AN ANALYSIS ON THE SUBJECT OF BILATERAL INVESTMENT TREATIES TERMINATION*

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Abstract

Bilateral investment treaties (BITs) are a major subset of international investment agreements, in which two States agree to promote and protect investments made by investors from respective countries. Many States have been willing to give up certain immunities and privileges for perceived economic benefits associated with BITs. In recent years, however, a slew of countries have voiced their dissatisfaction with the current international BIT regime and indicated intentions to terminate their BITs. Most, but not all, are developing countries, Indonesia included. This wave of terminations raises concerns about the stability of BITs and their future, and also questions on whether or not a rule of customary international law in regards to the termination of BITs is currently developing. This article analyses the State practices on BIT terminations in an attempt to further understand their legal effects and underlying causes, and also to discern whether these State practices form a pattern that can lead to the development of a new customary international law.

Intisari

Perjanjian Investasi Bilateral (BITs) adalah subset utama perjanjian investasi internasional, dimana dua Negara sepakat untuk mempromosikan dan melindungi investasi yang dilakukan oleh investor dari Negara masing-masing. Banyak Negara telah bersedia untuk menyerahkan kekebalan dan keistimewaan tertentu untuk manfaat-manfaat ekonomi terkait dengan BITs. Tetapi dalam beberapa tahun terakhir beberapa Negara telah menyatakan ketidakpuasan mereka dengan rezim BIT internasional saat ini dan menunjukkan niat untuk mengakhiri BITs mereka. Kebanyakan, walaupun tidak semua Negara tersebut merupakan Negara-negara berkembang, termasuk Indonesia. Gelombang pemutusan ini menimbulkan kekhawatiran tentang stabilitas BITs dan masa depan mereka, serta menimbulkan pertanyaan apakah aturan hukum kebiasaan internasional dalam pemutusan BITs sedang berkembang atau tidak. Artikel ini menganalisa praktik Negara pada pemutusan BIT dalam upaya untuk lebih memahami akibat hukum mereka dan penyebab yang mendasarinya, dan juga untuk melihat apakah praktik Negara ini membentuk pola yang dapat mengarah pad pengembangan hukum kebiasaan internasional yang baru.

Keywords: bilateral investment treaties, termination, international investment law
Kata Kunci: perjanjian investasi bilateral, pemutusan, hukum investasi internasional

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A. Background

The first BIT was concluded in 1959 between Germany and Pakistan.[1] There are now over 2500 BITs in force (UNCTAD, 2013). This dramatic increase is mainly attributed to perceived economic benefits, such as increases in the flow of foreign direct investment (FDI). While there are studies that underline the positive effect of BITs on FDI (Neumayer & Spess, 2005), a sizable number of countries have opted to terminate their BITs,[2] whether due to dissatisfaction with a prevailing BIT or accession to a regional economic organization. [3] This sparks concerns about the stability of the BIT regime and the fate of associated FDI. The question that follows, and the focus of this article, is how does States approach BIT termination? We will examine the practices of State when terminating the BIT. State practice is the general, consistent behavior of States regarding certain issues and one of the key components in ascertaining whether a rule of international customary law exists, alongside *opinio juris,* which is a sense of belief of the State that what they are doing is legally necessary. This article analyzes how and why States terminate their BITs, using data from the United Nations Conference on Trade and Development (UNCTAD), World Bank and Organization for Economic Cooperation and Development (OECD), and other international organizations. Part II of this article discusses the motivations behind BIT terminations. Part III analyzes state practices practice upon terminating BITs. Part IV discusses the legal effects of terminations and their effectiveness of various method of terminations. Finally, Part V considers the future of BITs.

B. Understanding the Motives Behind BIT Terminations

i. The economic benefits of BIT: real or illusory?

It is useful to analyze States' motives in concluding BITs, before analyzing why states may want to terminate BITs. In the 1980s and 1990s, when a sizeable number of BITs were concluded, a notion prevailed that BITs would increase FDI. Developing countries, eager to attract FDI were quick to conclude BITs with developed capital-exporting countries. In this period, BITs more closely resembled standard contracts rather than typical treaties between sovereign nations. Capital-exporting countries usually relied on a template or model BIT, to which developing countries usually agreed subject to few or no amendments, either because they had little negotiating power or they simply are too eager to conclude BITs and experience the alleged growth in FDI to care much about the terms. These model BITs also explain why many BITs are very similar and, despite their numbers, only a few BIT types exist. A typical modern BIT includes provisions designed to offer absolute (i.e. treatment in which the exact meaning is already pre-determined) and relative (i.e. treatment in which the meaning is determined by the treatment accorded to other investors) standard of treatments to investors, protections against expropriation or nationalization, investor-state dispute

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[1] See, the Entry into Force of Bilateral Investment Treaties, IIA Monitor No. 3, New York and Geneva (UNCTAD 2006), p. 2.

[2] See for example, the termination of Indonesia-Netherlands BIT. See for example, the termination of South Africa-Benelux BIT. A couple of countries, like Ecuador and Bolivia have gone further and denounced the ICSID Convention, which is the basis of many investor-State arbitration rules.

[3] Several EU Member States that joined in the 2000s have concluded BITs with older EU Member States prior to their accession, creating a network of intra-EU BITs. The European Commission has stated that these intra-EU BITs are obsolete and has asked Member States to terminate them.

settlement and other privileges, such as guarantees against restrictions on investors freely transferring money between contracting states.

Such privileges and benefits were designed to make a country as attractive as possible to investors. However, some evidence suggests that BITs may not have a significant economic impact. A 2002 study by World Bank suggests that "even the relatively strong protections in BITs do not seem to have increased flows of investment to signatory developing countries." This study further states that "countries that have concluded a BIT were no more likely to receive FDI than were countries without such a pact." Indeed, when one sees what has happened in Brazil, a country that has seen substantial FDI growth despite having no BITs currently in force, and compare this to the plight of some Central American nations which, despite having a great number of BITs in force only see little FDI growth (Peterson, 2004), one may conclude that the perceived economic advantages of BITs have been exaggerated. This may have contributed to the backlash against BITs.

ii. Abundant international arbitrations

Many of the countries that have recently opted to discontinue their BITs are developing countries. [4] Some of these developing countries are currently or have been involved in investor-state disputes.[5]

The dispute settlement clause in a BIT typically enables an investor to initiate a claim before an international arbitration tribunal against the contracting state for violations of the BIT's provisions. Such clauses were initially designed to protect investors from the alleged biases of local courts and provide them with another avenue of legal recourse where local remedies were impossible or cumbersome.

Countries usually have to issue policies in the name of public interest and fulfilling domestic and international developmental goals. Some of these policies can be quite intrusive, such as having a quota for domestic workers (which some countries claim is important to protect domestic workers from cheaper immigrant labor), restricting foreign access to certain industries, or giving preferences to certain marginalized groups in certain industries (which some countries claim is necessary to correct inequality).[6] These policies may be interpreted to be violating some of the substantive protections included in the BIT, such as fair and equitable treatment, and the non-discrimination principle. But even though states contend that these policies and regulations are necessary, most BITs do not have exceptions for policies designed to fulfill development goals. If an investor considers a policy or a regulation to be

[4] "Developing countries" in this journal article shall be defined as countries that are listed as "low-income countries" or "lower middle-income countries" or "upper middle-income countries" by the World Bank. According to the UNCTAD IIA database, 41 out of 68 BITs that have been terminated and not replaced involved at least one country in one of those three listed categories.

[5] See for example, *Churchill Mining PLC and Planet Mining Pty Ltd. v. Republic of Indonesia* (ICSID Case No. ARB 12/14 and 12/40). In 2007, a group of Luxembourgian and Italian investors brought a claim against South Africa under the South Africa-Italy BIT and the South Africa-Luxembourg BIT, claiming that the enactment of an act was a form of expropriation. The case was settled in 2010 which precluded deciding on the merits.

[6] For example, the claim that was brought by the Luxembourgian and Italian investors against South Africa is prompted by a bill that would give Black Africans, who have been historically marginalized, preferences over foreign investors and domestic White African investors in mining rights. While investors claim that the bill is discriminative, the South African government contends that the bill is needed to correct the injustice that has been borne by Black Africans for years.

violating their rights under the BIT, they could threaten to take a state to international arbitration.

Arbitration is expensive and not all countries can afford it. Moreover, there have been several studies that suggest that, relative to their per capita incomes and budgets, developing countries pay more than developed countries when defending themselves in international arbitrations. One must also take into account the large compensation amounts investors seek, which often reaches hundreds of millions of dollars.[7] It is not very surprising then, that a lot of countries chose to settle with investors making claims instead of going to arbitration.

Some recent examples of international arbitrations influencing governmental policy-making are when the Togolese and Australian governments were planning to introduce a plain-packaging policy to reduce cigarette consumption in their countries. A tobacco company threatened to initiate international arbitrations against both states under respective BITs if they proceeded with their plain-packaging policies. Furthermore, they sent a letter insinuating to the Togolese government that the plain-packaging policy would violate their constitution and binding regional and international agreements, and that Togo was in no position to anger their international partners; the Togolese government decided to scrap their proposed bill.[8] The Australian government decided to proceed with its bill and face the prospect of arbitration.[9] While the case against the Australian government was dismissed on jurisdictional ground, the Togolese government's decision to abandon its policy presents a clear example of how the mere threat of arbitration can influence a state's policy-making process. Considering that arbitrations often proceed behind closed doors and that settlement details with investors are also often confidential, which may lead to certain transparency issues. Some states pride themselves on having an independent legislature, and may not take too kindly to foreign investors using an arbitration clause as leverage to influence their decision-making process.

Judicial corruption and partial law enforcement are real issues that face investors, especially those who invest in developing countries. Historically, cases of forced expropriation and nationalization by a government have been supported by the judiciary, leaving investors with no legal recourse to recoup their assets. Local law also may also not uphold international standards. International arbitration is also sometimes more swift and effective compared to local court proceedings, which may go on for years. A BIT is designed to prevent such things from happening again, but the perceived disadvantages of investor-state dispute settlement clauses and arbitration threats by overzealous investors may have spurred some countries to shun BITs altogether.

C. State Practice Regarding BIT Terminations

i. Termination Clause

In the international law of treaties, a treaty is considered lawfully terminated if the procedure prescribed in the treaty itself is followed, or if all of the contracting parties consent to termination.[10] Most BITs have a termination clause that provides that

[7] For example, Churchill Mining seeks $1 billion in damages from Indonesia.

[8] Se: The Economist (2016, August 6). No logo. *The Economist*. Retrieved from: http://www.economist.com

[9] The case would then be adjudicated in the PCA as *Philip Morris Asia Limited (Hong Kong) v. the Commonwealth of Australia.*

[10] See VCLT, Article 59

the treaty will remain in force for a number of years before it can be terminated. The termination clauses in modern-day BITs are broad and varied, but they typically fall into two categories (UNCTAD, 2013). Either the treaty will remain in force for a number of years and thereafter it will:

- remain in force indefinitely until terminated. After the initial 'entry into force' period, a contracting party may invoke the termination procedure at any time. This is known as an "anytime termination" clause;[11] or
- there will be a window period when a contracting state may invoke the termination procedure. If the window period elapses with no termination, a second 'entry into force period' will commence. A contracting state may not invoke the termination procedure outside of the window period. This is also known as an "end-of-term termination" clause.[12]

Most BITs fall under the first category (UNCTAD, 2013). Regardless of the type of termination clause, there will usually be a waiting period before a termination can take effect. Generally, the termination clause only requires the contracting state to notify the other contracting state of its intention to terminate the BIT. This notification will trigger a waiting period after which the BIT will be terminated regardless of whether the other contracting state consents. Therefore, the procedure ascribed in the BIT falls under the category of unilateral termination.

Given it is easy to determine the exact termination date and the consent of the other contracting state is not required, countries tend to prefer the procedure laid out in the BITs when terminating them.[13] For example, Indonesia chose to use this method when terminating its BIT with The Netherlands, which had an "end-of-termination" clause. Ecuador also chose to follow this termination procedure when it terminated its BIT with the United States, which had an "anytime termination" clause. However, it is not very effective time-wise, as countries may have to wait a number of years before they can terminate, and vis-à-vis end-of-termination BITs, they would also have to be precise in doing so during the window period, or else they would risk putting the BIT in force for a number of years without there being a possibility of termination. This is not a viable option to states that have to terminate their BIT in order to conform with requirements laid out by a regional organization e.g. the European Union. This explains why there are some states that terminate their BITs outside of the ascribed procedure.

To ensure the legality of their action, most States when terminating their BITs prefer to follow the procedure laid out in the relevant BIT.[14] Nonetheless, it is possible to terminate outside of the procedure if both contracting parties consent. Terminating a BIT in this way is considered risky, as there is no definite legal definition of "consent" and one cannot make sure when the treaty is terminated. Considering that most BITs have very strict time-based rights and protections (e.g. relating to the sunset clause), this would only create confusion.

[11] See for example, South Africa-Nigeria BIT; see also, South Africa-Denmark BIT

[12] See for example, the Netherlands-Bangladesh BIT; see also, the Netherlands-Indonesia BIT.

[13] According to the UNCTAD IIA database, there are 53 cases of BIT termination categorized as"unilaterally denounced."

[14] According to the UNCTAD IIA database, there are 18 cases of BIT termination by consent, compared to 53 cases of BIT termination by expiration and unilateral termination.

The Vienna Convention on the Law of Treaties states that if a Party wishing to terminate a treaty notifies the other contracting party of its intention, and the other contracting party makes no objection for more than three months, "the party making the notification *may carry out*…the measure which it has proposed." [15] [Emphasis added.] The words "may carry out" are problematic as it is not clear whether the party wishing to terminate can terminate the treaty outright, or that it can carry out the procedure to terminate the treaty but the other party would still be able to make an objection past the three months date.. Some suggest that the treaty would still be operable until at least the acquiescence of the other contracting party has been established (Dorr & Schmalenbach, 2012) but again, there is no one definite way to establish acquiescence and it has to be assessed on a case-by-case basis. Considering most BITs have very strict time-based rights and protections (e.g. the sunset clause), it is paramount to accurately determine the exact date of the termination as it would influence the validity of investor claims.

Due to the legal uncertainty associated with this procedure, there are only few instances of states using it. Although, when both parties are willing and consent is clearly established, it is a useful and powerful tool to effectively terminate a BIT as one does not have to wait for the ascribed duration of the official termination procedure to take effect.[16]

ii. The Consequences of a BIT Termination

When a BIT is terminated, the host state is no longer required to afford investors that are nationals of the other contracting state the privileges and protections provided in the BIT. However, most BITs have a "survival clause". [17] This sunset clause ensures that existing investments still enjoy the privileges and protections under the BIT for a specified number of years after the termination. As a result, it is ineffective to terminate a BIT for the purpose of invalidating an ongoing investor-state arbitration. To get away from the survival period mandated by the BIT, a state could withdraw from the relevant multilateral investment arbitration treaty, as did Bolivia and Ecuador when they withdrew from the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (otherwise known as the ICSID Convention). But if the relevant BIT provides for recourse to another international arbitration tribunal, the claims would still have to be faced in such a tribunal. Barring very exceptional circumstances, a BIT termination could only prevent future investor-state disputes from going to international arbitration.

But not every country that terminates their BITs keep them terminated. A large number of them renegotiate at a later date.[18] Perhaps, over the years a country will gain a more advantageous bargaining position and become dissatisfied with the current BIT regime. But negotiating a new treaty is time-consuming. It could take months, perhaps even years, for a new BIT to be signed. Meanwhile, investors will be stuck in limbo, especially if the new BIT would only afford protections to investments

[15] Vienna Convention on the Law of Treaties, Article 65.

[16] For example, Ireland and Italy when terminating their intra-EU BITs opted to use this method instead. So far they have not faced any repercussions.

[17] See for example, Article XII of the Ecuador-United States BIT

[18] In the UNCTAD database, there are 104 cases of BIT termination and replacement involving developing countries.

made on or after the date of its entry into force.

On the other hand, terminating a BIT might have detrimental effects to FDI. New investors might hesitate in investing if they are not sure they would be guaranteed the same privileges and protections as those that came before. And, as stated above, a BIT is very likely the only protection investors have when dealing with an unstable government. A BIT termination could be taken as a signal that the government of a country is not very welcoming to investors.

iii. BITs: What Happens Next?

Though this wave of BIT terminations is quite concerning, in the long run, BITs will remain an important part of the international investment agreement network. While investor-state arbitration may be one of the leading causes of BIT termination, there is little evidence that investor-state dispute settlement clauses will be dropped altogether. A more likely course is a negotiation of more limited dispute settlement clauses, which will, for example, require investors seek remedies through local courts first or barring certain important measures to be brought to arbitration.[19] There is also a recent trend for multilateral investment treaties and free trade agreements to adopt a more BIT-like approach by including some clauses found in BITs, such as the investor-state dispute settlement clause. An example of such clauses can be found in the Trans-Pacific Partnership Treaty, which Australia has agreed to join. Some countries that have terminated their BITs now would still have obligations arising from some multilateral investment agreements.

However, the questions that arise when a country terminates their BITs should not be ignored. There has to be a reform in the international investment regime, not only in the way that international investment agreements are drafted, but also in how international investment arbitration tribunals work. The concerns about the transparency of international arbitration courts, the compatibility between BITs and developmental goals, the balance between government and investor rights and obligations are valid, but the solution is not to shun BITs altogether. That would be like amputating an arm when stitching the wound would suffice. Countries would need to band together to correct these deficiencies, perhaps by including clauses in the BIT that would allow leniency on policies that aim to fulfill developmental goals, pushing for more transparent and consistent arbitration tribunals, fostering dispute avoidance and promoting more peaceful alternative dispute resolution methods, such as mediation and conciliation

[19] A recent example of this type of dispute settlement clause is found on the Australia-Korea Free Trade Agreement.

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