promise of increased inflow of foreign investment for economic development. See Jeswald W Salacuse & Nicholas P. Sullivan, 'Do BITs Really Work?: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain' (2005) 46(1) Harvard International Law Journal 75; Kenneth J Vandevelde, 'A Brief History of International Investment Agreements http://jilp.law.ucdavis.edu/issues/volume-12-1/van5.pdf.

[203] International Monetary Fund, 'Review of Institutional View on the Liberalisation and Management of Capital Flows' (March 2022) IMF Policy Paper.

[204] Eric De Brabandere & Paula Baldini Miranda de Cruz, 'The Role of Proportionality in International Investment Law and Arbitration: A System Specific Perspective' [2020] 89 Nordic Journal of International Law 472.

Hence, implementation being contingent on how a tribunal chooses to interpret NPM clauses or their willingness to embrace proportionality analysis.

The balance to be struck lies between rights granted in protection standards contained in IIAs/BITs, and the host State's right to regulate. Usually, the IIAs/BITs do not always provide guidance for construing or establishing the standards of protection. Some standards of protection are broadly and vaguely defined, while others contain specific provisions for establishing the standards of protection. These textual differences make it challenging to achieve coherence in interpretation and application of proportionality analysis. Thereby affecting the possibility of a continuing and uniform jurisprudence on proportionality analysis in international investment law. [205]It is only where the protection standards are uniformly drafted, that tribunals may develop a uniform approach to interpretating the protection standards in relation to the proportionality of the measures. Otherwise, tribunals face the risk of stretching the standards of protection beyond their conceivable limits and breaching the letters and spirit of the terms agreed by the contracting parties in an attempt to achieve coherence and uniformity. [206] Thus, tribunals are faced with the reality of assessing the proportionality of the host State measure in relation to the rights in the protection standards based on the circumstances of each situation.[207]

What this means is that each tribunal must determine whether a specific situation requires the application of proportionality analysis, and what method of proportionality analysis will be adopted. Tribunals have relied on the proportionality principle expressly, or sometimes referred to a sub-element[208]. This is evident in the varied and disjointed methods of proportionality analysis in tribunal decisions ranging from *Continental Causalty*[209] – *Glamis Gold*[210]. It is necessary to point out that they do not always go into detail why they selected one method or system of proportionality analysis over another. [211] Nevertheless, the consequence of the

[205] Ibid 486.
[206] Calamita, N. Jansen, 'The Principle of Proportionality and the Problem of Indeterminacy in International Investment Treaties' in *Yearbook of Int'l Investment Law and Policy* (OUP, 2014) 158.
[207] Eric De Brabandere & Paula Baldini Miranda de Cruz, 'The Role of Proportionality in International Investment Law and Arbitration: A System Specific Perspective' 487.
[208] Jasper Krommendjik & John Morjin, 'Proportional by What Measure(s)? Balancing Investor Interests and Human Rights by way of Applying the Proportionality Principle in Investor-State Arbitration' in Pierre- Marie Dupuy (ed) *Human Rights in International Investment Law & Arbitration* (OUP, 2009) 439.
[209] *Continental Causalty*
[210] *Glamis Gold*
[211] Eric De Brabandere & Paula Baldini Miranda de Cruz, 'The Role of Proportionality in International Investment Law and Arbitration: A System Specific Perspective' 489.

freedom to determine whatever methodology or system of proportionality analysis they deem fit may result in the international investment law jurisprudence having too many conceptions and methodology for proportionality analysis, leading to various incoherent and inconsistent decisions given that tribunals are not obliged to follow each other's jurisprudence. Thereby contributing to the legitimacy crisis of the international investment regime.[212] However, in an event where a tiered system of proportionality analysis as advocated by this Chapter is recognised and adopted by tribunals across board, it will compel host States to justify their measures allegedly in violation of the protection standards in accordance with a 'structured legal criterion/criteria,' and ensure that tribunals follow a systematic approach.[213] To the effect that proportionality analysis within international investment law may be more rational, coherent and hopefully predictable.

7.5 Conclusion

Having a general overview of the investment treaty regimes as mapped by UNCTAD, it is undisputable that there exists limited policy flexibility for host State interventions in the face of impending crisis or existing crisis. While host States could rely on the fundamental change in circumstance doctrine codified in Article 62 of the VCLT 1969; or on the customary international law plea of necessity, it has been demonstrated that these options are not without own challenges in providing safeguard for host State macroeconomic space.

However, recourse may be had to NPM clauses to nip in the bud the possible challenges substantive standards such as FET, or Transfer of Fund clauses may pose for host State macroeconomic policy making in relation to portfolio investments. Analysis of the NPM clause depends on whether it provides for general exceptions or specific sectoral exceptions such as exceptions for financial/economic measures. Where there is a necessity requirement, a least restrictive means approach of proportionality analysis for interpreting the necessity requirements is an effective framework in tackling the challenges of substantive protection standards and preserving host State regulatory autonomy.

[212] J. Kurtz, 'Building Legitimacy through Interpretation in Investor-State Arbitration: On Consistency, Coherence, and the Identification of Applicable Law' in Z. Douglas, J. Pauwelyn and J. E. Viñuales (eds.), *The Foundations of International Investment Law: Bringing Theory into Practice* (OUP, Oxford, 2014).
[213] M Andenas and S Zleptnig, 'Proportionality and Balancing in WTO Law: A Comparative Perspective' (2007) 20(1) Cambridge Review of International Affairs.

While the effectiveness of the above is constrained by its lack of pervasiveness given the limited number of BITs with NPM clauses, ISDS is encouraged to adopt proportionality analysis where NPM safeguards are absent, to efficiently balance the interests of foreign portfolio investors and emerging and frontier economies. Though this might significantly empower ISDS to review State objectives, it serves as an objective opportunity for ISDS to evaluate the benefits of both competing rights and decide which is most necessary. Consequently, it is submitted that based on this approach, it is very likely that ISDS will find macroeconomic changes for preventing or mitigating crisis which affects foreign portfolio investments as necessary given that the benefits of safeguarding host State macroeconomic rights outweighs the costs foreign investors will incur since the riskiness of investing in emerging and frontier economies are contemplated, and voluntarily assumed when moving capital therein.

Chapter Eight

Conclusion

8.0 Introduction

Globalisation through widespread adoption of capital account liberalisation and improvements in information technology ushered in massive movements of foreign portfolio investments capital (FPI). Access to foreign portfolio investments can now be had electronically through mobile brokerage trading platforms[1] such as Charles Schwab, Robinhood, Fidelity etc. These transactions are mostly done outside the host State's territorial jurisdiction, and often, without the host State directly receiving proceeds of the transactions especially when they exchange hands extra-territorially. Also, monetary easing in developed countries after the global financial crisis resulted in significant capital movements into emerging/frontier economies.[2] The past ten (10) years mostly witnessed the increase in capital flows to emerging/frontier economies.[3] The increase in FPI flows into emerging markets in the past decade is attributable to their higher interest rates compared to developed countries owing to monetary easing, and the narrowing of risk perception between developed and emerging/frontier economies.[4] However, the Covid-19 pandemic, and the consequential supply chain crisis amidst high inflation, has resulted in a tightening of global economic conditions with massive FPI flows out of emerging/frontier economies.[5]

8.1 Why Unrestricted FPI Should not be Protected

While FDI involves the ownership of assets by foreign investors for the purposes of controlling and influencing the use of those assets; Foreign portfolio investments are essentially the results of investor decisions to move foreign portfolio investment assets wherever they are likely to make themselves better off. Thus, global, and domestic factors play a pivotal role in foreign portfolio investment movement, volatility, and risks. Historically, these risks were managed by

[1] Madison Darbyshire, 'Traders Phone Up Gambling Helplines as Game-like Broker Apps Spread' *Financial Times* October 6, 2021.
[2] Gaston Gelos et al., 'Capital Flows at Risk: Taming the Ebbs and Flows' file:///C:/Users/rxxn34/Downloads/CapitalFlowsAtRisk_TamingTheEbbsA_preview.pdf
[3] Emerging and Frontier Markets: Capital Flows, Resiliency, Risks, and Growth https://bankinglibrary.com/emerging-and-frontier-markets-capital-flows-resiliency-risks-and-growth-2/
[4] Yilmaz Akyuz, 'Capital Flows to Developing Countries in a Historical Perspective: Will the Current Boom end with a Bust?' (2011) South Centre Research Paper 37, 15.
[5] Patrick Schnieder et al., 'Managing volatile capital flows in emerging and frontier markets' CEPR https://cepr.org/voxeu/columns/managing-volatile-capital-flows-emerging-and-frontier-markets; Gaston Gelos et al., 'Capital Flows at Risk: Taming the Ebbs and Flows'

merchant banks and even the now defunct corporation of foreign bondholders, but now these risks are managed by domestic financial regulations and financial engineering.

However, the unrestricted movement of FPI is mostly viewed negatively. Since after the first World War, liberalized FPI capital movements were considered as destabilizing. This was the prevailing view until the 1970s and 1980s with the advent of neoliberalism in developed countries which resulted in the adoption of capital liberalisation in finance and investment. With the drying up of capital in the 1980's developing countries under the influence of developed countries began to adopt capital liberalisation policies, including within their international investment law framework and policies, to attract capital for development. However, the effects of the Asian Financial Crisis in 1997 was a reminder of the destabilizing effects of unrestricted FPI capital flows. Consequently, numerous studies were conducted to determine the relationship between unrestricted capital flows, especially FPI and economic distress/crisis. According to Hausmann & Fernandez Arias, foreign portfolio investments are 'driven by speculative considerations based on interest rate differentials and exchange rate expectations, not on long-term considerations.'[6] As a result, they are 'bad cholesterol'.

Unrestricted FPI movement is associated with an economic boom-bust cycle because of their search for favourable economic conditions. Reliance on short-term debt financing denominated in foreign currency by emerging/frontier economies; as well as high interest rates and improved growth prospects in emerging and frontier markets, amid low interest rates and monetary expansion in developed economies accounts for the boom phase of capital flows.[7] However, tightening of global conditions especially in developed countries like the US and the UK, results in massive and sudden flow reversals, sell-offs, and repayment demands which can account for the bust phase of capital flows.[8] The effect of this massive and sudden reversals if not contained could be crisis.[9] The economic and financial crisis of the past 40 years have followed this template.[10] To curb this, and prevent economic crisis, emerging/frontier economies must adopt macroeconomic and capital flow measures.[11] The international

[6] Ricardo Hausmann & Eduardo Fernandez Arias, 'Foreign Direct Investment: Good Cholesterol?' (2000) Inter-American Development Bank Research Department Working Paper No. 417, 3.
[7] Yilmaz Akyuz, 'Capital Flows to Developing Countries in a Historical Perspective' (n 4) 1.
[8] Ibid 23.
[9] Guillermo A. Calvo and Carmen M. Reinhart, Capital Flow Reversals, the Exchange Rate Debate, and Dollarization (1999) 36(3) IMF Finance and Development; Pablo Emilio Guidotti, Federico Sturzenegger, Agustin Villar, 'On the Consequences of Sudden Stops' (2004) 4(2) Economia Journal 171-214.
[10] Yilmaz Akyuz, 'Capital Flows to Developing Countries in a Historical Perspective' (n 4) 5.
[11] https://mronline.org/2022/07/27/capital-flight-from-emerging-markets/

economic law institutions like the IMF and World Bank recognise the necessity for macroeconomic capital flow control measures.[12]

It then begs the question why academics and investment arbitration tribunals would recognise and uphold unrestricted FPI movement by extending international investment law protection to FPI? Investment treaty law protection of foreign portfolio investment can incapacitate host state macroeconomic flexibility necessary in times of economic distress and economic/financial crisis. Macroeconomic policies including Capital Flow Management measures[13] (CFM), are designed to address macroeconomic challenges within the wider economy.[14] Economic theories support macroeconomic flexibility and interventions to control capital movements. Keynesian as well as Monetarist economics advocates for Macroeconomic flexibility[15]. It is fundamental for host State's to have macroeconomic policy flexibility, and monetary policy independence to deal with economic distress and financial crisis as could be seen in the financial crisis in Asia, Argentina etc.

Most BITs/Investment Chapters mostly between the major developed home States, and emerging/frontier economies reviewed in this thesis embody an absolute, non-derogable form of capital liberalisation in which emerging/frontier economies must recognise and protect all kinds of FPI. They create obligations without any possible or potential safeguards.[16] A broad definition of investment with guarantee of unrestricted transfer of funds without any safeguards but with investment arbitration protection is the most radical and farthest reaching international economic framework for entrenching capital liberalisation on emerging/frontier markets. Such that, any form of macroeconomic interference will be the subject of investment arbitration, even if such interference is meant to mitigate or avert crisis. The effect is that where there are no express or implied exclusion of foreign portfolio investments, or no available safeguards, foreign portfolio investments may be considered as investments in these BITs/Investment

[12] International Monetary Fund, 'Review of the Institutional View on the Liberalisation and Management of Capital Flow' (2022).
[13] Capital Flow Management measures (CFM) are host State measures to manage sudden and large destabilising capital inflows and outflows.
[14] Federic Mishkin, 'Financial Instability and Monetary Policy' A Speech delivered at the Risk USA 2007 Conference in New York on 05 November 2007 https://www.federalreserve.gov/newsevents/speech/mishkin20071105a.htm
[15] Internal balance includes employment and price stability, while external balance includes a balance of payment equilibrium and exchange controls. See Deepak Nayyar, 'Rethinking Macroeconomic Policies for Development' (2011) 31(3) Brazilian Journal of Political Economy 340
[16] Rachel D Thrasher, Sarah Sklar, Kevin P Gallagher, 'Policy Space for Capital Flow Management: An Empirical Investigation' (2021) 24(4) Journal of International Economic Law 780

Chapters, and extended substantive protection rights, without any corresponding rights in favour of the host States[17]. Thus, permitting international investment law foreign portfolio investment protection without providing exceptions, can give investment arbitration the vires to review host State macroeconomics policies including monetary policies like interest rates, exchange rates etc., when they affect portfolio investments negatively. It goes without saying how this can hamper host State macroeconomic flexibility in times of crisis[18] contrary to the economic independence of finance and monetary authorities as well as the principle of economic sovereignty of host States.[19]

Interestingly, during the World Bank and IMF Annual Meeting in Honk Kong in October 1997[20], the IMF attempted to amend its remit to include capital account liberalisation. However, it was cautioned that for liberalisation to take place, host State must have strong and stable financial institutions and strong regulatory framework. Instructively, none of the arbitration decisions allowing jurisdiction nor the academic proponents of a broad definition of investments, took into consideration the factor of financial development. This is quite critical because some emerging and particularly frontier economies do not have the institutional and regulatory structures necessary to support capital liberalisation policies as identified by the IMF[21], nor do they have the adequate safety nets for supporting their citizens should crisis deteriorate. Financial and economic crisis has distributional consequences in emerging and frontier economies such as unemployment, lower income etc which is made worse by the lack of or unavailability of social safety nets when compared to developed States.[22] According to the IMF, the chances of significant outflows when financial market depth improves by a standard deviation, reduces to less than 10%.[23] Instead, academics and arbitration tribunals advocate for the indiscriminate promotion and protection of capital account liberalisation without considering emerging and especially frontier economies' capacity to manage foreign

[17] Arcuri, Alessandra, 'The Great Asymmetry, and the Rule of Law in International Investment Arbitration' in Lisa Sachs, Lise Johnson and Jesse Coleman, eds., *Yearbook on International Investment Law and Policy* (OUP, 2019) Available at SSRN: https://ssrn.com/abstract=3152808 or http://dx.doi.org/10.2139/ssrn.3152808 p 6
[18] Rachel D Thrasher, Sarah Sklar, Kevin P Gallagher, 'Policy Space for Capital Flow Management: An Empirical Investigation' (n 16) 783.
[19] See Adaeze Agatha Aniodoh, 'Host States' Monetary Sovereignty Within the Construct of Bilateral Investment Treaties' (2021) 65 (1) Journal of African Law 5-6.
[20] World Bank Group-IMF Annual Meeting in Hong Kong 1997
[21] Barry Eichengreen & Michael Mussa, 'Capital Account Liberalisation and the IMF' *Finance & Development* December 1998 35(4) https://www.imf.org/external/pubs/ft/fandd/1998/12/eichen.htm
[22] Joseph Stiglitz, 'Capital Market Liberalisation, Economic Growth and Instability' (2000) Columbia Business School https://www0.gsb.columbia.edu/mygsb/faculty/research/pubfiles/1479/Stiglitz_CapMktLiberaliz.pdf p 4.
[23] International Monetary Fund, *Global Financial Stability Report: Markets in the Time of Covid-19* (April 2020) Chapter 3 p 55

portfolio investments, and its consequences. Promisingly, some BITs between mostly emerging/frontier economies are now currently being executed with express exclusion of foreign portfolio investments.[24]

Consequently, this thesis argues against the extension of investment law regime protection to foreign portfolio investments because they are most sensitive to host State macroeconomic changes thereby increasing the risk of host State macroeconomic measures being challenged by foreign investors before investment arbitration. Protecting them will entrench capital liberalisation in its most extreme form especially where investment agreements have no safeguard clauses, because it will mean that any form of capital can enter and leave a host State without any regulation by the host State. The effect will be that host States will be forced to maintain only favourable policies reflective of capital liberalisation, even if those policies make no sense at all.

8.2 Preventing Unrestricted FPI capital flow Protection

To address the above issues with FPI protection, this thesis illustrated jurisdictional and substantive concerns within the international investment law regime which challenges the entrenchment of this detrimental radical type of capital liberalisation. Thus, host States can effectively defend their policies and maintain macroeconomic independence. To mitigate the effect of a blanket adoption of capital liberalisation within the extant international investment law regime, this thesis relies on jurisdictional and substantive doctrinal analysis which may be adopted to exclude extant BITs/Investment Chapters with such broad and blanket adoption of unrestricted capital to prevent or mitigate potentially catastrophic economic effects of such adoption on emerging and frontier economies at the brink of, or amidst economic and financial crisis.

[24] There are about 31 BITs out of over 2000 that excludes FPI. For instance, see Agreement between The Government of the Republic of Rwanda and the Government of the Republic of Turkey Concerning the Reciprocal Promotion and Protection of Investments (2016) Article 1, which excludes share acquisition less than 10%, and requires lasting economic relations in host state. See also, Mapping of IIA Content | International Investment Agreements Navigator | UNCTAD Investment Policy Hub

8.3 A Correct Meaning of Investment under the International Investment Law Regime

This thesis points out that in uncovering the meaning of 'investment,' recourse has been had to just the specific definitions contained in Bilateral and Multilateral investment treaties,[25] or the ordinary objective meaning of the word from usage.[26] However, for the latter approach to be within the framework of the ICSID convention demands examining the meaning of the word, 'investment' within the context of the convention.[27] This can be achieved if ICSID tribunals move from a BIT-party autonomy subjectivist conception of investments which encompasses portfolio investments,[28] to a more objective meaning of investments related to the object and purpose of the ICSID convention which is economic development. It is the narrative of BIT deference that has led to the expansion of the meaning of investment to encompass portfolio investments in the form of sovereign bonds,[29] corporate bonds,[30] and potentially, investment funds.[31]

Consequently, ICSID tribunals must consider whether protecting portfolio investments will derogate from host State economic development owing to their chilling effect on host State macroeconomic policy. For instance, protecting sovereign bonds as investments have been known to undermine host State sovereign debt restructuring efforts.[32] Similarly, protecting speculative ETFs for arbitrage, or speculative short-term debt for carry-trade will undermine host State exchange rate and interest rate policy making efforts. Therefore, it is contended that that extending ICSID coverage to portfolio investments exposes the State to potential challenges of its macroeconomic and macro-prudential policies, which will result in undermining host State economic development.

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[25] *Lanco Int'l Inc v. Argentina* (ICSID Case No. ARB/97/6) Decision on Jurisdiction and Admissibility of 8 December 1998 para 48.

[26] *Fedax N.V v. The Republic of Venezuela* (n 4); *Salini Costruttori S.p.A v. Kingdom of Morrocco* ICSID Case No. ARB/00/4 Decision on Jurisdiction 23 July 2000.

[27] Rudolf Dolzer & Christoph Schreuer, *Principles of International Investment Law* (OUP 2nd edn, 2012) p. 61.

[28] Julian Davies Mortenson, 'The Meaning of "Investment": ICSID's Travaux and the Domain of International Investment Law [2010] 51 Harvard International Law Journal 281; Emmanuel Gaillard, 'Identify or Define? Reflections on the Evolution of the Concept of Investment in ICSID Practice' in Christina Binder et al., (eds) *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer* (OUP, 2009).

[29] *Abaclat & Others v. Argentine Republic* ICSID Case No. ARB/07/5 Decision on Jurisdiction and Admissibility (4 August 2011); *Ambiente Ufficio SPA & Ors v. Argentina* (ICSID Case No. ARB/08/9) Decision on Jurisdiction and Admissibility of 8 February 2013.

[30] *Olguin v. Republic of Paraguay* ICSID Case No. ARB/98/5 Decision on Jurisdiction (8 August 2000).

[31] *Gruslin v. Malaysia* ICSID Case No. ARB/99/3 Award (27 November 2000)

[32] *Abaclat & Others v. Argentine Republic*; *Ambiente Ufficio SPA & Ors v. Argentine Republic*.

However, where jurisdiction is found, foreign portfolio investment investors as claimants can claim host State macroeconomic policy violation of any of the following substantive standards of protection contained in BITs/Investment Chapters to wit: violation of Fair and Equitable Treatment;[33] and Transfer Clause Restriction;[34] while host States can rely on safeguards contained in BITs/Investment Chapters to justify macroeconomic policy independence and flexibility, or where safeguards are absent, can rely on a proportionality analysis of the conflicting rights to demonstrate the necessity of the macroeconomic policy in the face of instant or impending crisis. This is because Financial/economic crises though rare and extreme events have massive economic and social cost implications for the State in question or the global economy. To this end, States must act to avert such crisis or mitigate its impact. However, host State macroeconomic measures deployed to avert or mitigate economic and financial crisis such as, sovereign debt crisis, currency crisis etc., incidentally, will adversely affect portfolio investments owing to their sensitivity to macroeconomic and systematic risk conditions. Where such host State macroeconomic countercyclical measures cause loss of value to foreign portfolio investments protected under BITs, it can justify a claim for breach of substantive protection standards such as FET and Transfer of Funds clauses.

8.4 Foreign Portfolio Investment & Fair and Equitable Treatment

FET is the most widely used protection standard for challenging all facet of host State conduct or omission that affects foreign investors' investments. In the realm of portfolio investments, the contested host State measures are macroeconomic measures. Given the propensity for FET to freeze host State regulatory powers, FET potentially could constrain host State macroeconomic measures autonomy, or result in positive discrimination in favour of portfolio investments. The effect of this outcome may portend negative economic consequences especially in times of economic crisis, where such macroeconomic measures will be necessary to address the economic situation.

Bearing all this in mind, this thesis demonstrates that foreign portfolio investments, may not be in breach of the Fair and Equitable Treatment (FET) standard of protection. This is because jurisprudentially, the circumstances of each case, and context of each situation (including the

[33] *Abaclat & Others v. Argentine Republic*; *Ambiente Ufficio SPA & Ors v. Argentine Republic*.
[34] *Gruslin v. Malaysia*

economic condition of the host State) are usually considered by the tribunals to deny FET protection. What this means is that a mere claim of FET violation does not automatically mean a finding of breach. The incidence of FET breach such as legitimate expectation etc, will be considered in relation to circumstances of each case including whether there was an express stabilisation commitment leading to a creation of expectation,[35] and the economic condition of the host State[36] will be considered in determining the existence of FET. Furthermore, a stricter standard based on the egregiousness of the macroeconomic measure is required where FET is tied to the minimum standard of treatment under customary international law such as in US and Canadian treaties[37], makes it quite difficult for the claimants to prove the egregiousness of the macroeconomic measure to succeed in the FET claim.

8.5 Foreign Portfolio Investment & Transfer of Funds Clauses

One of the cornerstones of capital liberalisation is the unrestricted freedom to move capital in and out of a host State. This right is enshrined and protected in Transfer of funds clauses in BITs/Investment Chapters which in most cases have no exceptions. However, though debatable, there is some correlation between liberalised capital movement and economic/financial crisis.[38] The best evidence of this is the recognition within international economic governance of the need for capital movement control, even pre-emptive control to prevent economic distress.[39]

Consequently, host States must have the right to intervene amidst unrestricted FPI flows by adapting macroeconomic measures such as transfer restrictions which may be harmful to foreign portfolio investments but are necessary for mitigating or preventing economic/financial crisis. These safeguards could be in the form of exceptions contained within Transfer of funds clauses in BITs.[40] However, majority of BITs do not contain exceptions to transfer clauses,

[35] *Total S.A. v. The Argentine Republic* ICSID Case No. ARB/04/01 Decision on Liability 27 December 2010 para 164.
[36] *EDF (Services) Limited v. Romania* ICSID Case No. ARB/05/13 Award 8 October 2009.
[37] NAFTA, Article 1105(1) now replaced by USMCA Article 14.6; US Model BIT 2012 Article 5; Canada Model FIPA (2014) Article 6.
[38] Ricardo Hausmann & Eduardo Fernandez Arias, 'Foreign Direct Investment: Good Cholesterol?' (n 6) 3; United Nations Conference on Trade and Development, Trade and Development Report 1999 112-113.
[39] International Monetary Fund, 'Review of the Institutional View on the Liberalisation and Management of Capital Flow' (2022).
[40] For instance, see UK-Bangladesh BIT (198) Article 6; Morocco – UK BIT (1990) Article 7.

though some BITs contain exceptions to transfer clauses. Where present, these exceptions include BoP exceptions which forms part of the transfer clause.[41]

Where specialised exceptions such as BoP exceptions are included in transfer of fund clauses in BITs/Investment Chapters, they offer some space for host State macroeconomic flexibility in imposing transfer restrictions, sometimes even better than the International Monetary Fund and the World Trade Organisation where they allow restrictions on capital and current transactions without being subject to the IMF.

However, such autonomy and flexibility to restrict transfer may be constrained by the effect of MFN clauses. Possible policy solutions include, removing any obligation or penalties on foreign investors if they don't transfer into the home State;[42] or removing MFN completely from BITs/Investment Chapters. The challenge with removing MFN remains whether developed countries will be willing to sign such treaties.

8.6 Exceptions and Proportionality Analysis of Foreign Portfolio Investment Protection

Having a general overview of the investment treaty regimes as mapped by UNCTAD, it is undisputable that there exists limited policy flexibility for host State interventions in the face of impending crisis or existing crisis. While host States could rely on the fundamental change in circumstance doctrine codified in Article 62 of the VCLT 1969; or on the customary international law plea of necessity, these options are not without own challenges in providing safeguard for host State macroeconomic space.

In relation to the fundamental change in circumstance doctrine codified in Article 62 of the VCLT 1969 the host state must satisfy the condition precedent under Article 65 to succeed. The host State must notify the foreign portfolio investor home State of its intention to suspend the treaty provisions in view of impending crisis, and it is only where the home State does not object that the host State can issue an instrument suspending the operation of the treaty. However, where the home State objects, the parties must settle the emerging dispute based on the consensual mechanism within the treaty (investment arbitration), or through other

[41] For instance, the Mexico-UK BIT (2006), Article 8(4) allows for temporary restriction of transfers during serious Balance of payment crisis.
[42] Jeswald Salacuse, *The Law of Investment Treaties* p 261, See Canadian Model BIT and Article 1109(3) NAFTA

mechanisms provided in Article 33 UN Charter.[43] It is quite doubtful a developed home state will not object.

While in the customary international law plea of necessity under Article 25 ILC Responsibility of States for International Wrongful Acts (RSIWA),[44] the host State macroeconomic measure which affected FPI, to be permissible must be the 'only way' of dealing with the exceptional crisis. This will be quite challenging for emerging/frontier economies[45] given the preponderance of macroeconomic policies that could be adopted during a crisis, or to avert a crisis. It will be difficult to show that the specific measure is the only way of addressing the crisis.

However, where available, recourse can be had to NPM clauses to nip in the bud the possible challenges substantive protection standards may pose for host State macroeconomic policy making in relation to portfolio investments amidst crisis. Analysis of the NPM clause depends on whether it provides for general exceptions or specific sectoral exceptions such as exceptions for financial/economic measures. Where there are specific NPM safeguards such as prudential or economic/financial measures carve-out clauses in IIAs, host States can rely on such clauses to justify macroeconomic measures for macroeconomic or prudential purposes taken by the host State.[46] Here, FPIs will be unable to complain about macroeconomic measures undertaken by emerging/frontier economies.

Furthermore, where there is a general NPM safeguard clause with a 'necessity' requirement, a least restrictive means approach of proportionality analysis for interpreting the necessity requirements is an effective and objective framework in dealing with the competing interests of ensuring substantive protection and preserving host State regulatory autonomy. In this scenario, the investment arbitration tribunal when presented with the emerging/frontier economy's justification for the offending measure, must consider the following factors: (i) whether the measure is necessary in achieving the host State's objective; (ii) whether the

[43] United Nations, Vienna Convention on the Law of Treaties, 23 May 1969, United Nations, Treaty Series, vol. 1155 Entry into force: 27 January 1980, Article 62(3).
[44] International Law Commission Draft Articles on Responsibility of States for International Wrongful Acts (RSIWA), Article 25.
[45] Stephen Schill, International Investment Law & Host State's Power to Handle Economic Crisis (2007) 280-281. Owing to the stringency of the 'only way' requirement under a customary plea of necessity, especially as it relates to economic measures, reliance is best had to NPM clauses.
[46] Armenia-Canada BIT (1997) Article XI (1); Burkina Faso-Canada BIT (2015) Article 18(2); Chile-Hong Kong, China SAR BIT (2016) Article 18(2); Australia-Japan EPA (2014) Article 14.16(1) & (2).

measure contributed to achieving the objective; and (iii) whether among the suite of possible measures, the offending measure is the least restrictive of the investor's rights. It is submitted that most emerging/frontier economies macroeconomic measures in times of crisis, affecting FPI will meet this requirement since the crisis or impending crisis makes them necessary for crisis aversion or mitigation. *Ex post,* the measures contributed to crisis aversion or mitigation like capital controls, though debatable; and there may not be alternative measures that will achieve the host State objectives with less restriction on FPI rights.

However, while the effectiveness of the least restrictive means analysis is constrained given the limited number of BITs with NPM clauses, investment arbitration tribunals are encouraged to adopt proportionality analysis where NPM safeguards are absent, to efficiently balance the interests of foreign portfolio investors and emerging and frontier economies. Though this might significantly empower investment arbitration to review emerging/frontier economies' objectives, it serves as an objective framework for investment arbitration to evaluate the benefits of both competing rights and decide which is most necessary. Consequently, it is submitted that based on this approach, it is very likely that investment arbitration will find macroeconomic measures for preventing or mitigating crisis which affects foreign portfolio investments as necessary given that the benefits of safeguarding host State macroeconomic rights outweighs the costs foreign investors will incur since the riskiness of investing in emerging/frontier economies are contemplated, and voluntarily assumed when moving capital therein. Additionally, most times the investment is not totally lost due to the measure, just the value which is decreased, and can recover as the economy improves and the effect of market forces. Finally, protecting foreign portfolio investments against macroeconomic policies changes will result in compensation for commercial/credit risk, and create a moral hazard problem[47] which may incentivise more and potentially reckless foreign portfolio investment movements owing to a reinforcement of risk-taking behaviour, and a situation of *fait accompli* on host States.

In sum, as has been demonstrated in this thesis, unrestricted FPI movement can have negative consequences, thus the need for regulation which can create risks for FPI. Resorting to the international investment law regime for foreign portfolio investment protection and

[47] Moral Hazard problem occurs where one party in a transaction is more comfortable taking financial risks because they are aware that they will not bear any negative consequences. As a result, they tend to act more recklessly.

management of systematic risks occasioned by macroeconomic flexibility is inefficient owing to the jurisdictional and substantive obstacles that must be overcome. Thus, success is not guaranteed when considering the percentage of investor successes in investment arbitration. According to the 2022 ICSID Caseload Statistics for 2021, 31% of claims were in favour of the investor, while 33% were in favour of the State broken down as 18% declined jurisdiction and 15% failed on the merit.[48] The percentage will be lower for foreign portfolio investments specifically because of the ICSID jurisdictional threshold issues, which most FDI investments may easily overcome. Aside that, succeeding with the international investment law regime will only result in macroeconomic flexibility chill, which will impose greater costs on host States' social welfare and economic growth due to their inability to react to prevent or mitigate economic crisis. Additionally, investment arbitration is an expensive means of dispute settlement[49] when compared to domestic commercial law and financial engineering which are a lot cheaper with significantly lesser negative externalities. It may also take a long time to deliver an award.[50] Consequently, the costs outweigh the benefit. Consequently, FPI investors can rely on domestic law and institutions for investor protection where applicable, as can be found in existing frameworks in finance and commercial law, and at the macro level, financial engineering strategies such as portfolio insurance, hedging etc., for diversification. Diversification should go beyond asset classes like equity and bonds, to include alternative investments like real estate, art etc. However, it will be difficult for retail investors to diversify owing to their limited resources. At best they may acquire interests in investment funds which may already be diversified. This will be challenging for retail investors. Needless to say, systematic/macroeconomic risks are non-diversifiable, therefore very little can be done.

[48] https://icsid.worldbank.org/news-and-events/comunicados/icsid-releases-2021-caseload-statistics. It is noteworthy that the financial sector accounted for less than 3% of cases in 2021.
[49] Lise Johnson & Lisa E. Sachs, 'The Outsized Costs of Investor–State Dispute Settlement' (2016) 16(1) AIB Insights 10.
[50] *Daimler Financial Services v. Argentine Republic* ICSID Case No. ARB/05/1 Award (22 August 2012). 245.

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