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# **The ASEAN Way of Investment Protection**

An Assessment of the ASEAN Comprehensive Investment Agreement

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*(Licence en Droit, Master en Droit)*

Submitted in fulfilment of the requirement for the Degree of PhD in Law

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December 2015

## Abstract

This thesis assesses the new ASEAN Comprehensive Investment Agreement (ACIA) in the light of international practice. Investment protection is at the heart of this investment regime. Considering the ACIA as a tool of regional integration, its structure and contents demonstrate its ultimate objective of attracting intra-ASEAN investment flows for the realisation of a single market and production base under the ASEAN Economic Community (AEC). Analysis focuses on the specific elements of the ACIA and how they balance two contradictory interests, *i.e.* the protection of ASEAN investors and the sovereignty of ASEAN Member States to regulate investments in their territory.

Tracking the solutions and innovations of substantial and procedural provisions introduced by the ACIA, it is found that the “ASEAN Way” of consensus and flexibility remains, even though ASEAN has become the AEC with rules and institutions. This general ASEAN Way is specifically reflected in the “ASEAN Way of Investment Protection”. Given the ASEAN-specific context, the ACIA shows a unique balance of States’ and investors’ interests which differs from that of international investment agreements of other regional integration initiatives. While the ACIA aims to protect ASEAN investors, it attempts to respect the sovereignty of ASEAN Member States, by giving more policy space to regulate for public purposes.

From these findings, recommendations are offered to improve the ASEAN investment regime. The understanding of the “ASEAN Way of investment protection” may help interpretation and application of investment protection standards of the ACIA, as well as the other existing investment agreements. The ACIA may also serve as a platform for negotiations of future ASEAN investment agreements.

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## Acknowledgements

First of all, I would like to express my sincere gratitude to my supervisor Professor Christian J. Tams for the continuous support of my Ph.D. study, for his patience, motivation, and immense knowledge. His valuable advice has helped me during the whole period of my research and writing up. He has always pushed me to go beyond my perceived capacity. Without him, my thesis on “the ASEAN Way of Investment Protection” could not have been viable and had such dynamic progress.

Besides the thesis, Professor Tams has also broadened my academic and professional perspectives by encouraging me to participate in conferences and seminars, related to my research: The International Court of Justice (Temple of Preah Vihear, Cambodia-Thailand, interpretation case) (2012); The Hague Academy of International Law (2013); the Franco-Italian International and European Laws Research Centre, Université de Nice Sophia Antipolis (2013); Arbitration Academy in Paris (2014); 4<sup>th</sup> Expert Seminar on Contemporary Perspectives on International Investment Law, Université de Lausanne (2014); the Inaugural Asian Conference on the Social Sciences and Sustainability, Hiroshima, Japan (2014); and the Thessaloniki Summer Course on International Energy Law (2015). Apart from studying in the most beautiful university, the University of Glasgow, these events have brought colour to my academic life.

I am very grateful to my second supervisor, Dr. Irini Papanicopolulu, not only for her academic advice but also for her inspirational and moral support. At the end of my Ph.D. journey, she has become my good friend, to whom I could express my thoughts and feelings in comfort. I am so thankful for her confidence in me.

I would like to extend my sincerest appreciation to my Ph.D. fellows: Kien, Huong, and special thanks to Jason, who helped to point out where my English needed attention and provided some comments on my legal writing. Without all of them, Glasgow would have been too cold to survive!

I would like to thank my family: my father, who has constantly reminded me of how this Ph.D. title could change my life and is always proud of me; and my mother, who has consistently comforted and encouraged me. Both of them have wholeheartedly loved me and I know that it will remain like this for all my life. I would like also to thank my little sister for her true love and spiritual support, especially at the very end of my thesis writing.

Finally, I acknowledge the King’s Scholarship awarded by H.M. King Bhumibol Adulyadej and the Royal Thai Government Scholarship for funding my higher education. As a civil servant, I also acknowledge the Office of the Council of State, Thailand, for allotting this three-year period to pursue my dreams.

## **Author's Declaration**

I declare that, except where explicit reference is made to the contribution of others, that this dissertation is the result of my own work and has not been submitted for any other degree at the University of Glasgow or any other institution.

Signature:

Printed name: Pakittah Nipawan



## Abbreviations

ASEAN	Association of South East Asian Nations
ACIA	ASEAN Comprehensive Investment Agreement
ACC	ASEAN Coordinating Council
AEC	ASEAN Economic Community
AEM	ASEAN Economic Ministers
AANZFTA	ASEAN Australia and New Zealand Free Trade Area
AFTA	ASEAN FTA
AIA	ASEAN Investment Area
AICO	ASEAN Industrial Cooperation Scheme
AKIA	ASEAN-Korea Investment Agreement
BIT	Bilateral Investment Agreement
CAFTA	Central American FTA
CCI	ASEAN Coordinating Committee on Investment
CETA	Canada-EU Comprehensive Economic and Trade Agreement
CLMV	Cambodia, Laos, Myanmar and Vietnam
COMESA	Common Market for Eastern and Southern Africa
DSB	Dispute Settlement Body
DSM	Dispute Settlement Mechanism
ECT	Energy Charter Treaty
EDSM	ASEAN Enhanced Dispute Settlement Mechanism
EPA	Economic Partnership Agreement
EU	European Union
EUSFTA	EU-Singapore FTA
FDI	Foreign Direct Investment
FET	Fair and Equitable Treatment
FTA	Free Trade Area
FTC	Free Trade Commission
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
ICJ	International Court of Justice
ICSID	International Centre for Settlement of Investment Disputes
IGA	ASEAN Investment Guarantee Agreement
IIA	International Investment Agreement
IMF	International Monetary Fund
ISDS	Investor-State Dispute Settlement
LDC	Least Developed Countries
MAI	Multilateral Agreement Investment
MERCOSUR	<i>Mercado Común del Sur</i> , Southern Common Market
MNC	Multi-national Corporation
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Co-operation and Development
RCEP	Regional Comprehensive Economic Partnership
REIO	Regional economic integration organization
SADC	Southern African Development Community
SBO	Substantial Business Operations
SEOM	Senior Economic Officials Meeting
TTIP	Transatlantic Trade and Investment Partnership
TTP	Trans-Pacific Partnership
UNCITRAL	United Nations Commission on International Trade Law
VCLT	Vienna Convention on the Law of Treaties
WTO	World Trade Organisation

# Part I. The ASEAN Way and the ACIA

## Chapter 1. Thesis Introduction

*“As the name suggests, the ACIA is comprehensive, but more than that, it is also based on international best practices and on a par with other international investment agreements in terms of its scope, rights and obligations.”*

Surin Pitsuwan,  
ASEAN Secretary-General, Jakarta, 2012<sup>1</sup>

### Section 1. Research Objective: The ACIA

#### 1.1 The ASEAN Comprehensive Investment Agreement (ACIA)

The Association of Southeast Asian Nations (ASEAN) claims that the ACIA, the new intra-ASEAN investment instrument, is comprehensive and comparable to other international investment agreements. This statement represents only one side of the coin. The ASEAN Comprehensive Investment Agreement (ACIA) is not only based on international best practices, but also takes into account the ASEAN-specific context, or the “ASEAN Way”. This refers to ASEAN’s history and principles underpinning the structure of the organisation and the relations among the ASEAN Member States. Given this background, the search for the “ASEAN Way” in the ACIA certainly clarifies the ASEAN approach to investment protection under the auspices of the forthcoming ASEAN Economic Community (AEC).

This thesis names the ASEAN-specific balanced approach the “ASEAN Way of Investment Protection”. It borrows the term “ASEAN Way” from ASEAN terminology which usually refers to ASEAN Way of cooperation, meaning respect of sovereignty and non-interference in domestic affairs among the Member States. The term is widely referenced in ASEAN studies, and in international politics or social studies. The “ASEAN Way” is also the name of the ASEAN Anthem, which is an expression of ASEAN unity in diversity. This term is used in this thesis to explain the attempt to balance the protection of the ASEAN Member States and the ASEAN investors in the ACIA. The concept of “ASEAN Way” will be fully elaborated in Chapter 2.

The ACIA is an intra-ASEAN investment agreement. It was signed by the Economic Ministers of the ASEAN Member States on 26<sup>th</sup> February 2009 in Cha-Am,

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<sup>1</sup> Interview by the Oxford Business Group (2012), posted online on 12<sup>th</sup> April 2013 by ASEAN Briefing. <http://www.aseanbriefing.com/news/2013/04/12/introduction-to-the-asean-comprehensive-investment-agreement.html#sthash.onhQabVN.dpuf> (Last accessed: 16 September 2015).

Thailand, and entered into force on 29<sup>th</sup> March 2012. The ACIA has more functions than just an international investment agreement (IIA). Pursuant to the ASEAN Economic Community (AEC) Blueprint, the ACIA is one of the key integration tools which aim to establish a common market or an integrated regional economy with the free flow of trade in goods, services, investment, labour and freer movement of capital by the end of 2015.

The idea of new ASEAN era, or an ASEAN Community, originates from the 1997 “ASEAN Vision 2020”<sup>2</sup> and the 2003 “Bali Concord II”.<sup>3</sup> The ASEAN Community comprises three pillars, namely: the ASEAN Economic Community (AEC); the ASEAN Political-Security Community; and the ASEAN Socio-Cultural Community (ASCS). ASEAN Member States agreed to prioritise the AEC because they realised that the AEC is the most advanced pillar in terms of integration. Besides, economic integration will help prepare ASEAN to integrate politically and culturally. Therefore, ASEAN Member States have accelerated the establishment of a common market from original 2020 goal to 2015.<sup>4</sup>

The AEC has four goals: (1) a single market and production base; (2) a competitive economic region; (3) equitable economic development; and (4) integration into the global economy.<sup>5</sup> Concerning the first goal, the ACIA aims to create a free and open investment environment through the consolidation of the two previous agreements, the ASEAN Investment Area (AIA) and ASEAN Investment Guarantee (IGA) agreements, into a single comprehensive investment agreement. The ACIA covers four corners of investment: protection, facilitation and cooperation, joint promotion, and progressive liberalisation. Apart from internal integration, the ACIA also results in external integration because the term “investor” under the ACIA means both ASEAN and non-ASEAN investors in the ASEAN States’ territory. The ACIA will enhance the attractiveness of ASEAN as a single investment destination.

The ACIA has marked a shift towards stronger regionalism and institutionalisation. It is an engine for economic and sustainable development of the AEC as well as an instrument for regional governance. Given the competitive global environment for foreign investment flows, the ACIA is envisioned to facilitate the transformation of ASEAN into an investment hub that would be able to compete effectively with other emerging economies.

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<sup>2</sup> Adopted by the ASEAN Leaders on the 30<sup>th</sup> Anniversary of ASEAN.

<sup>3</sup> At the 9<sup>th</sup> ASEAN Summit in 2003.

<sup>4</sup> Declaration on the Acceleration of the Establishment of an ASEAN Community by 2015, at the 12<sup>th</sup> ASEAN Summit, 13<sup>th</sup> January 2007, Cebu, Philippines.

<sup>5</sup> AEC Blueprint, Key characteristics of the AEC, p.8. The AEC Blueprint was adopted at the 13<sup>th</sup> ASEAN Summit on 20 November 2007 in Singapore.

In the AEC-building process, ASEAN has become a new actor in determining the practice of international investment treaty-making. ASEAN has pursued a policy of active negotiation of investment agreements.<sup>6</sup> This effort is a confirmation of the “sustained high level of commitment from policymakers in this region for closer economic integration and investment protection and liberalization”.<sup>7</sup> In order to create an attractive investment environment, the ASEAN Member States have incorporated new and forward-looking provisions. They have accepted some constraints on their sovereignty by entering into investment treaties that (1) impose substantive obligations to protect foreign investors and (2) create procedural mechanisms that permit investors to bring investor-State arbitral claims to enforce those obligations.

## 1.2 The ASEAN Investment Area (AIA)

The ASEAN region has been the largest recipient of foreign direct investment (FDI) in Asia Pacific, relative to gross domestic product (GDP). After the entry into force of the ACIA in 2012, FDI flowed into ASEAN in 2013 and continued to surge, on a par with FDI to China for the first time since 1993.<sup>8</sup> In 2013, ASEAN attracted 127 billion USD, accounting for 8% of the global FDI.<sup>9</sup> In 2014, realised FDI was 136 billion USD, among which 21.5 percent of FDI came from the European Union, followed by ASEAN countries (17.9%), Japan (9.8%) and the US (9.6%).<sup>10</sup> Meanwhile, ASEAN’s collective GDP is expected to grow to more than 6.2 trillion USD by 2023, expanding at a share of global GDP from 3.2 percent to 4.7 percent.<sup>11</sup> Hence, ASEAN is a region with strong growth prospects, as it is becoming a preferred destination for FDI.

Singapore has been the largest FDI recipient in ASEAN since the 1960s. In 2014, a number of mega-projects took place in Singapore and drove FDI inflows to a new record of 67 billion USD, which accounted for more than half the total FDI to the whole region (52.9%). Indonesia ranked second with a 16.4 percent share, followed by Thailand with 8.5 percent. However, many FDI projects in Thailand were shelved due to political instability.

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<sup>6</sup> According to UNCTAD’s World Investment Report 2013, Ten ASEAN countries had concluded 553 IIAs.

<sup>7</sup> UNCTAD (2008), *World Investment Report: Transnational Corporations, and the Infrastructure Challenge*, UN, New York and Geneva.

<sup>8</sup> ASEAN Secretariat (2014), *ASEAN Investment Report 2014, FDI Trends and Development in 2013*.

<sup>9</sup> ASEAN Secretariat (2014), *ASEAN Investment Report 2013-2014: FDI Development and Regional Value Chains*.

<sup>10</sup> ASEAN Secretariat (2015), Top ten sources of foreign direct investment inflows in ASEAN, Table 27, ASEAN Foreign Direct Investment Statistics Database as of 26 May 2015, [http://www.asean.org/images/2015/June/FDI\\_tables/Table%2027.pdf](http://www.asean.org/images/2015/June/FDI_tables/Table%2027.pdf) (Last accessed: 7 September 2015)

<sup>11</sup> Chehab, C. (2014), *AEC: Assessing the Regional Impact*, BMI Research Asia, 23 October 2014, <http://www.bmiresearch.com/blog/aec-assessing-the-regional-impact#sthash.1cFxUPx4.dpuf> (Last accessed: 7 September 2015)

Among the ASEAN's low-income economies, Viet Nam's FDI inflows ranked first, reaching 9.2 billion USD (6.8%).<sup>12</sup>

As mentioned above, intra-ASEAN FDI figures at approximately one-sixth (17.9%) of the total FDI. At the beginning of ASEAN integration, intra-ASEAN FDI was insignificant. It started to increase in the 1990s. Intra-ASEAN FDI was assessed in 1995 at approximately 4.6 billion USD and increased by five times in 2014 to 24.37 billion USD.<sup>13</sup> However, the extra-ASEAN sources have been consistently significant FDI sources for several decades. In 2012-2014, the extra-ASEAN FDI is five times more important than the intra-ASEAN FDI.<sup>14</sup>

The investment flows are expected to rise higher with the full implementation of commitments by 2015. With an estimated combined GDP of 2.4 trillion USD and a combined population of about 625 million people, which is 8.8% of the world's population, ASEAN is becoming a regional economic force and free trade hub of Asia.<sup>15</sup> The variance among ASEAN economies means certain countries already benefit more from the single market and production base. Singapore remains the preferred regional base for 80 percent of multinational companies, while the middle income countries are expected to profit thanks to their strong manufacturing infrastructure. The CLMV countries (Cambodia, Laos, Myanmar and Vietnam) will attract more investment flows due to their natural resources and low-wage labour force.<sup>16</sup> From now on, doing business in ASEAN will allow for economies of scale.

The best example to illustrate potential benefits of the ASEAN Investment Area is the ASEAN automotive industry. The automotive industry has exhibited strong growth over the last few years. The industry engages multiple production bases across ASEAN, as the participating countries have a sound investment policy for the auto industry, competitive labour costs and strong engineering support. Typically, Thailand serves as the main assembly base, whereas Indonesia, Malaysia, and the Philippines serve as producers of parts and components.<sup>17</sup> With full implementation of the AEC, an increasing number of

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<sup>12</sup> Net Inflows of Foreign Direct Investments to the ASEAN Member States, p.50, ASEAN FDI Database, <http://www10.iadb.org/intal/intalcdi/PE/2014/14222.pdf> (Last accessed: 7 September 2015)

<sup>13</sup> ASEAN Secretariat (2006), *ASEAN FDI Database 2006*, Table 4.1.1 Inward intra-ASEAN direct investment flows 1995-2005, <http://www.asean.org/archive/5187-6.pdf> (Last accessed: 7 September 2015)

<sup>14</sup> ASEAN Secretariat (2015), Table 25 FDI net inflows, intra- and extra-ASEAN, [http://www.asean.org/images/2015/June/FDI\\_tables/Table%2025.pdf](http://www.asean.org/images/2015/June/FDI_tables/Table%2025.pdf) (Last accessed: 7 September 2015)

<sup>15</sup> ASEAN Secretariat (2014), *ASEAN Investment Report 2014*, p.14.

<sup>16</sup> OECD (2013), *Economic Outlook for Southeast Asia, China and India 2014: Beyond the Middle-Income Trap*, OECD Publishing, pp.8-11.

<sup>17</sup> ASEAN Secretariat, *Invest in ASEAN: Automotives*.

<http://investasean.asean.org/index.php/page/view/automotive> (Last accessed: 7 September 2015)

investment projects will know about ASEAN and use it profitably as a single production base.

The 2007 Cebu Declaration had set the realisation of the AEC at 1<sup>st</sup> January 2015. However, the ASEAN Member States realised that this goal was too ambitious. The AEC is a top-down initiative. ASEAN uses policy-led and law-led strategies, whereas the awareness among stakeholders (States, investors, ASEAN peoples) is low and uneven. The regional initiative needs to be implemented by national authorities, who require more time to prepare the legal and infrastructural environments. Moreover, according to the International Labour Organisation (ILO)'s survey, more than 50 percent of local enterprises, especially the CLMV countries, lack knowledge of the AEC and of the interests and challenges available for them in the ASEAN market.<sup>18</sup> Therefore, the commencement of the AEC is postponed to 31<sup>st</sup> December 2015,<sup>19</sup> in order to inform ASEAN investors of their opportunities in the Area and to allow ASEAN governments to prepare necessary legal frameworks according to the AEC obligations.

Now as the new deadline approaches, the success of the AEC initiatives of an integrated market and production base needs to be assessed with a certain nuance, because the AEC remains a work in progress. This progress needs to be evaluated against the ASEAN background, as the success of the "ASEAN Way" of investment protection in the ASEAN Investment Area has been influenced by the ASEAN Way of cooperation. It is in no way similar to other integration initiatives.

## **Section 2. Research Contribution: ACIA and Realisation of a Single Market and Production Base**

The ACIA is the key regional investment integration initiative. It is different from other regional investment treaties, because it does not only aim to create a freedom of investment in the neighbouring countries but to create part of the AEC, *i.e.* the single production base or the ASEAN Investment Area. As illustrated in section 1, increase of investment flows is expected with the realisation of the AEC. All investment flows among ASEAN Member States are covered by the ACIA regime. The ACIA has restored investors' confidence after the Asian economic crisis. It also promotes intra-ASEAN investment flows in the ASEAN Investment Area. This will make ASEAN Member States

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<sup>18</sup> Rynhart, G., Chang, J-H. (2014), *The Road to the ASEAN Economic Community 2015: The Challenges and Opportunities for Enterprises and Their Representative Organizations*, ILO Regional Office for Asia and the Pacific, Geneva, ILO. Figure 4 Understanding of the impact the AEC will have on Business, p.23.

<sup>19</sup> The Phnom Penh Agenda for ASEAN Community Building, endorsed by the Leaders at the 20<sup>th</sup> ASEAN Summit in April 2012.

rely more on themselves and less on the extra-ASEAN investments, especially when large investors withdraw their investments and leave ASEAN unexpectedly.<sup>20</sup>

Despite its four decades of existence, ASEAN has just become a subject of international law aiming to be a rule-based organisation with the entry into force of the ASEAN Charter in December 2008. Previously, ASEAN was a politico-economic association which had cooperated in an informal “ASEAN Way”, with totally opposite underlining principles. The explanation of this tension will be thoroughly discussed in Chapter 2.

Most literature on ASEAN in the last century has been undertaken from economic, political or cultural perspectives. Due to the influence of the AEC, economic literature and investment flow statistics have been studied by the ASEAN Secretariat,<sup>21</sup> the Asian Development Bank (ADB),<sup>22</sup> the Asian Economic Integration Monitor (AEIM),<sup>23</sup> the Economic Research Institute for ASEAN and East Asia (ERIA),<sup>24</sup> the Institute of Southeast Asian Studies (ISEAS),<sup>25</sup> OECD<sup>26</sup> and UNCTAD.<sup>27</sup> However, despite the growing economic importance of the South-East Asian region, the legal literature to date on ASEAN investment regime is comparatively small.

Most of legal research studies have addressed ASEAN economic integration in broader terms, or addressed trade and investment together.<sup>28</sup> A series of literature has observed a movement of the ASEAN community-building processes through institutions

<sup>20</sup> See detailed discussion on external relations in Chapter 2.5, and the 1997 ASEAN economic crisis in Chapter 4.3.

<sup>21</sup> [www.asean.org](http://www.asean.org) See ASEAN Secretariat, e.g., *ASEAN Economic Community Handbook for Business; Thinking Globally, Prospering Regionally, AEC 2015* (2014); *Investing in ASEAN 2014-2015* (2014), *ASEAN Investment Report 2012: “The Changing FDI Landscape”* (2013), Jakarta.

<sup>22</sup> See e.g. ADB (2014), *ASEAN 2030: Toward a Borderless Economic Community*; ADB (2006), *The ASEAN Economic Community: A Work in Progress* (2013), edited by Severino R., Menon J., Shrestha O.L., Basu Das S.; *The ASEAN Economic Community and the European Experience* (2006), Working Paper Series on Regional Economic Integration No.1; *ASEAN Economic Integration: Features, Fulfillments, Failures and the Future* (2010) No.69; ADB (2015), *Realizing an ASEAN Economic Community: Progress and Remaining Challenges*, WP No.432.

<sup>23</sup> <http://aric.adb.org/publications/aeim> (Last accessed: 16 September 2015).

<sup>24</sup> ERIA (2012), *Mid-Term Review of the Implementation of AEC Blueprint: Executive Summary*, ERIA, Jakarta.

<sup>25</sup> See e.g. Basu, D.S. (2012) (Ed.), *Achieving the ASEAN Economic Community 2015: Challenges for Member Countries and Businesses*, Singapore ISEAS.

<sup>26</sup> See e.g. OECD, International investment in Southeast Asia, <http://www.oecd.org/daf/inv/investment-policy/seasia.htm> (Last accessed: 16 September 2015).

<sup>27</sup> UNCTAD (2013), “The Rise of Regionalism in International Investment Policymaking: Consolidation or Complexity?”, *IIAs Issue Note*; UNCTAD (2008), *South-South Trade in Asia: the Role of Regional Trade Agreements*.

<sup>28</sup> See e.g. ADB Working Paper Series on Regional Economic Integration: Capannelli G. (2014), *The ASEAN Economy in the Regional Context: Opportunities, Challenges, and Policy Options*, WP No.145; Chaisse, J., Hamanaka, S. (2014), *The Investment Version of the Asian Noodle Bowl: The Proliferation of International Investment Agreements*, WP No.128; Plummer M.G. (2006), *The ASEAN Economic Community and the European Experience*. See also ERIA Discussion Papers: *ASEAN Rising: ASEAN and AEC Beyond 2015* (2014). Das, S.B. (2012), *Achieving the ASEAN Economic Community 2015: Challenges for Member Countries and Businesses*, ISEA, Singapore.

and laws,<sup>29</sup> and ASEAN external relations.<sup>30</sup> A few papers have studied the ASEAN investment Area and ASEAN countries' investment laws, but only under the previous regime.<sup>31</sup> Other papers have commented particularly on investment liberalisation of the ACIA, as it is more sensitive to public policy and is more concerned with the opening of the market.<sup>32</sup>

States and investors are more used to the protection pillar which has been in the bilateral investment treaties (BITs) for several decades. The IGA agreement (the previous ASEAN investment protection treaty) is, to some extent, similar to the BITs concluded in the 1990s. Regarding these BITs, studies of international investment law and international investment agreements (IIAs) in general by UNCTAD and UNCITRAL, as well as other academic studies, are abundantly available. In contrast, the ASEAN investment protection regime seems to draw less attention from the public than does liberalisation.

The research in the field, thus far conducted, has not specifically addressed the protection pillar of the ACIA regime under the AEC in a comprehensive manner. Recently, some articles have studied the ACIA regime, in a limited way.<sup>33</sup> The more detailed studies in the literature have focused on investment treaty language through a case study of the ACIA.<sup>34</sup> Others have studied specific issues, such as dispute settlement resolution.<sup>35</sup> Although an increasing number of work has been devoted to investment in ASEAN, none pays sufficient attention to the influence of the "ASEAN Way" on the design of the intra-

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<sup>29</sup> Chesterman S. (2015), *From Community to Compliance?: The Evolution of Monitoring Obligations in ASEAN*, No.2; Piris J.-C., Woon W. (2015), *Towards a Rules-Based Community: An ASEAN Legal Service* No.3; Inama S., Sim E.W. (2015), *The Foundation of the ASEAN Economic Community: An Institutional and Legal Profile*, No.5; Chia S.Y., Plummer M.G. (2015), *ASEAN Economic Cooperation and Integration: Progress, Challenges and Future Directions*, No.8, CUP, Cambridge.

<sup>30</sup> Cremona M., Kleimann D., Larik J., Lee R., Vennesson P. (2015), *ASEAN's External Agreements: Law, Practice and the Quest for Collective Action*, No.4; Kuijper P.J., Kuijper J.H., Morris-Sharma N.Y., *From Treaty-Making to Treaty-Breaking: Models for ASEAN External Trade Agreements*, No.6; Nguitragool P., Rüländ J. (2015), *ASEAN as an Actor in International Fora: Reality, Potential and Constraints* (No. 7), CUP, Cambridge.

<sup>31</sup> Thanadsillapakul L. (2004), *ASEAN Bilateral Investment Agreements* <http://asialaw.tripod.com/articles/aseanbit3.html>; *The Investment Regime in ASEAN Countries* [www.thailawforum.com/articles/lawaninvestment.html](http://www.thailawforum.com/articles/lawaninvestment.html); *Open Regionalism and Deeper Integration: The Implementation of ASEAN Investment Area (AIA) and ASEAN Free Trade Area (AFTA)*. <http://www.dundee.ac.uk/cepmlp/gateway/index.php?news=28152> (Last accessed: 18 September 2015).

<sup>32</sup> ERIA Discussion Paper: Intal, S. (2015). *AEC Blueprint Implementation Performance and Challenges: Investment Liberalization* (No. 2015-32); Nurridzki, N. (2015), *Learning from the ASEAN+1 Model and the ACIA*, No.2015-19.

<sup>33</sup> Tevini, A.G. (2013), "Regional Investment Protection and Liberalization within the ASEAN", in Hofmann, Schill, Tams (eds.), *Preferential Trade and Investment Agreements: From Recalibration to Reintegration*, Nomos, pp.335-354.

<sup>34</sup> Yen T.H. (2014), *The Interpretation of Investment Treaties*, International Litigation in Practice Series, Brill, Leiden.

<sup>35</sup> Wongkaew T. (2014), "A Resilient Boat Sailing in Stormy Seas: ASEAN Investment Agreements and the Current ISDS Regime", the special issue on the *Reform of Investor-State Dispute Settlement: In Search of a Roadmap*, edited for Transnational Dispute Management, Vol.11, issue 1, chapter 3.



ASEAN investment regime, especially in relation to the balance of interests between ASEAN Member States and ASEAN investors.

Therefore, a study on intra-ASEAN investment protection under the newest intra-ASEAN investment agreement is needed. The ACIA should be analysed in the light of new economic circumstances and new requirements, especially the rule-based principle of the ASEAN Charter. Analysis of the ACIA is expected to give modern answers in order that ASEAN Member States and potential ASEAN investors are enabled to deal with the coming AEC.

The purpose of this thesis is to address this gap in academic literature. It explores the new aspect of the ASEAN investment legal framework. This thesis addresses one of the four corners of the ACIA: the protection of ASEAN investment, mainly in the post-establishment phase. This thesis is the first of its kind to use the “ASEAN Way” to systematically analyse investment treaty practice under the new ASEAN investment regime. It studies the sources, scope, substantive rights and procedural rights in dispute settlement mechanism. Its findings contribute to the mapping of the ASEAN investment regime in the broader context of the AEC integration, and international investment protection standards.

The ACIA is the only instrument which redraws the intra-ASEAN investment map. The ASEAN Investment Area in the Post-2015 AEC Era will be a battlefield of investment flows. Three main stakeholders are mentioned. Firstly, ASEAN investors need to understand the ACIA and so be enabled to claim their rights. The understanding of the ACIA guides how they will craft their strategies in South-East Asia. That said, this thesis is not intended to be an ACIA guidebook for businesses and investors like that issued by the ASEAN Secretariat.<sup>36</sup> Secondly, the national authorities, who exercise sovereign powers, must comply with ACIA obligations and understand their remaining role in controlling or regulating the entry and the stay of foreign investment in their territory. National authorities include the judiciary interpreting the ACIA in concrete cases, legislators who transpose international obligations into national laws, and policy-makers who will decide to modify the ASEAN investment regime or negotiate future agreements which include investment chapters. Thirdly, as investment projects have greater impact on the economy and society both at national and regional levels, ASEAN people should be aware of the ACIA regime and its consequences.

To summarise, given the broad policy implications that intra-ASEAN investment flows have on the ASEAN Investment Area (AIA) and the realisation of the AEC, this

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<sup>36</sup> ASEAN Secretariat (2013), *ACIA: A Guidebook for Businesses and Investors*, Jakarta.

thesis is undertaken with a view to improving mutual understanding and outcomes of the agreement. It explores key themes of the practice of investment protection and regulation under the ACIA. It explains the concepts of the ACIA and tracks its innovations, by assessing their developments in the light of the current international practices. It aims to clarify the selected ACIA rights and obligations in order to elaborate an “ASEAN Way” of investment protection regime. In this sense, understanding of the ACIA can serve as a platform for future investment treaties negotiations, also beyond ASEAN.

### **Section 3. Research Questions: Balance of Investment Protection and State Regulatory Space under the ACIA**

The balance of protection between the State’s interests and investors’ interests has been a core debate in international investment law.<sup>37</sup> In order to discover whether the “ASEAN Way” of investment protection is a balanced approach, a general understanding regarding the shifting power in the investment agreement practices is imperative. The general development of the IIAs is addressed in Chapter 2. This development concerns not only the content of the investment agreements but also their style and structure.

The ASEAN investment treaty has been transformed from an old-fashioned investment treaty, with vague and undefined standards, into a modern investment agreement which gives more detailed rights and obligations. The vagueness of the standards in the previous regime would allow for several possibilities of interpretation. Arbitral tribunals sometimes interpret the standards in a broad manner in order to protect the investor’s interests (*in dubio pro investore*), at the expense of State interests. For example, in *SGS v. Philippines*, the Tribunal found that:

The object and purpose of the BIT supports an effective interpretation of Article X(2). The BIT is a treaty for the promotion and reciprocal protection of investments. According to the preamble it is intended “to create and maintain favourable conditions for investments by investors of one Contracting Party in the territory of the other”. It is legitimate to resolve uncertainties in its interpretation so as to favour the protection of covered investments.<sup>38</sup>

The pro-investor approach has increasingly become more questionable. NAFTA has offered a model which increased “policy space” for the host States. This model could

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<sup>37</sup> Bungenberg, M., “Towards a More Balanced International Investment Law 2.0?”, in Herrmann, C., Simma, B., Streinz, R. (Eds.)(2015), *Trade Policy between Law, Diplomacy and Scholarship: Liber Amicorum in Memoriam*, European Yearbook of International Economic Law, Special Issue, Springer International Publishing, Switzerland, pp.22-23.

<sup>38</sup> *SGS Société Générale de Surveillance v. Philippines*, ICSID Case No.ARB/02/6, Decision on Jurisdiction, 29 January 2004, para.116.

be appealing to a wide range of countries, because at present both developing and developed countries play the role of investor and host State.<sup>39</sup> The interests of the host State also need to be protected. Consequently, the trend of best practice has also changed into a more balanced approach. Due to its precision, the interpretation and application of modern investment agreements are more certain than in past BITs. At the conclusion of the agreements, States can opt for the narrow approach by including indications or guidelines for interpretation. Therefore, the trend of international investment law in the 21<sup>st</sup> century calls for a hybrid approach which recognises both investors' and States' interests in a sustainable way.

Tribunals are increasingly recognising that while the investment protection is a significant policy objective, it should be weighed against the regulatory interests of host States. For instance, in the *Saluka v. Czech Republic* case, the tribunal stated:

The protection of foreign investments is not the sole aim of the Treaty, but rather a necessary element alongside the overall aim of encouraging foreign investment and extending and intensifying the parties' economic relations. That in turn calls for a '*balanced approach*' to the interpretation of the Treaty's substantive provisions for the protection of investments, since an interpretation which exaggerates the protection to be accorded to foreign investments may serve to dissuade host States from admitting foreign investments and so undermine the overall aim of extending and intensifying the parties' mutual economic relations.<sup>40</sup>

The ACIA negotiators agreed with this hybrid approach. They stated that "although the OECD failed to conclude the MAI due to its imbalanced objective by focusing too much on the investor's/ MNCs' point of view, the lessons learnt from the MAI would be useful for negotiators as reference in drafting the ACIA, particularly, the importance to take into consideration the views from various stakeholders".<sup>41</sup>

The ACIA drafters drew from the OECD's experience as regards the need to maintain a balanced objective. They recognised that the rights of investment protection and promotion are important, however, these rights are not absolute. The economic welfare goal should be weighed against a variety of non-economic welfare goals, such as national security, environmental protection, health and safety regulations, protection of human rights and labour, and wealth redistribution through taxation.<sup>42</sup> The "regulatory space" of

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<sup>39</sup> UNCTAD Stat (2014), *Inward and outward foreign direct investment flows*, Annual, 1970-2013, <http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=88> (Last accessed: 21 September 2015)

<sup>40</sup> *Saluka v. Czech*, UNCITRAL, Partial Award, 17 March 2006, para.300

<sup>41</sup> Report of the 2<sup>nd</sup> WG-ACIA, 29-31 January 2008, Kuala Lumpur, Malaysia, para.15.

<sup>42</sup> See *Noble Ventures v. Romania*, ICSID Case No.ARB/01/1, Final Award, 12 October 2005, para.52.

ASEAN Member States is justified especially at the beginning of the integration process of the AEC, which is the transitional period of the ASEAN legal regime.

In exceptional circumstances, the ASEAN Member States would need more policy and regulatory space to deal with problems. The ACIA provides exceptional defences in its article 17 (General Exceptions) and 18 (Security Exceptions) allowing ASEAN Member States to adopt or enforce measures necessary to maintain public order or to protect essential security interests. In addition to these two common exceptions, the ACIA also provides specific economic exceptions in article 16, allowing the States to temporarily control transfers of money.<sup>43</sup>

In ordinary circumstances, ASEAN Member States also need to regulate investments in their territory. The relationship between investment protection and State sovereignty is inversely proportional. The more the States can change regulations, the less investors can be assured of the stability of their situation. In other words, the broader the protection granted to foreign investors, the narrower the sovereignty retained by States. The question is how the ACIA balances these two legitimate, but sometimes opposite, goals: the preservation of legitimate regulatory space of the ASEAN Member States and the protection of legitimate interests of the ASEAN investors.

This thesis argues that the ACIA has introduced a balanced approach to the practice of the intra-ASEAN investment agreement. The ACIA has used several techniques also available in other IIAs. In general, the BITs of colonised or developing countries tend to adopt models or approaches of developed countries virtually without modification. Given the different background of ASEAN and the Western countries, ASEAN investment agreement is different from that of the EU or NAFTA. This thesis argues that the ACIA is not just a common “copy-paste” investment agreement.

This thesis illustrates that the ACIA has specificities which are different from international practices. These specificities are pertinent and practical options to solve some ASEAN-specific problems. They also take account of cultural sensitivities and regional preferences in order to justify ASEAN choices or legitimise some weaknesses of the ASEAN investment regime and policies. In brief, this thesis assesses the ACIA regime and locates it among the existing and upcoming investment practices. It recommends investment law reforms at domestic level and legal harmonisation at regional level which could foster better policy design for the preparation and implementation of investment protection.

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<sup>43</sup> See detailed discussion in chapter 4.3 Transfers.

This thesis uses the “ASEAN Way” to justify the choices of the ASEAN Member States in the process of making, application and interpretation of the ACIA. The change of ASEAN investment regime over time is a result of the change of the “ASEAN Way” from an Association of informal cooperation to a rules-based and institutions-based Community. This thesis proposes that the re-conceptualisation of the “ASEAN Way” affects the balance of power in the ASEAN investment treaty practice. The ASEAN Member States concluded the ACIA with ASEAN-specific needs in order to achieve a “normative-pragmatic” balance.<sup>44</sup> This resulted in the ACIA’s attempt to simultaneously uphold high standards of investment protection and legitimatise ASEAN Member States’ power to control or regulate investments within their respective territories.

In order to discover the “ASEAN Way of Investment Protection”, each chapter of this thesis is organised into two parts. The first part traces the general investment agreement practices appearing in the ACIA. The second part tracks the ASEAN-specific elements which have rarely been found in the other treaties or have been newly invented by the ACIA. An explanation on how this thesis distinguishes general and specific practices is further given in an “issues note to substantive chapters”.<sup>45</sup>

## Section 4. Research Methodology

In order to find the specific characteristics of the intra-ASEAN investment protection regime and to further conclude whether the ACIA is a balanced system for investors and States, systematic research on the content of the substantive and procedural provisions has been undertaken. The “architecture” of the ACIA has been assessed primarily in the light of international practices, such as BITs, economic treaties with investment chapter, and decisions of arbitral tribunals related to these issues, as well as speeches, minutes, reports, preparatory works. In addition, the guidelines of the international organisations, such as UNCTAD, OECD, IMF, have provided extremely rich materials for the analysis. For the secondary sources, this thesis utilises books, journals, articles, news, and academic commentaries. These sources are complemented by numbers of conferences, trainings, summer courses and visits to national and ASEAN legal centres.

The ACIA was written in an almost complete absence of litigation, so “ASEAN jurisprudence” is not a key factor for the development of ASEAN investment law. As a result, this thesis employs two main complementary research methodologies to

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<sup>44</sup> Somjee, A.H., Somjee G. (1993), *Development Success in Asia-Pacific*, New York, St. Martin’s Press, p.3.

<sup>45</sup> See pp.52-56.

achieve its objectives: doctrinal research and comparative research. As it remains debatable whether IIAs really help to attract investment flows, this thesis analyses the ACIA irrespective of any empirical research on whether a positive causal relationship between IIAs and FDI is established.<sup>46</sup> Besides, the thesis leaves national implementation of the ACIA by the ASEAN Member States for further research. The scope of this thesis is limited to the international responsibility of the ASEAN Member States in the case of breaches of international obligations towards protected investors.

#### 4.1 Doctrinal Research

Doctrinal methodology is employed to analyse the rights and obligations of ASEAN investors and ASEAN Member States under the ACIA. It helps clarify the application and interpretation of the essential investment protection principles, and the implications of particular ASEAN approaches and terms. It also assists in delimiting and facilitating the role of arbitral tribunals.

Modern international investment law is very new, and most of its rules diverge from international law in general. However, in the absence of treaty regulation, *lex generalis* would apply.<sup>47</sup> Tribunals may fill gaps in the text of the ACIA by reference to the general rules of interpretation pursuant to the Vienna Convention on the Law of Treaties (VCLT).<sup>48</sup> “One must therefore consider each of the three main elements in treaty interpretation – the text, its context and the object and purpose of the treaty”.<sup>49</sup> According to the ACIA Preamble, the object and purpose of the ACIA consists of promoting and protecting foreign investments by ensuring the stability and predictability of their investment activities and their investment-related rights. Contrarily, the ACIA’s interpretation takes into account the legitimate exercise of ASEAN Member States’ regulatory power. This inclusive approach is particularly helpful when ACIA texts are found unclear or appear to justify different interpretations.

In addition, interpretation of the ACIA takes into account footnotes and annexes to the ACIA. Due to the evolving nature of investment flow and the diversity of existing

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<sup>46</sup> See e.g. UNCTAD (2014), *The Impact of IIAs on FDI: an Overview of Empirical Studies 1998–2014*, IIAs Issues Note, September 2014; Sauvant, K.P., Sachs, L.E. (eds.) (2009), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows*, Oxford, OUP.

<sup>47</sup> Dolzer, R., Stevens, M. (1995), *BITs*, The Hague, Boston, London, Martinus Nijhoff Publishers.

<sup>48</sup> VTLC, article 31 General rule of interpretation. See also International Law Association, G.B., Sub-Committee on Investment Law, (2010), *The Determination of the Nationality of Investors under Investment Protection Treaties*.

<sup>49</sup> Aust, A. (2000), *Modern Treaty Law and Practice*, Cambridge, New York, CUP, p.187. See also Aust, A. (2013), *Modern Treaty Law and Practice*, 3<sup>rd</sup> ed., Cambridge, New York, CUP, Chapter 13 Interpretation, pp.205-226.

approaches, the ACIA uses recent methods of providing more precision: additional information, qualifications or clarification of statements made in the text. These materials are related to, but not appropriate for, inclusion in the text itself.<sup>50</sup> For short explanatory notes, the ACIA adds footnotes to articles with provisions needing to be explained. These explanatory memorandums are found under both definitional (*e.g.* the definition of desired investments) and substantive provisions (*e.g.* in the case of MFN clause, the footnote records the common intention of ASEAN Member States on the limitation of the MFN effects). For particularly complicated or technical issues, the ACIA has created two annexes: Annex 1 Approval in writing, and Annex 2 Expropriation and Compensation. These explanatory notes form an integral part of the ACIA,<sup>51</sup> and are extensively used in this thesis in the interpretation of the ACIA. This explanatory technique gives assurance that the ACIA is coherently implemented which, in turn, limits the discretion of arbitral tribunals in applying the text.

## 4.2 Comparative Research

As there has been no case under the ACIA, research on the ACIA requires external sources to assess the position of the ASEAN Member States. It is noted that “while no *de jure* doctrine of precedent exists in investment arbitration, a *de facto* doctrine has in fact been building for some time.”<sup>52</sup> Nowadays, the BITs are evidenced as a “virtual network”.<sup>53</sup> Other international investment agreements and cases could be seen as a “soft precedent” or “*de facto* precedent”.<sup>54</sup> The interpretation of the ACIA can use the method of “interpretative externality”<sup>55</sup> of other treaty practices. This method can largely be used for the examination of each specific element in order to see how norms are similar or different from one jurisdiction to another, and how such norms can be borrowed or transplanted to the ACIA. With regard to international arbitration, the “judicial borrowing”<sup>56</sup> method is particularly useful in clarifying or interpreting some investment principles. This thesis

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<sup>50</sup> VII. Explanatory footnotes, UN Editorial Manual Online, (Last accessed: 18 September 2015) [http://dd.dgacm.org/editorialmanual/ed-guidelines/footnotes/footnotes\\_index.htm](http://dd.dgacm.org/editorialmanual/ed-guidelines/footnotes/footnotes_index.htm)

<sup>51</sup> ACIA article 45, Annexes, Schedules and Future Instruments

<sup>52</sup> McLachlan, C., Shore, L., Weiniger, M. (2007), *International Investment Arbitration: Substantive Principles*, NY, OUP, p.18. See also Bjorklund, A. (2008), *International Treaty Arbitration Decision as Jurisprudence Constante*, UC Davis Legal Studies Research Paper No.158.

<sup>53</sup> Montt, S. (2012), *State Liability in Investment Treaty Arbitration, Global Constitutional and Administrative Law in the BIT Generation*, Hart Publishing, USA, p.83-124.

<sup>54</sup> *Idem*, p.113.

<sup>55</sup> *Idem*.

<sup>56</sup> Watson, A. (1994), “Legal Transplants: An Approach to Comparative Law” in Glendon M.A., Gordon M., Osakwe C., *Comparative Legal Traditions*, West Publishing Co., St. Paul, 2<sup>nd</sup> ed.; Vadi, V. (2013), *Public Health in International Investment Law and Arbitration*, Routledge, USA, pp.178-183; Voeten, E. (2010), “Borrowing and Non-Borrowing among International Courts”, *Journal of Legal Studies*, Vol.39, No.2, p.547.

demonstrates that the ASEAN Member States do not just recognise international practices in an unproblematic way, but have already scrutinised the available options before transplanting the model. Remarkably, some solutions in the ACIA are not found elsewhere. This shows that the ACIA is a truly engaging treaty-making process which results in a unique regional investment agreement.

This thesis surveys leading investment agreements, such as NAFTA, US Model BIT, EU investment agreements, MERCOSUR, COMESA, CAFTA, other agreements concluded by the ASEAN Member States bilaterally and plurilaterally (the investment chapter in the ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA), ASEAN-Korea Investment Agreement (AKIA), ASEAN-China Investment Agreement (ACHIA)), and newly and on-going-negotiated treaties (CETA, TTIP, TTP, SADC, Singapore-EU), as well as decisions rendered under these agreements.

## **Section 5. Thesis Structure**

This thesis investigates the protection regime in the post-establishment phase, *i.e.* once the investment is admitted into the ASEAN Investment Area. The protection pillar is at the heart of the investment regime. In many respects, the protection rights and obligations are susceptible to legal analysis, whereas the liberalisation pillar depends more on national policy and schedules of commitment, and the promotion and facilitation pillars are not legally binding. However, this thesis addresses liberalisation to the extent that it provides useful analysis of the protection regime, especially of the definition of investments and investors, and MFN and national treatment clauses. Meanwhile, the promotion and facilitation pillars, which are subsidiary to protection and liberalisation, are addressed as complementary tools for the realisation of ASEAN economic integration.

After this introductory chapter, Chapter 2 addresses the ASEAN background and context against which the ACIA was conceived, in order to facilitate analysis of the ACIA provisions in the following chapters. The background chapter provides the history of the ASEAN investment regime after World War II until the conclusion of the ACIA under the auspices of the AEC. This chapter highlights the principle of the “ASEAN Way” which has underlined the ASEAN structure and has created the tension between the protection of investment and the regulatory power of the ASEAN Member States in the ACIA. This chapter also reviews ASEAN Members States’ active participation in the proliferation of international trade and investment agreements, and shows that the ACIA is part of the whole network of international investment treaties.



Chapter 3 addresses potential beneficiaries of the ACIA. It defines the terms “investment” and “investor”, and sets the requirements of “covered investments”. Only “covered investments” of a certain range of individuals and legal entities, categorised as “ASEAN investors”, will profit from the privileges of protection and liberalisation accorded by the ACIA dealt with in Chapters 4 and 5, and can invoke dispute settlement mechanism in Chapter 6.

Following the chapter on the scope of the ACIA, the next two chapters scrutinise the substantive provisions of the ACIA with the question of balance of investor-State interests. Chapter 4 discusses three absolute rights and obligations under the ACIA which contain ASEAN specific elements – unlawful expropriation, fair and equitable treatment and right to transfers. Chapter 5 discusses two eminent non-discriminatory rights, *i.e.* MFN and national treatment. This research on substantive rights allows investors to know which protections (and to what extent) are provided for against the State’s risks under the ACIA regime.

In case a claim is alleged against an ASEAN Member State, the ACIA has provided for a comprehensive dispute settlement mechanism (DSM), both investor-State and State-State dispute settlements. Chapter 6 analyses necessary conditions of eligibility of investors to submit claims before international arbitration, which, in turn, defines the boundaries of ASEAN Member States’ exposure to possible investor-State claims. The chapter explores the DSM forum available for the disputing parties, and addresses the flaws in the ACIA which could be improved. It also suggests that the ACIA’s State-State mechanism is designed in accordance with the objective of the realisation of ASEAN Community Order.

Finally, in the light of the findings thus far in this thesis, Chapter 7 summarises and offers a re-conceptualisation of the distinguishing characteristics of ASEAN, or of the “ASEAN Way”, which appears in the investment protection under the ACIA regime. This leads to the overall assessment whether the ACIA strikes a better balance of conflicting interests between investors and States. This chapter reiterates the propositions or available options which have been made in the previous chapters for the improvement of the intra-ASEAN investment regime. Finally, the chapter observes that ASEAN pursues a law-driven policy or integration through law. This means that, in theory, the ACIA would create an investment-friendly environment which could eventually increase investment flows in the ASEAN Investment Area. In reality, the establishment of the deeper economic integration is not an easy task. Several questions are left open regarding the effectiveness of the ACIA and its implementation at national level. At the turn of the AEC Era, the

search for “ASEAN best practice”, in the context of ASEAN Regionalism, will have an important role to play in fostering the ASEAN single market and production base.

## Chapter 2. Mapping ASEAN Investment Normative Context

*Finally, it is common knowledge that co- operation and ultimately integration serve the interests of all – something that individual efforts can never achieve.*

Thanat Khoman  
Ex-Minister of Foreign Affairs, Thailand,  
One of the ASEAN Founding Fathers, Bangkok, August 1967<sup>57</sup>

*The ASEAN Economic Community is the realisation of the end-goal of economic integration as outlined in the ASEAN Vision 2020, to create a stable, prosperous and highly competitive ASEAN economic region in which there is a free flow of goods, services, investment and a freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities in year 2020.*

Declaration of ASEAN Concord II, Bali, October 2003

This chapter provides an introduction to the ASEAN investment regime and observes the treaty-making practice of ASEAN Member States in the context of ASEAN economic integration. The ASEAN investment regime has developed along with the development of ASEAN from an international association to the ASEAN Economic Community, with strengthened legal institutions and objectives, to stand among the leading international economic players. The content of ASEAN investment agreements has been shaped by the political, economic and legal contexts in which they have been negotiated. The modern history of the ASEAN investment agreements began in the Post-Colonial Era.<sup>58</sup> This thesis classifies investment instruments of ASEAN Member States into three categories: first, international investment agreements (IIAs) concluded between an ASEAN Member State and a third State, usually a Western State, or extra-ASEAN-BITs; second, IIAs concluded between two ASEAN Member States, or intra-ASEAN BITs; and third, IIAs concluded collectively by all ASEAN Member States.

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<sup>57</sup> Khoman, T. (1992), “ASEAN Conception and Evolution”, *The ASEAN Reader*, ISEAS, Singapore. Reprinted: <http://www.asean.org/news/item/asean-conception-and-evolution-by-thanat-khoman> (Last accessed: 17 August 2015).

<sup>58</sup> According to Vandevelde, international investment agreements are classified in three Eras: the Colonial Era (late 18<sup>th</sup> Century to World War II), the Post-Colonial Era (the end of the War to the end of the Cold War in 1990s), and the Global Era (from 1990s onwards). See Vandevelde, K.J. (2005), *A Brief History of IIAs*, University of California, Davis, Vol.12, pp.158-194.

Due to Western influence, most BITs of the first category, concluded after the decolonisation period, have based their model on the “Dutch gold standard” BITs.<sup>59</sup> In the 1970s, ASEAN’s progress in trade and investment were manifestly influenced by interaction with external factors.<sup>60</sup> ASEAN Member States have relied more on bilateral extra-ASEAN relations than the internal ones. ASEAN Member States had not concluded any BIT among themselves. They had no interest in each other because they possessed the same natural resources and same kind of skills and labour. So they turned to outsiders, who could transfer high technology, skilled knowledge and expertise to them. More than 25 BITs were concluded between an individual ASEAN State and a Third Party.<sup>61</sup> Most of those were with European countries, especially Germany, Denmark, Norway, the Netherlands, and the Belgium-Luxembourg Economic Union (BLEU). While the extra-ASEAN investment flows and the number of extra-ASEAN BITs largely increased, ASEAN Member States started very late to conclude BITs among themselves. It was only in 1990 that the first intra-ASEAN BITs were signed between Laos-Thailand, and Malaysia-Vietnam.

The majority of these followed a relatively restrictive approach to market access, in conformity with the absence in customary international law of any obligation of the host State to allow the entry of investors and aliens.<sup>62</sup> The content and structure of these extra-ASEAN or intra-ASEAN BITs are common to the “Post-Colonial” BITs. They were concluded with short provisions in plain language and do not give details on standards of protection. They offer the best protection to investors owing to their broad scope of application, or extensive definitions of “investment” and “investor”. They also provide for a strong substantive protection: *inter alia*, unqualified most-favoured nations (MFN), national treatment (NT), fair and equitable treatment (FET); broad umbrella clause; full compensation for direct and indirect expropriation; no exceptions for certain sectors; no filter mechanisms; broad choice of investor-State (ISDS) mechanisms; and free choice of arbitrators.<sup>63</sup>

This chapter focuses only on the third category of IIAs concluded among ASEAN Member States. It traces the evolution of legal instruments relating to regional investment

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<sup>59</sup> The first extra-ASEAN BIT was concluded between Germany and Malaysia in 1960, just one year after the world’s first BIT between Germany and Pakistan.

<sup>60</sup> Ortuoste, M.C. (2008), *Internal and External Institutional Dynamics in Member-states and ASEAN: Tracing Creation, Change and Reciprocal Influences*, Proquest, Arizona State University, pp.63-69.

<sup>61</sup> See the UNCTAD Data Base. <http://investmentpolicyhub.unctad.org>

<sup>62</sup> UNCTAD (2004), *Key Terms and Concepts in IIAs: A Glossary*, UNCTAD Series on Issues in IIAs, p.15.

<sup>63</sup> See the notion of “Dutch Gold Standard” in Lavranos, N. (2013), *The New EU Investment Treaties: Convergence towards the NAFTA Model as the New Plurilateral Model BIT Text?*, European University Institute (EUI), WP 29 March 2013, p.2.

integration, along with the development of the concept of the “ASEAN Way” in the ASEAN investment regime. Section 1 addresses the origin of ASEAN as an intergovernmental organisation in the 1970s, and the “ASEAN Way” of pursuing regional matters. The notion of the “ASEAN Way” underlines all ASEAN cooperation and integration initiatives, including investment.

Section 2 deals with the beginning of political cooperation among ASEAN Member States, when economic cooperation was less evident. For the first quarter century, there were several attempts to establish intra-ASEAN schemes, which are considered as the first generation of the ASEAN investment agreements. This section continues to explain how ASEAN Member States responded to the situation in the 1990s, after the Cold War had ended, when their attitude changed towards economic regionalism. ASEAN started to conclude the second generation of ASEAN investment instruments, and created the “ASEAN Investment Area” (AIA).

Section 3 highlights ASEAN’s identity in the 21<sup>st</sup> Century, in which ASEAN has reached its middle age and is becoming the ASEAN Economic Community (AEC). The constitution and legal structures of the AEC have intensely modified the classic “ASEAN Way” from “consensus” to contemporary “rule-based” organisation. This change clearly impacts on forms and contents of investment agreements. In order to create deeper ASEAN economic integration, ASEAN has finalised the third version of ASEAN investment agreement, *i.e.* the ACIA, a “comprehensive” framework of protection and liberalisation.

Section 4 observes the discrepancies between the intention for deeper integration and the actual un-readiness of the ASEAN Member States, which reflect the tension of interests in the ACIA. In law, the consolidation of two major pillars of investment into a single document sets high objectives and emphasises the significance of the ACIA as part of the AEC-building process. In fact, ASEAN takes into account the ASEAN Way of non-interference and the development gaps between the ASEAN-6 and the four newcomers: Cambodia, Laos, Myanmar, and Vietnam (CLMV). The implications of this tension are two-fold: (1) ASEAN Member States need to retain their regulatory power over the liberalisation and admission of investments into their territory; and (2) a principle of “special and differential treatment” grants a transitional period to CLMV.

Lastly, section 5 observes that the discrepancies examined in section 4 have external implications. In parallel to the ACIA, individual ASEAN States have concluded a number of investment agreements with different economic partners. Having adopted “Open Regionalism”, the ASEAN Member States simultaneously rely on various channels of investment integration at multi-track and multi-speed. The question arises as to the value

of the intra-ASEAN regime: can the ACIA stand firm in a wave of investment agreements negotiated daily with better standards of treatment? This question emphasises the importance of the thesis which investigates the ACIA to find its appropriate interpretation and application, and to make recommendations for its improvement.

## Section 1. ASEAN Way: Origin of ASEAN Investment Regime

The Association of Southeast Asian Nations (ASEAN) is an inter-governmental organisation, formed on 8<sup>th</sup> August 1967 by Indonesia, Malaysia, the Philippines, Singapore and Thailand. Its original motivation was to reduce the political and military threat of countries outside the agreement in the Cold War period. ASEAN's background does not resemble any integration initiative, it can be compared neither to the most advanced example of the European Union, nor to the strong economic integration of the NAFTA, although South America and African countries do have more distant influences.

The uniqueness at the very heart of ASEAN is its great diversity, probably more so than any other grouping in the world.<sup>64</sup> This economic, political, cultural and linguistic diversity was accentuated by colonial era experiences.<sup>65</sup> The political structures of the Member States are divergent, and from time to time unstable. ASEAN includes one top wealthy nation, Singapore, whereas Laos is the world's poorest land-locked State. It includes Indonesia, the world's fourth most populous nation, and Brunei, whose population is less than half a million.<sup>66</sup> These socio-economic indicators highlight several distinctive features of ASEAN, and they have important implications for how ASEAN operates.<sup>67</sup> This section analyses key features of the ASEAN process.

ASEAN cooperation is based on the principles of the "ASEAN Way".<sup>68</sup> The term "ASEAN Way" is used by ASEAN Member States to describe a regional method of multilateralism, which functions in a networking-style of regionalism.<sup>69</sup> Amitav Acharya has defined the "ASEAN Way" as "soft regionalism" and "flexible consensus".<sup>70</sup> Acharya explains that the term refers to a distinctive approach to dispute-settlement and regional

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<sup>64</sup> Chia, S.Y. (2010), *Trade and Investment Policies and Regional Economic Integration in East Asia*, ADBI WP No.210. (Last accessed: 17 August 2015)

<http://adbi.adb.org/working-paper/2010/04/05/3652.trade.investment.policies.east.asia/>

<sup>65</sup> Many achieved political independence only in recent decades and are still in the process of nation-building. See Church, P. (2009), *A Short History of South East Asia*, 5<sup>th</sup> Ed., Singapore, John Willey and Sons. (Last accessed: 17 August 2015)

[http://aero-comlab.stanford.edu/jameson/world\\_history/A\\_Short\\_History\\_of\\_South\\_East\\_Asia1.pdf](http://aero-comlab.stanford.edu/jameson/world_history/A_Short_History_of_South_East_Asia1.pdf)

<sup>66</sup> World Bank (2013), United States Census Bureau. <http://data.worldbank.org/country/>

<sup>67</sup> Hill, H., Menon, J. (2012), "ASEAN Economic Integration: Driven by Markets, Bureaucrats or Both?", in Kreinin, M.E., Plummer, M.G. (Eds.), *The Oxford Handbook of International Commercial Policy*, p.358.

<sup>68</sup> See the 1976 Treaty of Amity and Cooperation in Southeast Asia (TAC).

<sup>69</sup> Severino, R. (2006). *Southeast Asia in search of an ASEAN community: insights from the former ASEAN Secretary-General*, Singapore, ISEAS; Acharya, A. (2012), *Foundations of Collective Action in Asia: Theory and Practice of Regional Cooperation*, ADBI WP No.344.; Acharya, A. (2014), "Foundations of Collective Action in Asia: Theory and Practice of Regional Cooperation", in Capannelli, G., Kawai, M., *The Political Economy of Asian Regionalism*, London, ADB Institute, p.29.

<sup>70</sup> Acharya, A. (1997). "Ideas, identity, and institution-building: From the 'ASEAN way' to the 'Asia-Pacific way'?", *The Pacific Review*, Vol.10, Issue 3, pp.319-346.

cooperation developed since 1967 by ASEAN Member States with a view to ensuring regional peace and stability.

The “ASEAN way” consists of a code of conduct for inter-state behaviour as well as a decision-making process based on consultations and consensus. The code of conduct incorporates a set of well-known principles, e.g. non-interference in the domestic affairs of each other, non-use of force, pacific settlement of disputes, respect for the sovereignty and territorial integrity of member states, that can be found in the Charter of the United Nations as well as regional political and security organizations elsewhere in the world. To this extent, the “ASEAN way” is not an unusual construct. But where it can claim a certain amount of uniqueness is the manner in which these norms are operationalized into a framework of regional interaction. In this respect, the “ASEAN way” is not so much about the substance or structure of multilateral interactions, but a claim about the *process* through which such interactions are carried out. This approach involves a high degree of discretion, informality, pragmatism, expediency, consensus-building, and non-confrontational bargaining styles which are often contrasted with the adversarial posturing and legalistic decision-making procedures in Western multilateral negotiations.<sup>71</sup>

The most important feature associated with the “ASEAN Way” is the preference for personal contact, informality and absence of strong institutions. The “ASEAN Way” can be construed as a decision-making and a dispute settlement process. As a decision-making process, the “ASEAN Way” of informality creates a comfort zone among the States and allows room for national bargaining. Without strong institutions, consensus is a common decision-making method. In the ASEAN context, the notion of the “ASEAN Way” is traced to a particular style of decision-making within Javanese village society in Indonesia, according to which “consensus or *musjawarah* is a way by which a village leader makes important decisions affecting social life in the village”.<sup>72</sup> As H. Faith observes, “*musjawarah* means that ‘a leader should not act arbitrarily or impose his will, but rather make gentle suggestions of the path a community should follow, being careful always to consult all other participants fully and to take their views and feelings into consideration before delivering his synthesis conclusions’”.<sup>73</sup> In a consensus-building process, consultation or *mufakat* is a condition precedent, which is considered another important component of the “ASEAN Way”.

As a dispute settlement mechanism, the “ASEAN way” involves a commitment to carry on with consultation, however, without any specific timeline or modality for achieving a desired outcome. As Lee Kuan Yew observes, “[f]or Asians, it’s not in our

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<sup>71</sup> *Idem*, pp.328-329.

<sup>72</sup> *Idem*, p.330.

<sup>73</sup> Faith, H. (1962), *The Decline of Constitutional Democracy in Indonesia*, Ithaca, NY, Cornell University Press, quoted in A. Acharya, (1997), p.330.



nature to want to disagree with people publicly”.<sup>74</sup> While ASEAN Member States can debate and disagree on a particular position behind closed doors, they refrain from divulging their intra-mural differences in public, especially to outsiders. According to J.N. Mak, the ASEAN dialogue process is “unstructured, with no clear format for decision-making or implementation” and “often lacks a formal agenda, issues are negotiated on an *ad hoc* basis as and when they arise”.<sup>75</sup> Acharya concludes that “ASEAN multilateralism is process-oriented, rather than product-oriented.”<sup>76</sup> In other words, the “ASEAN Way” requires an obligation of conduct, rather than an obligation of result.

ASEAN regionalism has developed differently from “European-type” regionalism.<sup>77</sup> The most significant difference between the two organisations is the scope of power and competence which the organisation has *vis-à-vis* its Member States. The European Union is a supranational organisation which overarches all States Parties and the Member States are obliged to follow European Union Law. In contrast, ASEAN diplomacy and cooperation have been characterised by caution, pragmatism and a consensus-based approach, which results in lowest-common-denominator decision-making. The relationship of ASEAN Member States is governed by international law. The implementation of the ASEAN obligations depends on whether a Member State is Monist or Dualist.<sup>78</sup> For forty years, ASEAN leaders have deliberately avoided creating a strong supra-national regional permanent institution, the ASEAN Secretariat has been expressly underpowered, serving more as a diplomatic facilitator and administrator rather than a strong EU-type agency.

The modality of ASEAN cooperation has been very loose and flexible, based on the ideas of non-interference of domestic affairs, respect for national sovereignty, non-use of force and non-confrontation, and has been characterised by informality, minimal institutionalisation, and avoidance of any legal commitment.<sup>79</sup> The supreme authority is the ASEAN Summit of national leaders. They make decisions at the summit, which are intended to represent a “consensus” among the ASEAN Nations. The nature of these “decisions” resembles merely political resolutions or recommendations, not legally-

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<sup>74</sup> Lee Kuan Yew, Asian Wall Street Journal, 24 June 1994, Vol.1, p.6, quoted in A. Acharya, (1997), p.331.

<sup>75</sup> Mak, J. N. (1995) “The ASEAN process (“way”) of multilateral cooperation and cooperative security: the road to a regional arms register?”, paper presented to the MIMA-SIPRI Workshop on an ASEAN Arms Register: Developing Transparency, Kuala Lumpur, 2-3 October, quoted in A. Acharya, (1997), p.329.

<sup>76</sup> Acharya, A. (1997), p.329.

<sup>77</sup> Chia, S. Y. (2010), p.4.

<sup>78</sup> Most of ASEAN Member States are dualists, while Indonesia, Myanmar, Brunei systems are unclassified because the relationship of international law and domestic law is very blurred and their methods of incorporation/ transformation are suspicious. No clue is found either in the constitution or statutory laws. Besides, some legal systems are newly established, like the ones with non-statutory laws traditions (Laos), or of Military law traditions (Myanmar).

<sup>79</sup> Hill, H., Menon, J. (2010), *ASEAN Economic Integration: Features, Fulfillments, Failures and the Future*, ADB WP No.69, p.10.

binding formulations with enforcement. These characteristics constitute both strengths and weaknesses: they explain ASEAN's durability, but they limit its effectiveness and capacity for strong and decisive action.<sup>80</sup> The ASEAN consensus approach remains hostage to the imperative of national interests of the ASEAN Member States, which explains the slow integration of ASEAN over half a century. In order to survive in the 21<sup>st</sup> century, ASEAN Member States realise that they need to integrate in a more substantial way, to be a rules-based organisation, and to have strong institutions. ASEAN must surpass its own "ASEAN Way".

## **Section 2. ASEAN Investment in the Rise of the New Economic Regionalism**

ASEAN Declaration article 2(1) states the first aim and purpose of the Association, *i.e.* "to accelerate the economic growth, social progress and cultural development in the region through joint endeavours in the spirit of equality and partnership in order to strengthen the foundation for a prosperous and peaceful community of South-East Asian Nations".<sup>81</sup> Despite the economic objective mentioned in the ASEAN founding instrument, the economic potential of ASEAN was previously latent, as ASEAN focused only on security issues. In the late 1970s, ASEAN attempted to enhance its economic cooperation by using the political cooperation platform for investors to trade and invest in a peaceful environment.<sup>82</sup> Nonetheless, ASEAN investment schemes were not fruitful. It was only in the 1990s that ASEAN could substantially boost its intra-ASEAN FDI by creating an "ASEAN Investment Area".

### **2.1 Early Attempts of the ASEAN Investment Integration**

With investment legal frameworks for ASEAN Industrial Cooperation, ASEAN pushed forward the notions of joint industrial projects and reciprocity among the parties involved.<sup>83</sup> Nevertheless, none of these programs had any significant impact on regional economic relations, given the lack of flexibility of the ASEAN governments and lack of

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<sup>80</sup> *Idem*, p.2.

<sup>81</sup> ASEAN Declaration, adopted by the Foreign Ministers at the 1<sup>st</sup> ASEAN Ministerial Meeting in Bangkok, Thailand on 8 August 1967.

<sup>82</sup> ASEAN economic cooperation started after the publication of "Kansu-Robinson" Report (1972), conducted by the United Nations (since 1969).

<sup>83</sup> These projects comprised: the ASEAN Preferential Trading Agreement (APTA), the ASEAN Industrial Projects (AIPs), the ASEAN Industrial Complementation (AIC), and the ASEAN Industrial Joint Ventures (AIJVs).

support by the private sector.<sup>84</sup> ASEAN was in a period of trial-and-error searching for more legally robust frameworks of investment integration.

The true precursor of the ASEAN investment regime is the 1983 ASEAN Industrial Cooperation (AICO) Scheme, which should be considered as the first generation of the ASEAN investment regime. It set the requirement of an “ASEAN-based company”, encouraging technology-based investments. It still provided consultation as a mechanism of dispute settlement. In this sense, the AICO scheme was an early indication of how the administration of further ASEAN economic integration was likely to proceed.

Despite this success, some drawbacks remained, such as the inconsistent or contradictory criteria for the approval process and slow implementation. For the first quarter of its existence, ASEAN was not particularly successful in terms of an economic integration. The intra-ASEAN arrangements covered only about five percent of regional economy by the end of the 1980's. For this problem, the “ASEAN Way” of consensus and flexibility is not just an abstract notion, but has proven useful in fostering ASEAN economic cooperation. It was applied to addressing the problem of hesitancy and indifference among ASEAN Members States toward the ASEAN industrial joint ventures and tariff reductions.<sup>85</sup> The efforts at intra-regional economic cooperation had provided a foundation for ASEAN's initiatives towards an outward looking and more open regionalism in the subsequent years.

After the slow progress in the early decades, several incidents justified the new wave of ASEAN Regionalism as Economic Liberalism, especially changes in the regional and global commercial architecture.<sup>86</sup> By the 1990s, the Cold War had ended, globalisation had advanced, and the European Single Market and NAFTA were formed. ASEAN was in between the two giant emerging markets, China and India, which were attracting large FDI inflows, particularly in key sectors such as electronics and labour-intensive manufacturing industries.<sup>87</sup> Later on, the Asian financial crisis of 1997-1998 was another significant coercion.<sup>88</sup> Concurrently with the economic crisis, ASEAN had further expanded its

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<sup>84</sup> UNCTAD (1991), *Review of the Economic Integration Experience of ALADI, ASEAN, CACM and ECOWAS*, UNCTAD/ECDC/217, p.10; Cuyvers, L., Pupphavesa, W. (1996), *From ASEAN to AFTA*, CAS Discussion paper No.6, Centre for ASEAN Studies, RUCA, p.5.

<sup>85</sup> Acharya A. (1997), p.331.

<sup>86</sup> World Bank (2004), *Global Economic Prospects 2005: Regionalism, Trade and Development*. Washington, D.C. World Bank; ADB (2008), *Emerging Asian Regionalism A Partnership for Shared Prosperity*, ADB; Heydon, K., Woolcock, S. (2009), *The Rise of Bilateralism Comparing American, European and Asian Approaches to Preferential Trade Agreements*, Tokyo, UNUP.

<sup>87</sup> Dahlman, C.J., Aubert, J.E. (2012), *China and the Knowledge Economy: Seizing the 21<sup>st</sup> century*, WBI Development Studies, World Bank Publications, Washington, p.16.

<sup>88</sup> ASEAN Economic Crisis had consequences on the specific provisions of the ACIA, i.e. balance-of-payment exceptions. See Chapter 4.3 Transfers.

membership to include the last four countries, to complete ten ASEAN countries.<sup>89</sup> These newcomers were Cambodia, Laos, Myanmar and Vietnam, also known as the “CLMV” countries. Cambodia, Laos, Myanmar, the poorest countries in Southeast Asia, are henceforth part of the “ASEAN Way of consensus”.<sup>90</sup> The expansion of membership has resulted in political, economic and social disparities between the old (ASEAN-6) and the new Member States (CLMV), which have become one of the biggest challenges for ASEAN integration.

This situation pressured ASEAN to accelerate the ASEAN internal integration process. ASEAN sought to attract foreign investment by creating an investment-favourable environment.<sup>91</sup> Only through a regional association could ASEAN member States see their weak voices amplified and their political and economic leverage strengthened. The time could not have been more opportune for a concerted effort to shift from its original “ASEAN way” of preventive diplomacy to the constructive diplomacy of community building to cope with increasing economic competition.<sup>92</sup>

## **2.2 Precursors of the ASEAN Comprehensive Investment Regime: the IGA and the AIA**

The regional investment integration was indeed motivated by the different economic rationale targeting the level of import-substituting industrialisation.<sup>93</sup> ASEAN countries with their small markets realised that they could moderate the cost of industrialisation by attaining economies of scale through opening preferential markets with one another.<sup>94</sup> Hence, they decided to boost the situation of ASEAN investments by concluding two agreements: one for investment protection, the other for investment liberalisation. These agreements may be classified as the second generation of ASEAN investment agreements. Both the IGA and the AIA Agreements applied to all direct

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<sup>89</sup> Severino, R. C. (2007), “The ASEAN Developmental Divide and the Initiative for ASEAN Integration”, *ASEAN Economic Bulletin*, Vol.24, No.1 (2007), pp.35-44.

<sup>90</sup> The 11<sup>th</sup> ASEAN country may be Timor-Leste. It has been applying for membership of ASEAN since February 2011, but many questions have been raised regarding the benefits of membership and the young country’s readiness. See also ASEAN Secretariat (2007), (2008), *Vietnam in ASEAN: Toward Cooperation for Mutual Benefits*, Statement by the Secretary-General of ASEAN welcoming Cambodia as the 10<sup>th</sup> Member State of ASEAN, 30 April 1999; Gates, C.L., Than, M. (2001). *ASEAN Enlargement: Impacts and Implications*, Singapore, ISEAS, pp.11-12.

<sup>91</sup> Vandevelde, K.J. (1998), “Investment Liberalization and Economic Development: The Role of Bilateral Investment Treaties”, *Columbia Journal of Transnational Law*, vol.36, pp.501-503.

<sup>92</sup> Acharya, A. (2014), *Constructing a Security Community in Southeast Asia: ASEAN and the Problem of Regional Order*, Oxon, New York, Routledge, p.140.

<sup>93</sup> Daquila, T.C. (2007), *The Transformation of Southeast Asian Economies*, New York, Nova Sciences Publishers, pp.68-69.

<sup>94</sup> Bhagwati, J. (1993), “Regionalism and Multilateralism: An Overview”, in Melo, J. D., Panagariya, A. (Eds.), *New Dimensions in Regional Integration*, Cambridge, CUP, pp.29-31.

investments, but they exclude portfolio investment and matters relating to investment covered by other ASEAN liberalisation agreements.

The 1987 ASEAN Agreement for the Promotion and Protection of Investment, commonly known as the ASEAN Investment Guarantee Agreement (IGA), primarily covered protection against expropriation, guaranteeing repatriation of capitals and profits. It provided for arbitration as dispute settlement mechanism between investors and States. The IGA was subsequently amended to include more modern provisions, *i.e.* simplification of investment procedures and approval process, transparency and predictability, as well as provisions on accession of new members.<sup>95</sup>

A decade later, in 1998, the Framework Agreement on the ASEAN Investment Area (AIA) was signed with the accession of Cambodia, extending the AIA across all ten ASEAN countries. The purpose of the ASEAN investment regime had extended to liberalisation. ASEAN decided to allow the freer flow of investments. The most significant initiative of the AIA was the introduction of the concept of “ASEAN investor” and the preferential treatment afforded to ASEAN investors for a fixed period of time. This treatment took the form of access to particular industrial sectors, namely, manufacturing, agriculture, fishery, forestry, mining and quarrying, and services incidental to those five sectors.<sup>96</sup> The AIA Agreement aimed to extend national treatment to ASEAN investors by 2010 and to all other investors by 2020, on reciprocal basis. The AIA did not provide for arbitration. Despite this effort, the intra-ASEAN investment flows increased only slightly, the ASEAN Member States’ economic policy remained leaning towards attracting inward FDI mainly from external industrialised countries.

In the meantime, ASEAN Member States preferred encouraging and creating favourable conditions for intra-ASEAN investments by concluding BITs. From 1990-2008, the ASEAN Member States signed 28 intra-ASEAN BITs, only 18 of which have entered into force.<sup>97</sup> Brunei has no BIT with any ASEAN member. Indonesia and Viet Nam have the most BITs (8), followed by Laos and Cambodia (7).<sup>98</sup> The latest BITs were signed in 2008, before the conclusion of the ACIA, between Cambodia-Laos, and Myanmar-Thailand. These statistics show that some States have concluded BITs with almost every ASEAN Member State. These bilateral relations may be seen either as an attempt to create a closer network between two ASEAN countries, or as a response to an unsuccessful

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<sup>95</sup> Protocol to amend the IGA, signed in 1996, Jakarta, entered into force on 6<sup>th</sup> January 2006.

<sup>96</sup> Protocol to amend the AIA, signed by the AIA Council in Ha Noi, on 14<sup>th</sup> September 2001, not in force.

<sup>97</sup> Update the statistics <http://investmentpolicyhub.unctad.org>

<sup>98</sup> Indonesia (8), Vietnam (8), Cambodia (7), Laos (7), Thailand (6), Philippines (5), Myanmar (5), Singapore (5), Malaysia (4), Brunei (0).

regional investment programme. Most of these BITs have accorded both unconditional national treatment and most-favoured nation treatment to investors of another party. They also provided arbitration for dispute settlements.

In addition, as the “ASEAN Way” of dispute resolution did not promote the adjudicatory channels which would result in legally-binding decisions, there has been only one case under the IGA/AIA regime, while there are no statistics on the cases being brought under the intra-ASEAN BITs. *Yaung Chi Oo vs. Myanmar* case,<sup>99</sup> the only investment dispute under the IGA, was provocative on several issues, *e.g.* scope of coverage, MFN treatment and dispute settlement mechanism. This case illustrates the problem of coordination of the IGA and the AIA. For the new millennium, ASEAN needed to design a new ASEAN investment regime which could correct the weak points of these parallel investment regimes, *i.e.* a consolidation of these two separate investment regimes in the ACIA.

The ASEAN Member States had shown the willingness to be more rule-oriented in creating regional regime, the ASEAN Investment Area. However, these IGA/AIA regimes seemed to be overlapping. Simultaneously, the ASEAN Member States were reluctant and desired to remain consensual, as well as to preserve their policy space, by way of bilaterally granting preferential investment treatment to particular ASEAN Member States. To summarise, while the IGA and the AIA are relevant in the creation of the ASEAN Investment Area, they were mere precursors of the ACIA. Under the ASEAN Economic Community Era, the ACIA is the decisive step of ASEAN investment integration.

### **Section 3. Investment regime under the ASEAN Economic Community**

In the 21<sup>st</sup> century, the new “ASEAN Way” has set the scene for a contemporary ASEAN investment regime. In order to achieve the community-building process, the 2007 ASEAN Charter<sup>100</sup> provides for the legal personality of ASEAN,<sup>101</sup> and strengthens the institutional framework, especially the ASEAN Secretariat.<sup>102</sup> The Charter also requires ASEAN Member States to adhere “to multilateral trade rules and ASEAN’s rules-based regimes”. ASEAN has been working on rules-creating and rule-enforcing processes with

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<sup>99</sup> *Yaung Chi Oo v. Myanmar*, ASEAN I.D. Case No.ARB/01/1, Award 31 March 2003; Gaillard, E. (2004), “Yaung Chi Oo Trading v. Myanmar: The First ASEAN Investment Arbitral Award”, *Transnational Dispute Management*, Vol.1, Issue 2, May 2004.

<sup>100</sup> Entered into force on 15<sup>th</sup> December 2008.

<sup>101</sup> ASEAN Charter article 3.

<sup>102</sup> Concerning the ASEAN investment regime, the Secretariat-General will have an expanded role in dispute settlement mechanism. See Chapter 6 DSM.

the establishment of institutions and dispute settlement mechanisms. The shadow of the “ASEAN Way” from the 1970s seems to be disappearing. However, despite its seemingly ambitious transformation, the AEC has much more limited objectives.<sup>103</sup> According to Balassa’s theory of economic integration,<sup>104</sup> the AEC is a “common market”, not yet a “customs union” which requires coordination and harmonisation of external tariffs and macroeconomic policies of Member States.<sup>105</sup>

Once the AEC is realised, ASEAN will be characterised by free movement of goods, services, and investments as well as freer flow of capital and skills. ASEAN has adopted a policy roadmap in 2007, also known as “AEC Blueprint”.<sup>106</sup> The AEC Blueprint mandates a conclusion of a set of “AEC-related agreements” which support the realisation of the AEC.<sup>107</sup> The ACIA is the key legal framework for the intra-ASEAN investment integration, which replaced the IGA and the AIA. With harmonised trade and investment regimes, ASEAN will become more attractive as a rules-based organisation and as a single investment destination. ASEAN Member States have committed to maximise opportunities for mutually beneficial regional integration. In creating a new investment regime, the ACIA has provided a transitional period between past (IGA/AIA) and new (ACIA) agreements. However, the problem of consistency remains between the existing BITs and the ACIA.

### 3.1 A Consolidated Regime under the ACIA

ASEAN Member States realised that the IGA/AIA investment regime was inadequate to meet broader and more concrete AEC objectives. Two fundamental reasons may be given: legal and economic. Firstly, as mentioned *supra*, the liberalisation pillar under the AIA and the protection pillar under the IGA had an overlapping scope of application, and they were not well-coordinated, as there was no provision for explanation of the connection between the two treaties. Secondly, the IGA and the AIA were drafted in the context before the Asian Economic Crisis, while now the economic landscape has

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<sup>103</sup> Chia, S.Y. (2010), p.7.

<sup>104</sup> Balassa, B.A. (1961), *Towards a Theory of Economic Integration*, Kyklos, Vol.14, Issue 1, Greenwood Press, pp.1-17.

<sup>105</sup> The “economic union” is envisaged as being on the negotiation table of the post-2015 agenda.

<sup>106</sup> Together with the Initiative for ASEAN Integration (IAI) Strategic Framework and IAI Work Plan Phase II (2009-2015), they form the Roadmap for and ASEAN Community 2009-2015.

<sup>107</sup> The building blocks are the ASEAN Trade in Goods Agreement (ATIGA), ASEAN Framework Agreement on Services (AFAS), ACIA, ASEAN Agreement on Movement of Natural Persons (AAMNP), and Mutual Recognition Arrangements on Services (MRAs).

changed considerably, in that IIAs play more important roles in regional or mega-regional economic integration.<sup>108</sup>

Therefore, the 2007 AEC Blueprint called for a review of the IGA/AIA with the objective of realising an ASEAN Comprehensive Investment Agreement (ACIA), “which is forward-looking, with improved features and provisions, comparable to international best practices in order to increase intra-ASEAN investments and to enhance ASEAN’s competitiveness in attracting inward investments into ASEAN”.<sup>109</sup> The ACIA was signed in February 2009. The Agreement was scheduled to enter into force by the end of that year. However, with the internal process of each member States to ratify international agreements, the ACIA, together with its Schedule (Reservation Lists), took effect on 29<sup>th</sup> March 2012, three years after its conclusion.

As a consolidated agreement, the ACIA covers four corners of investment: (1) enhanced protection for investors of all Member States and their investments, (2) facilitation and cooperation to create favourable conditions for investment, (3) joint promotion of the region as an integrated investment area, and (4) progressive liberalisation. Innovatively, the ACIA has improved the elements of transparency and predictability in investment rules and procedures. By virtue of the “no back-tracking of commitments” obligation,<sup>110</sup> the lowest threshold of the ACIA is the existing commitment made under the IGA/AIA regime.

In accordance with the objectives of a rule-based organisation, ACIA article 42 reinforces the institutional aspect of the AEC. It provides a mechanism of “treaty management”. The Coordinating Committee on Investment (CCI)<sup>111</sup> and the ASEAN Investment Area (AIA) Council<sup>112</sup> mainly provide policy guidance, oversee, coordinate and review the implementation of the ACIA. The AIA Council may also recommend to the ASEAN Economic Ministers any amendments to the Agreement.

Regarding the continuity of the previous and new regimes, ACIA article 47 provides that the IGA/AIA Agreements are terminated upon the entry into force of the ACIA. A three-year transitional period option applies to investors whose investments fall within the ambit of the previous regimes. In case the investor chose the IGA or the AIA

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<sup>108</sup> See more in section 5.

<sup>109</sup> ACIA Preamble.

<sup>110</sup> ACIA article 2(e), Guiding Principles.

<sup>111</sup> The CCI was established at the inaugural meeting of the AIA Council in October 1998. It is composed of senior officials responsible for investment, and other officials from other government agencies, and supports the AIA Council in carrying out its functions.

<sup>112</sup> The AIA Council is the Ministerial body under the ASEAN Economic Ministers, composing of Ministers from the ten Member States responsible for investment and the Secretary-General of ASEAN.



Agreement, as the case may be, one would apply in its entirety. By the end of March 2015, this transitional period was over. There is no record of the choice of investors regarding the transitional provision.

### 3.2 Question of Inconsistency between existing BITs and the ACIA

While the question of inconsistency between the IGA/AIA and the ACIA has been solved by the transitional provision provided in the ACIA, the question of inconsistency regarding the continuous validity of the BITs between ASEAN Member States remains unanswered. In theory, the overlap between the ACIA and these BITs may render the ACIA less effective and cause “legal uncertainty” in the ASEAN Investment Area. Not only do the ASEAN Member States have no obligation to terminate these BITs, they also retain internal and external sovereign powers, including the competence to conclude new BITs. The situation raises issues similar to that faced by the European Union (EU), but there is no equivalent to the detailed European debates about the matter.<sup>113</sup>

For ASEAN, while the legal setting appears complicated in theory, the question of potential inconsistencies may, in practice, be ignored. Firstly, the important issues usually arise at the dispute settlement stage, and from the statistics, no case has been filed under these intra-ASEAN BITs. Secondly, neither “ASEAN Law” nor an “ASEAN Court” exists, so no one will judge the issue of inconsistency between regional obligations and bilateral obligations. Thirdly, the BITs do not primarily serve as instruments of investment protection; they are actually the expression of closer links between two ASEAN countries, especially in areas of border development and infrastructure. Fourthly, and contrary to what could be expected in term of regional solidarity, the ACIA encourages deeper

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<sup>113</sup> TFEU article 351 (ex-article 307 TEC). See Towards a Comprehensive European International Investment Policy, 7 July 2010, com(2010) 343 final, 4, (Last accessed: 18 August 2015) [trade.ec.europa.eu/doclib/docs/2010/july/tradoc\\_146307.pdf](http://trade.ec.europa.eu/doclib/docs/2010/july/tradoc_146307.pdf); Council of the EU, Conclusions on a comprehensive European international investment policy, 3041<sup>st</sup> Foreign Affairs Council Meeting, Luxembourg, 25 October 2010 (Last accessed: 18 August 2015) [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/foraff/117328.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/foraff/117328.pdf); European Parliament Resolution of 6 April 2011 on the Future European International Investment Policy, (2010/2203 (ini)), Official Journal C296E, 2 October 2012. (Last accessed: 18 August 2015) <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2011-0141&language=EN> For detailed discussion: Shan W., Zhang S. (2010), “The Treaty of Lisbon: Half Way toward a Common Investment Policy”; *EJIL*, Vol.21, Issue 4, pp.1049-1073; Reinisch, A. (2014), *The EU on the Investment Path - Quo Vadis Europe? The Future of EU BITs and other Investment Agreements*, Santa Clara Journal International Law, Vol.12, Issue 1, Article 6, p.111; Reinisch, A., Bungenberg, M., The Anatomy of the (Invisible) EU Model BIT: An Introduction, *JWIT*, 07/2014, Special Issue, Vol. 15, Issue 3-4, pp.375-378; Hoffmeister, F., Ünüvar, G. (2013), “From bits and Pieces towards European Investment Agreements” in Bungenberg, M., Reinisch, A., Tietje, C. (eds.), *EU and Investment Agreements: Open Questions and Remaining Challenges*, Nomos, Hart Publishing, p.57-86.

integration between ASEAN Member States by means of sub-regional arrangements.<sup>114</sup> This legal permission breaks ground for the multi-track integration within ASEAN, which, again, confirms the reincarnation of the “ASEAN Way” of economic cooperation.

Nevertheless, some plausible solutions are proposed to solve this legal conflict. ASEAN Member States have several options by mutual consent of the parties. First, straightforwardly, they may terminate BITs by a termination agreement or an exchange of verbal notes. More discretely, as BITs usually enter into force for a period of ten years, the ASEAN Member States may take no action to renew expiring BITs. Once BITs exist no longer, the ACIA, which has no expiry date, will naturally apply to intra-ASEAN investments. Notwithstanding this, by virtue of the transitional period after the date of termination of the BITs, existing investments will still benefit from the BITs protection. ASEAN Member States may also put effort into renegotiating existing BITs in order to bring incompatible provisions in line with the ACIA. This option is, however, unreasonable because it would render the BITs futile as they would contain exactly the same content as the ACIA.

Recently, Indonesia has been the only ASEAN country which has explicitly expressed its intention to terminate and renegotiate the “old” BITs.<sup>115</sup> However, as ASEAN currently focuses more on network-creation than network-termination, the life of the intra-ASEAN BITs is not in jeopardy. Arguably, the multi-speed integration and flexibility approach will emphatically subsist in the ASEAN philosophy. ASEAN uniqueness will make ASEAN struggle between the past and the future, both internally and externally.

## Section 4. Internal Tension between the Past and the Future

ASEAN Member States have a strong will to push forward the AEC in the hope of finally reducing the development gap among them. Ten ASEAN countries desire more investment flows within the region: the CLMV countries need technology and capital, while the ASEAN-6 countries have become aware of these unexploited countries and desire to be the “first mover” to benefit from the resources.<sup>116</sup> The ACIA sets ambitious

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<sup>114</sup> ACIA article 6(3). See Chapter 5.1 on MFN.

<sup>115</sup> See Netherlands Embassy in Jakarta, Indonesia.

<http://indonesia.nlembassy.org/organization/departments/economic-affairs/termination-bilateral-investment-treaty.html> (Last accessed: 20 September 2015).

<sup>116</sup> For example, the Myanmar-Thailand BIT, signed in 2008, entered into force on 6<sup>th</sup> June 2012. As a neighbour State, Thailand naturally recognised the first-handed opportunity in the newly-opened State and

objectives of investment liberalisation and protection, but not every ASEAN Member State is ready to open the market and to extend the benefits of the ACIA to a new horizon. This contradiction reflects a fundamental principle of ASEAN: “flexibility”. Apart from the protection provisions which are discussed later in this thesis, the principle of “flexibility” appears in sub-principles of (1) “progressive liberalisation” and (2) “special and differential treatment”. The challenge remains of achieving a balance between maximising the gains from ACIA investments and addressing the need to face greater social and economic problems brought by the new regime. Under this tension, it is observed that the traditional “ASEAN Way” is still surviving in the intra-ASEAN relations.

## 4.1 Liberalisation Regime: New Horizon?

Investment liberalisation is a growing element in regional trade and investment agreements. The AEC Blueprint has set three objectives for liberalisation: (a) progressive reduction or elimination of investment restrictions and impediments; (b) free and open investment regime with minimal investment restriction; and (c) harmonisation of investment measures. In doing that, the main question is how to structure the ACIA in order to preserve the regulatory powers of individual States over the admission and operation of foreign investment, and simultaneously to open up the market to attract investment flows. Liberalisation extends the scope of protection of the ACIA, because some designated sectors benefit also from the protection of the pre-establishment phase, on top of the post-establishment one.

The ACIA adopts the GATS “hybrid” model,<sup>117</sup> where specific commitments on market access and national treatment are made in a positive list of sectors (ACIA article 3(3)), but where limitations to these commitments are presented in a negative list (ACIA article 9). Based on this principle of “progressive liberalisation”, also known as the “GATS-plus” agreement,<sup>118</sup> only the sectors positively inscribed in specific commitment of a Member State are liberalised.<sup>119</sup> Unlike the “one-shot” liberalisation pursuant to the NAFTA model,<sup>120</sup> there is no automatic liberalisation under the ACIA. The GATS-

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then revealed its special interests in many contracts on road constructions, deep sea port, power grid, natural gas and industrial estate.

<sup>117</sup> OECD (2008), *International Investment Law: Understanding Concepts and Tracking Innovations*, p.275.

<sup>118</sup> It contains a higher number of sectors and sub-sectors compared to those made under the GATS.

<sup>119</sup> UNCTAD (2000), *IAs: Flexibility for Development*, New York, Geneva, UN, pp.60-64; UNCTAD (2002), *Admission and Establishment*, New York, Geneva, UN, p.47; UNCTAD (2006), *Preserving Flexibility in IAs: the Use of Reservations*, UNCTAD Series International Investment Policies Development, New York, Geneva, UN, pp.17-35.

<sup>120</sup> OECD (2008), “The Interaction between Investment and Services Chapters in Selected Regional Trade Agreements”, Chapter 4, in *International Investment Law: Understanding Concepts and Tracking*

inspired approach grants ASEAN Member States certain flexibility, as they can select for liberalisation only the sectors which are beneficial and sufficiently strong.

Compared to NAFTA model, the level of investment liberalisation of the ACIA appears to be disadvantageous in terms of the number of liberalised sectors and the degree of transparency and predictability. The ACIA maintains the same list of five sectors which had been liberalised under the AIA regime – manufacturing, agriculture, fisheries, forestry and mining – as well as the services incidental to these sectors. The admission of investment of other sectors, and the application of all other measures to investment, remain subject to national laws and regulations of State parties. However, the ACIA leaves an opportunity to open any other sectors, as may be agreed upon by all Member States in the future, through a review mechanism by the AIA Council.<sup>121</sup>

The ACIA provides the enabling legal framework for Member States to “progressively” improve market access and non-discrimination obligations to investors of ASEAN Member States. It provides for both MFN and national treatment with a more expansive obligation of prohibition of performance requirement, envisaged under the WTO Agreement on Trade-Related Investment Measures (TRIMs).<sup>122</sup> Despite the ambitious objective of liberalisation, the ACIA recognises the development gap of the ASEAN Member States. The technique of “reservations” is key to balance flexibility of national authorities with regional obligations, either for sectors deemed important from a longer-term developmental perspective or for sectors where particular regulatory or policy sensitivities arise. Essentially based on a positive list of specific commitments, ASEAN employs a negative list approach to schedule non-conforming measures. ACIA article 9(2) allows each Member State to submit its reservation list to the ASEAN Secretariat for endorsement by the AIA Council.<sup>123</sup> This list forms part of the ACIA.<sup>124</sup>

On the list of non-conforming measures, the ASEAN Member States may maintain some measures in contradiction with National Treatment (Articles 5) and/or Senior Management and Board of Directors (Article 8) obligations. Additionally, each Member State reserves the right to make future reservations on measures that do not conform to

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*Innovations*, A Companion Volume to International Investment Perspectives, OECD Publishing, Paris, pp.250, 284.

<sup>121</sup> ACIA article 3(3)(g).

<sup>122</sup> ACIA article 7(1). The TRIMs Agreement prohibits measures that are inconsistent with States’ commitments not to discriminate against non-nationals in trade in goods, and with States’ commitments to remove quantitative restrictions on imports of goods. The AIA Agreement does not refer to the TRIMs Agreement.

<sup>123</sup> The ACIA Reservation List. <http://www.asean.org/communities/asean-economic-community/item/asean-comprehensive-investment-agreement-reservation-list> (Last accessed:18 August 2015)

<sup>124</sup> ACIA article 45 ACIA, Annexes, Schedule and Future Instruments.

these two articles on new and emerging sectors, or on existing sectors which are unregulated at the time of submission of the reservation lists.<sup>125</sup> Like other developing countries,<sup>126</sup> ASEAN Member States have lodged a long list of reservations, because most of them are encountering new regulatory contingencies with more limited resources and expertise. As a consequence, reservations contained in the ACIA may turn out to be unproductive or even counterproductive to the objective of liberalisation. However, the fact that the ACIA automatically extends the MFN treatment to all Members, at least, shows the sincerity of ASEAN Member States to open the ASEAN Investment Area with a comparable liberalisation level to that provided for third parties.

Despite this flexibility and regulatory autonomy, ASEAN Member States are obliged to gradually phase out their reservations in order to achieve the full liberalisation which is the end goal of economic integration under the AEC.<sup>127</sup> Having realised the lack of transparency of the Reservations,<sup>128</sup> the ASEAN Secretariat further recommended that the ASEAN Member States simplify and clarify their schedules of commitments. As a result, ASEAN Member States have recently concluded a Protocol to amend the ACIA, setting up the “Procedures for Amendment or Modification of Reservations” in the additional “Annex 3”.<sup>129</sup> Annex 3 helps ASEAN investors to predict the impending opened-up sectors or subsectors, and to prepare for the host States’ restrictive measures in a more systematic manner.

## 4.2 Special and Differential Treatment for Newer ASEAN Member States

By adopting the principle of “progressive liberalisation”, ASEAN Member States have already gained a transitional period to implement this regional liberalisation programme, to reform and establish new regulatory frameworks for the liberalised sectors. However, the development gap, shown in as average per capita GDP, economic growth, and basic infrastructure, between ASEAN-6 and CLMV is a fundamental problem.

The CLMV countries are promising intra-ASEAN investment destinations. They have recently opened up their once centrally planned economies to trade, FDI and the

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<sup>125</sup> Headnote to the Schedule to the ACIA (Reservation List).

<sup>126</sup> See Figure 4. Reservations on investment by group of countries, in UNCTAD (2006), *Preserving Flexibility in IIAs: the Use of Reservations*, p.43.

<sup>127</sup> ACIA article 9(3) and (4).

<sup>128</sup> ASEAN Secretariat, World Bank (2013), *ASEAN Integration Monitoring Report*, Joint Report, Washington, World Bank, p.183.

<sup>129</sup> Protocol to amend the ACIA, Article 3 Insertion of Annex 3 into the ACIA, signed at Nay Pyi Taw, Myanmar, 26 August 2014.

global market. In addition, these countries were not affected by the Asian Economic Crisis in 1997 as they had not yet opened their market. They also showed resilience to the global crisis of 2008-2009, due to their export growth, tourism, agricultural products and hydropower. Their trade and investment linkages within ASEAN have strengthened their economies.

However, although Cambodia, Lao and Vietnam have achieved strong economic growth rates and significant progress in poverty reduction in the past 20 years, they remain among the poorest countries in Southeast Asia.<sup>130</sup> Myanmar is at a different stage altogether. Myanmar is only now following up tentative political freedoms with economic liberalisation, even though it has been a WTO member since 1 January 1995. The CLMV countries are undergoing an inter-sectoral shift from agriculture to manufacturing, while the incidental services have an intermediate role and, so far, investment flows have stagnated, reflecting the relatively poor investment climate.<sup>131</sup> As the ASEAN economic integration greatly affects small and medium-sized enterprises (SME) in the CLMV markets, it would affect the social and political situation and may lead to greater opposition towards trade and investment integration.<sup>132</sup> Given the development gap, the challenge of ASEAN integration is how to realise the AEC and the ASEAN Investment Area so that ASEAN Member States and ASEAN investors will maximise and share benefits in creating an ASEAN economic of scale.

A gradual approach is needed in order that the CLVM countries overcome poverty and income disparities in their economic transition. In accordance with the objective of the AEC to create a region of “equitable economic development”, the ACIA sets out the “special and differential treatment for the newer ASEAN Member States” in the Preamble, articles 1 (Objective) and 2 (Guiding Principles). This principle has also been found in some treaties.<sup>133</sup>

In contrast to the usual objectives of BITs, even though the Preamble of the ACIA states that it aims “to increase intra-ASEAN investments and to enhance ASEAN’s competitiveness in attracting inward investments into ASEAN”, it is also “recognising the

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<sup>130</sup> OECD (2013), “Integrating CLMV Countries through Trade and Investment”, in OECD, *Southeast Asian Economic Outlook 2013: With Perspectives on China and India*, Paris, OECD Publishing, p.331.

<sup>131</sup> Menon, J. (2012), *Narrowing the Development Divide in ASEAN: The Role of Policy*, WP Series on Regional Economic Integration No.100, p.6.

<sup>132</sup> Sen, R., Srivastava, S. (2009), *ASEAN’s Bilateral Preferential Trade and Economic Cooperation Agreements: Implications for Asian Economic Integration*, ASEAN Economic Bulletin, Vol.26, No.2, Singapore, ISEAS, p.211.

<sup>133</sup> For example, COMESA CIA article 14(3). See Gallus N. (2005), “The Influence of the Host State’s Level of Development on International Investment Treaty Standards of Protection”, *Journal of World Investment and Trade*, Vol.6, p.711.

different levels of development within ASEAN especially the least developed Member States which require some flexibility including special and differential treatment as ASEAN moves towards a more integrated and interdependent future”. ACIA article 23(c) is further “recognising that commitments by each newer ASEAN Member State may be made in accordance with its individual stage of development.”<sup>134</sup>

Under the ACIA, the CLMV countries are granted delays in the application of certain investment integration measures, both in protection and liberalisation regimes. As expectations on the part of the investor are correlated with the investment environment in the host country, the conditions in the host State should play a part in the analysis of whether a standard has been breached. Tribunals should take into account the level of development of the ASEAN host State when it searches for the interpretative guidance of the ACIA’s provisions. This approach illustrates that the ACIA attempts to balance the interests of the developing States and the ASEAN investors.

Along with the interpretative guidelines, the Initiative for ASEAN Integration (IAI) and Narrowing the Development Gap (NDG)<sup>135</sup> are raising the capacity of the newer members to integrate their economies in the ASEAN mainstream. Increasing investment flows in ASEAN through protection and liberalisation should promote the development of a sound and modern legal and hard infrastructure. With the AEC, it is hoped that CLMV will succeed in escaping the least developed countries (LDCs) category, becoming more competitive, and will finally be ready to open itself to the world.

## Section 5. External Investment Relations: ASEAN Open Regionalism

The ASEAN economy has been relying on external relations, while the intra-ASEAN economy has made a modest contribution to the increase of FDI.<sup>136</sup> Since the 1990s, ASEAN diversity and the changing global economic environment has generated a unique ASEAN model of regionalism, which is dynamic, outward-looking, multi-track,

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<sup>134</sup> See the 2005 Hong Kong WTO Ministerial Declaration, exempting the LDCs for the service liberalisation.

<sup>135</sup> Initiative for ASEAN Integration (IAI) and Narrowing the Development Gap (NDG) was launched at the ASEAN Summit in 2000.

<sup>136</sup> Statistically, the leading source of FDI inflows to ASEAN region has been the EU, accounting for around 20% of total inwards FDI in ASEAN during 2009-2013. ASEAN, predominantly Singapore, Japan and the United States were the other major sources with a share of 10% or above in the same period, while China are increasing its interests in investing in ASEAN, becoming the fourth country at the end of 2013. See Table of *Top ten sources of foreign direct inflows in ASEAN*, ASEAN FDI Statistics Database, as of 1 June 2014. <http://www.asean.org/images/resources/Statistics/2014/ForeignDirectInvestment/Aug/Table%2027.pdf> (Last accessed: 18 September 2015).

and multi-speed, known as “Open Regionalism”. This approach underscores the importance of strengthening trade, investment, and capital flows within the region while maintaining strong ties with, and remaining open to, the rest of the world.”<sup>137</sup>

The ASEAN Charter requires each ASEAN Member State “to maintain the centrality and proactive role of ASEAN as the primary driving force in its relations and cooperation with its external partners in a regional architecture that is open, transparent and inclusive.”<sup>138</sup> ASEAN currently works towards “ASEAN Centrality” and “ASEAN Connectivity”<sup>139</sup> especially in its negotiations for free trade areas (FTAs) and comprehensive economic partnership (CEPs) agreements, which also cover investment issues. With the mixed rhythm of “ASEAN Plus” and “ASEAN Minus” formulas, the steps of ASEAN Member States are dissimilar in their schedules with respect to the choice of their major internal parameters and their diverse partners. Some interesting examples can be given regarding these formulas.

“ASEAN Plus” refers to the economic agreements between the ten ASEAN Member States plus one or more third States. For example, ASEAN and the EU started negotiation on the ASEAN-EU FTA in 2007.<sup>140</sup> ASEAN as a whole represents the EU’s third largest trading partner outside Europe, after the US and China. This FTA deal appears very appealing, given voluminous and dynamic region-to-region markets. Regrettably, the interregional strategy was temporarily abandoned in 2009 because of ASEAN/EU differences in expectations, objectives and interests. Presumably, ASEAN will resume collective negotiations upon the realisation of the AEC,<sup>141</sup> and the ASEAN-EU FTA may be the first inter-regional model for ASEAN. Currently, the trend is towards integration in Asia-Pacific.

ASEAN has concluded six “ASEAN Plus” FTAs (with Australia, China, India, Japan, Korea and New Zealand). ASEAN desires to upgrade these FTAs into one mega-FTA, the Regional Comprehensive Economic Partnership (RCEP).<sup>142</sup> The RCEP has the potential to transform ASEAN into an integrated market of half of the world’s

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<sup>137</sup> Menon, J., Ng, T.H. (2015), “Challenges Facing a Globally Connected ASEAN” in Chirathivat, S., Sabhasri, C., Chongvilaivan, A. (Eds.), *Global Economic Uncertainties and Southeast Asian Economies*, Singapore, ISEAS, p.20.

<sup>138</sup> ASEAN Charter article 1(15), Chapter I, Purposes and Principles.

<sup>139</sup> Master Plan on ASEAN Connectivity. <http://www.asean.org/resources/publications/asean-publications/item/master-plan-on-asean-connectivity-2> (Last accessed: 18 August 2015).

<sup>140</sup> More details of ASEAN-EU FTA, <http://ec.europa.eu/trade/policy/countries-and-regions/regions/asean/>

<sup>141</sup> Keynote Address by H.E. Le Luong Minh, Secretary-General of ASEAN at the Conference on the “EU and ASEAN: Prospects for Future Cooperation”, 15 October 2013, Val Duchesse, Brussels. <http://www.asean.org/news/asean-secretariat-news/item/asean-secretary-general-highlights-asean-eu-prospects-for-future-cooperation> (Last accessed: 18 August 2015).

<sup>142</sup> The RCEP negotiations were formally launched in November 2012 at the ASEAN Summit in Cambodia.



population.<sup>143</sup> The RCEP will be, in the first quarter of the 21<sup>st</sup> century, a gigantic stepping stone to achieving the Asia-Pacific Free Trade Area.<sup>144</sup> “Mega-Regionalism” is becoming a major feature of ASEAN trade and investment strategies.<sup>145</sup>

In the midst of long and exhaustive negotiations for the “ASEAN Plus” agreements, ASEAN Member States are impatiently searching for an international playing field. The parallel trend is “ASEAN Minus”,<sup>146</sup> meaning bilateral or plurilateral FTAs between two or more ASEAN Member States, or some ASEAN Member States and third countries. Malaysia,<sup>147</sup> Vietnam<sup>148</sup> and Thailand have individually negotiated FTAs with the EU. The latest success of such negotiation is the EU-Singapore FTA in 2013.<sup>149</sup> In addition, given the renewed interest of the United States and its partners from South America and Australia, it is possible that only five ASEAN Member States (Brunei, Malaysia, Singapore, Vietnam and Thailand) are likely to adhere to the Trans-Pacific Partnership (TPP).<sup>150</sup> Some ASEAN Member States have also interests in East Asia.<sup>151</sup> In total, since 1960 more than 390 BITs have been concluded between ASEAN Member States and Third Parties.

The application of the “ASEAN Way” is particularly appropriate and practical where circumstances require some flexibility for conducting regional inter-State relations. As Lee Kuan Yew observed, at a time when ASEAN consisted of only five original Member States, “[w]hen four agree [to a certain scheme] and one does not, this can still be considered as consensus and the five-minus-one scheme can benefit the participating four without damaging the remaining one”.<sup>152</sup> Even though the “ASEAN Way” has been

<sup>143</sup> With the combined GDP of about US\$21.2 trillion, or about 30% of global GDP, about 3.4 billion people.

<sup>144</sup> Petri, P.A., Ali, A.-R. (2014), “Can RCEP and the TPP be pathways to FTAAP?”, *State of the Region*, Chapter 2, Pacific Economic Cooperation Council. <http://www.pecc.org/state-of-the-region-report-2014/265-state-of-the-region/2014-2015/595-chapter-2-can-rcep-and-the-tpp-be-path-ways-to-ftaap> (Last accessed: 18 August 2015).

<sup>145</sup> Das, B.S. (2012), *RCEP: Going Beyond ASEAN+1 FTAs*, ISEAS Perspective; Baldwin R. (2014) “Multilateralising 21<sup>st</sup> Century Regionalism”, *Global Forum on Trade Reconciling Regionalism and Multilateralism in a Post-Bali World*, p.29. <http://www.oecd.org/tad/events/OECD-gft-2014-multilateralising-21st-century-regionalism-baldwin-paper.pdf> (Last accessed: 18 August 2015).

<sup>146</sup> With a desire to expedite liberalisation of trade in services within ASEAN, the AEM during their Retreat on 6 July 2002 in Genting Highlands, Malaysia, called for a “10 Minus X Principle” to be applied in services negotiation.

<sup>147</sup> The Malaysia-EU FTA (MEUFTA) negotiations were officially launched in October 2010.

<sup>148</sup> The Vietnam-EU FTA (VEFTA) negotiations were started in June 2012.

<sup>149</sup> The final negotiations for an FTA between Singapore and the EU were completed in December 2012, and initialled on 20 September 2013.

<sup>150</sup> TPP is proposed as regional FTA, currently being negotiated by twelve countries throughout the Asia-Pacific region, namely, Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam.

<sup>151</sup> An investment agreement (APTA) was signed between Laos and Bangladesh, China, Korea, Sri Lanka, in 2009. Not yet in force.

<sup>152</sup> Cited in Irvine, R., 1982, “The formative years of ASEAN: 1967-1975”, in Broinowski, A. (ed.) *Understanding ASEAN*, New York, St.Martin’s Press, cited in A. Acharya (1997).

modernised, ASEAN Member States keep applying consensus and flexibility as a way of moving forward with regional cooperation schemes. This emphasises the fact that ASEAN Member States desire to preserve their policy space and the exercise of their investment competence. On this matter, ASEAN countries seem to adopt a policy of “thinking multilaterally but acting bilaterally”,<sup>153</sup> while they should have adopted a policy of thinking globally and practicing prosperity regionally.<sup>154</sup> “Non-ASEAN” practice is no longer an “exclusive non-ASEAN” approach, but one that should be compatible with ASEAN goals.

The recent proliferation of trade and investment agreements has concocted the most chaotic landscape in the history of ASEAN treaty practice. The “ASEAN Way” of integration “à géométrie variable” and “Open Regionalism” result in multi-layer integration, or the complication of the “living noodle bowl”.<sup>155</sup> This approach has amplified the gains from global and regional liberalisation; however it reflects a detached position of ASEAN Member States which would weaken the voice of ASEAN as a whole. In fact, the question of how they can manage the relationships among their partners is a delicate one. The objective of this survey of the ASEAN external relations is to underline that the “Open Regionalism” approach raises several questions, especially regarding the value of the intra-ASEAN regime. Extra-ASEAN relations may outweigh the intra-ASEAN relations, and ASEAN Member States may eventually turn blind to the intra-ASEAN investment flows, and the ACIA may lose its standing among this deliberately complicated network.

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<sup>153</sup> Shafie, M.G. (1982), *Malaysia: International Relations*, Kuala Lumpur: Creative Enterprises, pp.161-162.

<sup>154</sup> ASEAN Secretariat (2014), *Thinking Globally, Prospering Regionally*, AEC 2015, Jakarta.

<sup>155</sup> ADB (2013), *Asian Free Trade Agreements: Untangling the Noodle Bowl*, www.abd.org; Kawai, M., Wignaraja, G. (2013), “The Future of the World Trading System: Asian Perspectives”, ADBI-Graduate Institute of International and Development Studies-WTO, Geneva; Findlay, C., Thangavelu S. (2013), *The living noodle bowl: ASEAN trade agreements*, East Asia Forum, <http://www.eastasiaforum.org/>; United Nations (2010), Chapter 4, *A Regional Policy for Regaining the Dynamism, Economic and Social Survey of Asia and the Pacific 2010: Sustaining Recovery and Dynamism for Inclusive Development*, United Nations Publications, 2010; Zhang, Y., Shen, M. (2011), *The Status of East Asian Free Trade Agreements*, ADBI Working Paper Series, Vol.282, ADBI.

## Conclusion to Part I

This Chapter has provided an introduction to the ASEAN legal landscape in which the ACIA is situated. Since the 1990s, countries in Southeast Asia have made impressive progress in regional economic integration and cooperation. This is the first, deepest and most comprehensive process of institutional integration in the eastern hemisphere. For more than 40 years, ASEAN has run the traditional “ASEAN Way” of cooperation, *i.e.* by consensus, non-legal binding decisions, and absence of institutions.

ASEAN is an intergovernmental organisation. Previously, although meetings held between ministers and government officials of Member States resulted in joint statements and joint press releases, they did not lead to firm decisions with enforcement or to real actions. An unwillingness to cede national sovereignty, wide disparities in economic development, social structures, and political systems, so combined, led to consultations and consensus in the “ASEAN way”, rather than to solutions or formulations of specific policies agreed upon. It appeared that ASEAN Member States cautiously tried to avoid any legal commitment to their other members, and preferred to remain in cooperation only at a certain level.

Most of legally binding agreements that ASEAN concluded were economic in nature. Investment schemes were one form of early ASEAN cooperation. Nonetheless, the first and the second generations of agreements under the ASEAN investment regime had only played a “minor and secondary role”<sup>156</sup> in attracting intra-ASEAN direct investment. In response to the economic reality in the 21<sup>st</sup> Century, ASEAN is transforming to be an ASEAN Economic Community based on a single market. By virtue of the ASEAN Charter, ASEAN has now become a well-established international entity, equipped with rules and institutions, which makes ASEAN stable, credible and effective. The “ASEAN Way” is undergoing a transformation. ASEAN believes that the success of a rules-based economic regime will gradually extend to other pillars of the ASEAN Community. In this “pre-AEC Era”, the ASEAN Member States are enthusiastically forming a new “ASEAN Way” of trade and investment. The tension between tradition and novelty of the “ASEAN Way” is reflected in the discussion on the ACIA throughout the thesis.

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<sup>156</sup> See UNCTAD (1998), *BIT in the Mid-1990s*, p.177.

The ACIA, considered the third generation of ASEAN investment agreement, is one of the key ASEAN economic integration instruments, and consolidates previous protection and liberalisation agreements into a single document. Under the ACIA, ASEAN should attract higher levels of foreign investments, and increase awareness of investment opportunities within ASEAN.<sup>157</sup> Nevertheless, the ACIA was concluded with a view to balance the goal of a single market and production base with the goals of equitable development and integration in the global economy. ASEAN Member States have made an internal effort to include CLMV into the regional force, by granting them more flexibility and special treatments. ASEAN Member States also take into account external factors which may determine the shape of the coming era. As a consequence, ASEAN will become a unique player with more tactics and strategies, both within and outside ASEAN.

The only case since the creation of the intra-ASEAN regime hints that ASEAN keeps the same “ASEAN Way” of doing business. ASEAN investors may rather avoid a rules-based, legally-bound mechanism, because they prefer a non-adjudicatory mechanism, combined with the fact that they do not yet believe in the ASEAN mechanism. Although ASEAN Member States may acknowledge the existence of the ACIA mechanism, they may not desire to complicate matters and may choose to solve problems amicably. Whatever the reason may be, the ACIA has undeniably contributed to the protection of ASEAN foreign investment, even without formal recourse to this Agreement.

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<sup>157</sup> ADB (2012), *ASEAN Economic Integration Monitor*, July 2012, pp.54-56.  
[http://aric.adb.org/pdf/aeim/AEIM\\_2012July\\_CoverHighlights.pdf](http://aric.adb.org/pdf/aeim/AEIM_2012July_CoverHighlights.pdf) (Last accessed: 18 August 2015)

## Issues Note to Substantive Chapters

The main objective of this thesis is to assess the ACIA in the light of general practice of rulemaking for international investment agreements (IIAs). After the thesis introduction and background of the ASEAN Way and the ACIA in Part I, this thesis contains three substantive chapters (chapters 3 to 5) and one procedural chapter (chapter 6) which focus on in-depth analysis of the ACIA approach related to substantive and procedural ACIA provisions. This thesis seeks to situate the making of the ACIA provisions in the general IIAs landscape. It traces and explains new issues within the ACIA which have also emerged in recent IIAs negotiations. To begin with, this thesis does not use a specific category of IIA (bilateral, regional or multilateral investment agreements) as a comparator to the ACIA.<sup>158</sup> For reasons of convenience, this thesis compares the ACIA with a large sample of IIAs, in the interests of having a benchmark against which the ACIA can be assessed.

This thesis uses a *summa divisio* approach to categorising existing IIAs practices: general practice and specific practice. In order to identify the trend in the normative developments of the elements addressed in the ACIA, chapters 3 to 6 are organised into two parts. They first describe areas where the ACIA follows “general practices”, and second, they examine “specific features” the ACIA has developed in its text. This division between general practice and specific features not only facilitates the assessment of the ACIA approach, but also demonstrates the normative evolution of the ASEAN Way of investment protection from the previous IGA/AIA regime to the ACIA regime.

For over forty years, ASEAN Member States have used ASEAN investment agreements as an instrument for protecting international investment and ensuring a more predictable and fair treatment for ASEAN investors. Since the early 1990s, the number of ASEAN BITs has increased significantly. However, a considerable degree of conformity has been found in terms of their main contents, which corresponds to the “Dutch gold standard”<sup>159</sup> or the traditional approach focusing on investment protection. Hence, “general practices” in this thesis refer to basic substantive or procedural provisions which can be commonly found in the BITs concluded between 1960s and 1990s, also known as

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<sup>158</sup> In this thesis, the term “BITs” refers to traditional bilateral investment treaties, whereas the “IIAs” refers to all international investment agreements (*e.g.* BITs, regional trade agreements (RTAs), economic partnership agreements (EPAs), multilateral agreements).

<sup>159</sup> See p.27.

“traditional BITs”. This approach remains mainstream investment law. Most BITs have a similar basic structure and content.<sup>160</sup>

The ACIA is a new generation of ASEAN investment agreements. While the ACIA has core standards which are common to every IIA, it is moving towards a more detailed-specified approach. Since 2000, IIAs have become more complex and cover a broader set of issues and more areas of host State activities in a more complex and detailed manner;<sup>161</sup> for instance, the US Model BIT<sup>162</sup> or the Canadian Foreign Investment Protection and Promotion Model Agreement (FIPA).<sup>163</sup> Therefore, “specific features” in this thesis refer to emerging elements and techniques used in modern and newly-negotiated IIAs. These IIAs have more elaborated provisions, as they opt for a rule-enhanced approach.

Specific features found in these new treaties differ from one to another, depending on how specific contracting States intend to clarify a treaty’s standards. States may leave undefined standards to arbitral tribunals who have traditionally been vested with interpretative power. Some specific details found in the ACIA may be found in other new generation agreements. Some details which are unusual in, or differ from, other modern IIAs practices are “ASEAN-specific” features, as they respond to specific concerns of ASEAN Member States and the realisation of the AEC. Compared to traditional BITs, these specific features add value to the ASEAN investment law practice.

Traditional IIAs only deal with protection of investments and investors. They establish binding obligations only with regard to the post-establishment phase and leave the contracting parties with discretion concerning the admission and establishment of foreign investors. Following the new trend, the ACIA covers four corners of foreign investment flows: protection, liberalisation, promotion and facilitation. The ACIA has brought liberalisation and protection together. Within the investment protection corner, the ACIA applies investment protection for both pre- and post-establishment phases of investments through the granting of national treatment and most-favoured-nation (MFN) treatment, subject to reservations and exceptions.

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<sup>160</sup> See generally UNCTAD (2007), *BITs in 1995-2006: Trends in Investment Rulemaking*, Geneva, New York, United Nations.

<sup>161</sup> See UNCTAD (2015), *Transformation of the IIA Regime*, Note by the secretariat 17 Dec 2014, TD/B/C.II/EM.4/2, Trade and Development Board Investment, Enterprise and Development Commission Expert Meeting on the Transformation of the International Investment Agreement Regime: The Path Ahead, Geneva, 25-27 February 2015, Item 3 of the provisional agenda.

[http://unctad.org/meetings/en/SessionalDocuments/ciiem4d2\\_en.pdf](http://unctad.org/meetings/en/SessionalDocuments/ciiem4d2_en.pdf) (Last accessed: 4 September 2015)

<sup>162</sup> Alvarez, J.E. (2010), “Comparision U.S. Model BIT (1984) and U.S. Model BIT (2004)”, *Transnational Dispute Management*, Vol.7 (online journal).

<sup>163</sup> These IIAs have undergone a major transformation in 2004 and have become models for several major economies of the world. Model BIT, Fact Sheet, Office of the Spokesperson, Washington, DC, 20 April 2012. <http://www.state.gov/r/pa/prs/ps/2012/04/188199.htm> (Last accessed: 7 September 2015)

In this connection, traditional BITs have not attempted to clarify the scope of national treatment and MFN any further. The ACIA has specified the scope and conditions of national treatment and MFN. In particular, the ACIA has confirmed ASEAN-specific exceptions, which existed in the previous regime, *i.e.* sub-regional MFN exceptions. Furthermore, while the MFN application to ISDS has been largely debated – as most BITs do not spell out on this issue – the ACIA specifically excludes the application of MFN treatment from the scope of the ISDS. These features have not frequently been found elsewhere.

The ACIA has significantly introduced normative innovations to the practice of ASEAN investment rulemaking. While the IGA previously had simple and plain definition of investment and investor, the ACIA clarifies their scope in details. The ACIA uses techniques for narrowing the scope of definition of investment. Nevertheless, the ACIA is more liberal compared to traditional BITs as it includes unusual elements into the definition of investment: portfolio investments and foreign-owned ASEAN-based (FOAB) investments. These particular elements serve the objectives of ASEAN capital market liberalisation under the AEC. The ACIA has inserted specific provisions to define the term “control” and has created a mechanism of “denial-of-benefits” for ASEAN Member States to deny investors and investments which they do not intend to grant the ACIA protection.

Apart from MFN and national treatment mentioned above, the ACIA provides other significant standards of protection: fair and equitable treatment (FET), full protection and security, repatriation of capital and earnings, expropriation and compensation, subrogation and ISDS. These core standards are commonly found in IIAs. After a survey, this thesis has selected four crucial and distinctive standards of the ACIA to be scrutinised: FET, transfers, expropriation and compensation, and ISDS. Full protection and security and subrogation provisions are left out of the scope of this thesis, as they are less specific to the ACIA, but common to all IIAs. Furthermore, this thesis analyses State-to-State dispute settlement mechanism, on top of the ISDS, in order to complete the assessment of the ASEAN Way of investment protection.

The ACIA defines the meaning and key elements of these four obligations. First, while most BITs include the FET standard, only a small number of them clarify its meaning. Attempts to identify elements of the normative content of FET have been relatively recent and are not uniform. Differing from various approaches in use, the ACIA has proposed explicit provisions narrowing down the reading of the FET standard.

Second, most BITs show a remarkable convergence concerning legal conditions for expropriation. Their provisions may differ on the degree of specificity regarding the

calculation and payment of compensation. Nonetheless, the majority of these traditional BITs do not explicitly deal with the newly emerging issue of regulatory takings. The ACIA confirms the expropriation and compensation standard for investment protection. Meanwhile, it has followed a more detailed approach and has specifically added “Annex 2 Expropriation and Compensation”.

Third, traditional BITs include a provision on transfer of monies, which guarantees foreign investors the right to freely transfer investment-related funds. Differences exist regarding the coverage of transfer provisions (inbound and outbound transfers) and the kinds of transfers protected (any kind of transfer or only those explicitly mentioned). In some modern IIAs, exceptions are mainly used to ensure compliance with specific laws (*e.g.* on bankruptcy, criminal offence, taxation). A specific exception clause dealing with a balance-of-payments crisis is unlikely to be explicitly included. Compared to traditional BITs, the ACIA is remarkably liberalised, as it allows for both direct investments and portfolio investments, and both inbound and outbound transfers. However, given the Asian economic crisis that ASEAN Member States experienced in the late 1990s, the ACIA provides not only common exceptions for certain application of national laws, but also specific exceptions in case of balance-of-payments crisis. The provisions on balance-of-payments exceptions, which have been written in an elaborated manner, evidence ASEAN Member States’ concerns, especially States in the process of economic development.

Fourth, the ACIA has undertaken to regulate ISDS in greater detail, whereas traditional BITs have sketched out only the main features of ISDS and have relied on specific arbitration conventions. The ACIA provides scope of the ISDS application, which generally limits access for investors to bring a claim before ISDS. Particularly, the ACIA has improved the transparency and predictability of the ISDS mechanism by providing more guidance to the disputing parties concerning the conduct of arbitration, and also orients other rules of adjudication mechanisms. Compared to traditional BITs, the dispute settlement mechanism of the ACIA is more politicised because of an explicit inclusion of State-to-State dispute settlement.

While a small number of newly negotiated IIAs contain a clause discouraging the lowering of environmental or core labour standards in order to attract foreign investment, the ACIA remains in the mainstream of investment agreements in that it has no additional chapters on sustainability, environment, or labour. This omission shows that the ACIA leaves these issues in the realm of ASEAN Member States. Meanwhile, the ACIA introduces other specific provisions. In contrast with traditional BITs which do not establish legally binding obligations but only a “best efforts” commitment of host States,



the ACIA has explicit provisions on special formalities and disclosure of information,<sup>164</sup> transparency,<sup>165</sup> entry, temporary stay and work of investors and key personnel.<sup>166</sup> These provisions are, however, not specifically treated in this thesis.

The more detailed approach in the ACIA focuses on a careful balance between promoting the ASEAN Investment Area (by providing strong and standardised investment protection and creating a stable and predictable business climate), and preserving regulatory flexibility or policy space for ASEAN host States to pursue their economic development policies. Although the ACIA asserts investment protection, it directly points out that investment protection should not be pursued at the expense of other essential public interests. Particularly, the ACIA includes, *inter alia*, general exceptions, security exceptions and balance-of-payments exceptions. Contrary to traditional BITs, the ACIA does not contain an umbrella clause.

On the last note, the distinction between “general practices” and “special features” of the ACIA rules, which runs through the analysis of this thesis, may not always be an obvious approach; one may categorise IIAs elements differently. Besides, these specific features are increasingly common in newly-negotiated agreements. However, this distinction serves as a practical tool which gives a particular perspective on the ASEAN Way of investment protection. The constructive assessment of this thesis may give final answers to whether the ACIA approach leads towards a rebalancing of investment treaties and ISDS. As a consequence, ASEAN host States should be aware of the fact that they have to pay a price for more “regulatory flexibility”. Similarly, ASEAN investors are advised to take these normative developments into account and adjust their investment strategy in the ASEAN Investment Area accordingly.

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<sup>164</sup> ACIA article 20.

<sup>165</sup> ACIA article 21.

<sup>166</sup> ACIA article 22.

## Part II. Investments and Investors

### Chapter 3. Definition of Investments and Investors

In order to create a liberal, facilitative, transparent and competitive investment environment within ASEAN, ASEAN Member States adhere to the benefits of “investors and their investments based in ASEAN”.<sup>167</sup> ACIA article 4 defines the terms “investment” and “investor”, and sets requirements of “covered investments”. In practice, investment agreements differ substantially in terms of the extent to which they cover.

Only “covered investments” by a certain range of individuals and legal entities, categorised as “ASEAN investors”, profit from the privileges of protection and liberalisation accorded by the ACIA. By these definitions, the ACIA defines the boundaries of ASEAN Member States’ exposure to possible investor-State claims.<sup>168</sup> The jurisdiction of the tribunal and the outcome of the awards depend on interpretation of the ACIA, whether a particular transaction or asset qualifies as a protected investment and whether a claimant qualifies as a protected investor. A person or an enterprise falling outside the scope of application is not considered a beneficiary of the ACIA.

The ACIA attempts to establish a more liberal and transparent investment environment in order to create a competitive ASEAN Investment Area.<sup>169</sup> The definitions of the terms “investment” and “investor” have a crucial role in the regionalisation and internationalisation of economic activities for deeper economic integration. The ACIA grants immediate benefits to ASEAN investors and ASEAN-based foreign investors, because ASEAN Member States encourage investment flows into ASEAN from both ASEAN and non-ASEAN sources. The ACIA follows basically the trend of the most used definitions, *i.e.* the broad asset-based definition of “investment” and nationality-based definition of “investor”.

Given the fact that most ASEAN Member States are developing countries, they should admit investments which contribute to national and regional development and reject harmful ones. The ACIA shows that ASEAN Member States take a precautionary approach in accepting investments into the ASEAN Investment Area. Even though an investment made is covered by the definitions, the ACIA specifically allows ASEAN Member States to exercise their power to select only beneficial investments, by denying investments without substantial business operations.

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<sup>167</sup> ACIA article 2(c), Guiding Principles.

<sup>168</sup> ACIA article 28-41, Section B.

<sup>169</sup> ACIA article 1 Objectives.

This chapter analyses definitions and conditions of admission of investment (section 3.1) and investor (section 3.2). It examines whether, and to what extent, the ACIA approach is in common with the general trend of IIAs practice; and which elements of these definitions are ASEAN-specific. The ACIA approach of scope and definitions reflects the “ASEAN Way” of investment integration. This chapter opens the way for discussion of the whole range of substantive and procedural rights enshrined in the ACIA in the subsequent chapters.

## Section 3.1 Investment

The ACIA follows a detailed approach of the IIAs practice. ACIA article 4(c) not only defines the term “investment” but also provides for a long list of investments. Its footnote 2 sets a requirement for positive characteristics of an investment, while footnote 3 sets negative criteria for what cannot be considered an investment.

ACIA article 4(c): “investment” means every kind of asset, owned or controlled, by an investor, including but not limited to the following:

- i) movable and immovable property and other property rights such as mortgages, liens or pledges;
- ii) shares, stocks, bonds and debentures and any other forms of participation in a juridical person and rights or interest derived therefrom;
- iii) intellectual property rights which are conferred pursuant to the laws and regulations of each Member State;
- iv) claims to money or to any contractual performance related to a business and having financial value;
- v) rights under contracts, including turnkey, construction, management, production or revenue-sharing contracts; and
- vi) business concessions required to conduct economic activities and having financial value conferred by law or under a contract, including any concessions to search, cultivate, extract or exploit natural resources.

The term “investment” also includes amounts yielded by investments, in particular, profits, interest, capital gains, dividend, royalties and fees. Any alteration of the form in which assets are invested or reinvested shall not affect their classification as investment;

ACIA Footnote 2: “Where an asset lacks the characteristics of an investment, that asset is not an investment regardless of the form it may take. The characteristics of an investment include the commitment of capital, the expectation of gain or profit, or the assumption of risk.”

ACIA Footnote 3: “For greater certainty, investment does not mean claims to money that arise solely from:

- (a) commercial contracts for sale of goods or services; or
- (b) the extension of credit in connection with such commercial contracts.”

### 3.1.1 Definition of “Investment”

Similar to most BITs, the ACIA adopts a broad approach to “investment”, which provides comprehensive, rules-based protection and guarantees high standards of treatment for all categories of foreign investment, thereby encouraging regional investment flows, while creating more efficient regional capital markets. However, the term “investment” pursuant to the ACIA has an unusual broad coverage, meaning both direct and portfolio investments.

#### 3.1.1.1 General Characteristics of “Investment”

Generally, foreign investment involves the transfer of tangible or intangible assets from one country to another for the purpose of their use in that country to generate wealth under total or partial control of the owner of the assets.<sup>170</sup> Under ACIA article 4(c), the term “investment” refers to “every kind of asset, owned or controlled, by an investor”.<sup>171</sup> This phrase is followed by an illustrative but usually non-exhaustive list of assets. The broad and open-ended asset-based definition focuses on the maximisation of investment protection.<sup>172</sup> In spite of some obscurity of what constitutes “investment”, it is at least certain that these categories are expressly included within the definition.<sup>173</sup> This approach allows ASEAN investments to evolve constantly in form and in substance, especially for ASEAN emerging markets. The last paragraph of article 4(c) allows investors to restructure the form and reinvest their investments.<sup>174</sup> While the ACIA does not impose any specific condition for reinvestment, a reinvestment remains covered only if it covers the same substance and is established in accordance with the conditions placed on the original investment.<sup>175</sup>

The ACIA “investment” includes a narrower concept of “commercial presence” or an “enterprise-based” approach, *i.e.* services incidental to investments.<sup>176</sup> ACIA provisions apply to any measure affecting the supply of a service by a service provider of a Member State through commercial presence in the territory of any other Member State, regardless of whether or not such a service sector is scheduled in the Member States’ schedule of

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<sup>170</sup> Sornarajah, M. (2010), *The International Law on Foreign Investment*, p.7.

<sup>171</sup> See Salacuse, J.W. (2010), *The Law of International Investment Treaties*, Oxford, OUP, p.160.

<sup>172</sup> UNCTAD, (2011), *Scope and Definition*, UNCTAD Series on Issues in IIAs II, New York, Geneva, UN, pp.24-27.

<sup>173</sup> *Siemens v Argentina*, ICSID Case No.ARB/02/8, Decision on Jurisdiction, 3 August 2004, para.137.

<sup>174</sup> For example, AANZFTA article 2 Chapter 11 Investment Section A. In contrast, no similar provision is found in the NAFTA Agreement, and in the 1994 Protocol of Colonia of MERCOSUR.

<sup>175</sup> ACIA article 4(c).

<sup>176</sup> GATS article XXVIII(d)(g).

commitments made under the ASEAN Framework Agreement on Services (AFAS).<sup>177</sup> However, ACIA provisions apply only to the extent that such a commercial presence relates to an investment and obligations under the ACIA.

While the ACIA has a broad definition of investment, it also uses an additional or explanatory technique for narrowing the scope of the definition. Footnote 3 to article 4(c)(iv) excludes claims to money arising solely from commercial contracts for sale of goods or services, because they are usually considered trades, and not investments. Moreover, footnote 2 to article 4(c) provides a non-exhaustive list of general characteristics of an investment, which includes 1) commitment of capital, 2) expectation of gain or profit, *or* 3) assumption of risk.

“Where an asset lacks the characteristics of an investment, that asset is not an investment regardless of the form it may take”.<sup>178</sup> A tribunal must question whether that asset has characteristics of an investment. The ACIA criteria correspond to the indispensable criteria in the “*Salini Test*”.<sup>179</sup> According to the *Salini* case, the indispensable criteria are “contributions, a certain duration of performance of the contract, and a participation in the risks of the transaction”. After considering a treaty’s preamble, “one may add the contribution to the economic development of the host State of the investment as an added condition”,<sup>180</sup> such as, public interest, or some transfer of know-how.

Nevertheless, the “*Salini Test*” itself is fairly controversial: “the existence of a contribution to the economic development of the host State as an essential – although not sufficient – characteristic or unquestionable criterion of the investment, does not mean that this contribution must always be sizable or successful”.<sup>181</sup> The concept of economic development is “extremely broad but also variable depending on the case”.<sup>182</sup> Tribunals have often located this test in ICSID Convention article 25, and not in specific BITs, or have a generic reference to some of the literature on the *Salini* criteria.<sup>183</sup>

The fact that the ACIA has a non-exhaustive list characteristic of investment leaves a space for a tribunal to interpret the term “investment”. The ACIA does not explicitly mention the duration of a project, as the ACIA specifically includes portfolio investments,

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<sup>177</sup> ACIA article 3(5). Usually the liberalisation of services are covered by the AFAS. See also p.148.

<sup>178</sup> Footnote 2 to article 4(c)

<sup>179</sup> *Salini v. Morocco*, ICSID Case No.ARB/00/4, Decision on Jurisdiction, 23 July 2001, paras.52-57.

<sup>180</sup> *Idem*.

<sup>181</sup> *Patrick Mitchell v. Congo*, ICSID Case No.ARB/99/7, Decision on Annulment, 1 Nov 2006, para.33.

<sup>182</sup> *Idem*.

<sup>183</sup> Schreuer, C.H. et al. (2009), *The ICSID Convention: A Commentary*, CUP, 2<sup>nd</sup> ed., Article 25, paras.153-174.

which may not stay in the Area as long as direct investments. Regarding economic development criteria,<sup>184</sup> it is explicit in the ACIA Preamble that the very purpose of foreign investment flows is for the “dynamic development of ASEAN economies”.<sup>185</sup> Providing that an investment fulfils the conditions of “covered investment”, discussed *infra*, such investment has responded to the goal of economic development.

### 3.1.1.2 Inclusion of Innovative Element: Portfolio Investments

The term “investment” under the ACIA refers to both direct and indirect investments. Direct investment is the principal category of investment protected under the ACIA.<sup>186</sup> Like other modern investment agreements, ACIA article 4(c) specifically recognises movable and immovable property and other property rights, including the contractual ones. It also includes amounts yielded by investments, in particular, profits, interest, capital gains, dividend, royalties and fees. For illustration, direct investment signifies a transfer of physical property such as equipment, or a physical property that is bought or constructed such as plantations or manufacturing plants.<sup>187</sup> Direct investment may supply additional contributions such as know-how, technology, management, and marketing. A direct investor must control a significant degree of influence over, and have a lasting relationship with the investment.<sup>188</sup>

The objectives of direct investment are different from those of portfolio or indirect investment, in which investors do not generally expect to influence the management of the enterprise.<sup>189</sup> Portfolio investment is normally represented by a movement of money for the purpose of buying shares in a company formed and functioning in another country. The advantage of portfolio investment is the free circulation of instruments such as shares and stocks; or promissory notes and bonds, which may or may not be linked with companies.<sup>190</sup>

The ACIA element of portfolio investment is innovative, compared to earlier ASEAN investment agreements. It was formerly excluded from the scope of the IGA/AIA regime. Portfolio investment has recently appeared in the definition of investment in some

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<sup>184</sup> See discussion in *Malaysian Historical Salvors v. Malaysia*, ICSID Case No.ARB/05/10, para.143.

<sup>185</sup> ACIA Preamble.

<sup>186</sup> “Direct investment is a category of cross-border investment associated with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is resident in another economy. As well as the equity that gives rise to control or influence, direct investment also includes investment associated with that relationship, including investment in indirectly influenced or controlled enterprises, investment in fellow enterprises, debt, and reverse investment.” See OECD (2009), *Benchmark Definition of FDI*, 4<sup>th</sup> Ed.; IMF (2009), *Balance of Payments and International Investment Position Manual*, 6<sup>th</sup> Ed.

<sup>187</sup> Sornarajah, M. (2010), *The International Law on Foreign Investment*, pp.8-9.

<sup>188</sup> UNCTAD, (2011), *Scope and Definition*, p.10

<sup>189</sup> *Idem*, pp.29-30, 66-67.

<sup>190</sup> Sornarajah, M. (2010), *The International Law on Foreign Investment*, p.227.

cutting-edged treaties, for instance, the 2012 US Model BIT, EUSFTA, and CETA. Previously, portfolio investment was not commonly protected by customary international law,<sup>191</sup> nor was it usually covered in the BITs, because such investment was attended by ordinary commercial risks where the investor ought to have been aware of the associated risk. Some tribunals have taken into account the evolution of the nature of investment and include portfolio investments in the definition of investment.<sup>192</sup>

ACIA article 4 has expanded the concept of investment by categorically including portfolios under its coverage, both for protection and liberalisation. The ACIA refused to adopt a compromised hybrid approach suggested for developing countries, where different definitions may be used for different stages of investment: a narrow approach for market access and investment liberalisation (pre-establishment) covers only FDI, and a broad approach covers a wide range of assets for protection of investment once it is established locally (post-establishment).<sup>193</sup>

The ACIA definition of investment includes shares, stocks, bonds and debentures and any other forms of participation in a juridical person and rights or interest derived therefrom. The objective behind reinforcing the definitional provisions of the ACIA is to ensure that treaty protection is given to a wide variety of portfolio investment associated with ASEAN investment. Encouraging portfolio investment will create “conducive investment environment”<sup>194</sup> for investors and enhance the freer flow of capital, in line with the AEC Blueprint which also aims to strengthen ASEAN capital market development and integration. The ACIA also covers disputes arising out of portfolio investments. Before this, such investment disputes were not covered under the former investment regime; examples are the Malaysia-Singapore Central Limit Order Book (CLOB) dispute in the late 1990’s<sup>195</sup> and the Thailand-Singapore dispute over the purchase of the Shin Corporation in 2006.<sup>196</sup>

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<sup>191</sup> The customary international law protected merely physical property of the foreign investor and other assets directly invested through principles of diplomatic protection and State responsibility. See Sornarajah, M. (2010), *The International Law on Foreign Investment*, p.8

<sup>192</sup> For example, *Siemens v Argentina*, ICSID Case No ARB/02/8, Decision on Jurisdiction, 3 August 2004, para.137.

<sup>193</sup> For the position of developing countries, see *Report (2002) of the Working Group on the Relationship between Trade and Investment to the General Council*, WTO, WT/WGTI/6, 9 December 2002, p.21. For the positions of Malaysia, Indonesia, Thailand and Philippines, see WTO Working Group on the Relationship between Trade and Investment, *Report on the Meeting Held on 3-5 July 2002: Note by the Secretariat*, WT/WGTI/M/18.

<sup>194</sup> ACIA Preamble.

<sup>195</sup> Malaysia imposed capital controls in 1998. It informed foreign investors that they would be unable to redeem their local shares for a year. The accounts of investors in Singapore’s CLOB, an offshore market for Malaysian shares, were frozen altogether, and their claims declared invalid. For more details, see Narine, S. (2002) *Explaining ASEAN: Regionalism in Southeast Asia*, London, Lynne Rienner Publishers, pp.165-166; Haggard, S. (2000), *The Political Economy of the Asian Financial Crisis*, Washington, Institute for

However, given the example of the financial crisis of the late 1990s, the inclusion of portfolio investments by ASEAN Member States is very risky. On the one hand, short-term speculative capital is potentially destabilising, as it can be easily withdrawn and may cause capital volatility in the event of economic turbulence. On the other hand, the financial structure and institution of ASEAN Member States are not sufficiently reliable. Therefore, while the ACIA guarantees the free transfer of funds, including portfolio investments, a balance-of-payment exception clause is set as a safeguard in ACIA article 16.<sup>197</sup>

### 3.1.2 Definition of “Covered Investment”

Even if the definitions of “investment” in the ACIA are broadly defined, only investments which comply with the three requirements set forth in article 4(a) are “covered” and may benefit from the ACIA privileges.

“covered investment” means, with respect to a Member State, an investment in its territory of an investor of any other Member State in existence as of the date of entry into force of this Agreement or established, acquired or expanded thereafter, and has been admitted according to its laws, regulations, and national policies, *and where applicable*, specifically approved in writing by the competent authority of a Member State;<sup>198</sup> [Emphasis added.]

While the requirements regarding territory, time, and legality of investment, are usually found in current IIAs practice, a requirement of approval in writing attaching to legality of investment and ACIA Annex 1 are specifically included in response to particular ASEAN questions under previous regime.

#### 3.1.2.1 General Requirements

The ACIA specifies the limits of its application to investment which is made only within the territory of the contracting parties and in existence at the date of entry into force of the ACIA. Regarding the territorial requirement, neither does the ACIA have a separate

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International Economics, pp.79-83; Jin, N.K. (2003), “Regional Financial Integration in Southeast Asia”, in Freeman, N.J. (ed.), *Financing Southeast Asia’s Economic Development*, Singapore, ISEAS, pp.287-288.

<sup>196</sup> Singapore State investor Temasek Holdings Pvt Ltd and Surin Upatkoon bought the 96 percent of the ex-Prime Minister Shinawatra family’s shares in Shin Corp, holding through a vehicle known as Kularb Kaew and Cedar Holdings. The change of this portfolio of telecoms investments ownership triggered accusations of insider trading and tax evasion under Thai laws. For more details, see Ng, W. (2010), “The Evolution of Sovereign Wealth Funds: Singapore’s Temasek Holdings”, *Journal of Financial Regulation and Compliance* (JFRC), Vol.18, Issue 1, pp.6-14; Lhaopadchan, S. (2010), “The Politics of Sovereign Wealth Fund Investment: the Case of Temasek and Shin Corp.”, JFRC, Vol.18, Issue 1, pp.15-22; Goldstein, A., Pananond, P. (2008) “Singapore Inc. Goes Shopping Abroad: Profits and Pitfalls”, *Journal of Contemporary Asia*, Vol.38, Issue 3, pp.417-438.

<sup>197</sup> See detailed discussion in Chapter 4.3 Transfers.

<sup>198</sup> ACIA article 4(a).



provision of “territory” like in the MAI Agreement,<sup>199</sup> nor does the ASEAN Charter provide a meaning of this particular term.<sup>200</sup> The term “territory” under the ACIA may well be understood in accordance with the concept of territory in customary international law.<sup>201</sup> The territory requirement is primarily to secure benefits brought by foreign investments to ASEAN host States and ASEAN people.

For the temporal requirement, the ACIA applies to any existing investment qualified within the scope of application at the date of its entry into force, such investments enjoy rights to and benefits from the ACIA protections. However, the “claims arising out of events which occurred, or claims which have been raised prior to the entry into force of this Agreement”<sup>202</sup> are excluded from investor-State arbitration provided by the ACIA, because ASEAN Member States desire to preclude investors from forum shopping among different legal regimes, and to ensure that disputes arising previous to the ACIA’s enforcement are adjudicated in according to the original treaty, under which the investment was initially made.

Lastly, the admission “according to laws, regulations, and national policies” of the host States is commonplace in BITs practice. This requirement refers to any law and regulation of general application in a particular country at the time of investment. Regarding the legality of investment, the ACIA has added a requirement of “approval in writing”, “where applicable”, in its text. This requirement is not usually found elsewhere, and needs to be clarified regarding its origin and application, in the following section.

### **3.1.2.2 Specific Requirement: Approval in Writing, Where Applicable**

Approval in writing is an additional requirement of the host States’ screening test for the admission of investments, in addition to the “accordance with law” requirement. The government screening process is an exercise of State’s discretion to receive desirable investments. This exercise reflects a long-cherished principle of sovereignty and non-interference in domestic affairs enshrined in the “ASEAN Way”. Hence, it is not surprising that the ACIA links the admission procedures of foreign investments to domestic laws and regulations of ASEAN host countries, and that ASEAN investments may be subject to any

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<sup>199</sup> Under the title “Geographical Scope of Application”, MAI Draft consolidated Text.

<sup>200</sup> The term “territorial” appears in the ASEAN Charter as fundamental principle of “territorial integrity” in its article 2, which is the principle of non-interference in domestic affairs.

<sup>201</sup> Shaw, M.N. (1982), *Territory in International Law*, Netherlands Yearbook of International Law, Vol.13, December 1982, pp.61-91, T.M.C. Asser Press 1982, Brownlie, I. (2008). *Principles of Public International Law*, 7<sup>th</sup> ed., Oxford, New York, OUP; Crawford, J. (2012), Brownlie’s Principles of public international law, 8<sup>th</sup> ed., Oxford, OUP.

<sup>202</sup> ACIA article 29, Scope of Coverage, Section B ISDS.

form of approval requested by the host State, as it deems proper.<sup>203</sup> The legality of investment, in particular national approval requirements, is interpreted in relation to the determination of the validity of investment, and not the definition of investment. Stated differently, while the national laws of ASEAN Member States considerably influence the definition of “covered investment”, they will not intervene with the definition of “investment” which is already settled under the ACIA.

The objective of both national law compliance and the admission criteria of ASEAN Member States is to screen out the entry of “harmful” foreign investments as much as to ensure that foreign investments flowing in the ASEAN Investment Area contribute to the host countries’ development scheme. This, in turn, requires ASEAN Member States’ good faith and transparency by setting clear domestic laws and regulations on ASEAN investments. Hence, Annex 1 on “Approval in Writing” is established to balance with the State’s regulatory power to set specific admission rules.

Annex 1 establishes rules of application, notification, reasoning of the denial of approval, opportunity of submitting a new application, and connection via respective national institutions. Foreign investors are presumed to have complied with local law requirements and their investments must be legally constituted or assume a certain legal form under the laws of host State. Moreover, the host State may require an ASEAN investor to satisfy special formalities and to provide information for informational or statistical purposes, notwithstanding national treatment or most-favoured-nation treatment standards.<sup>204</sup>

This requirement of approval in writing is not universal in the IIAs practice. The ACIA goes beyond the general rule for a foreign investment to enjoy treaty protection. The ACIA may cover only investments which have been specifically approved in writing by the competent authority of a Member State. An ASEAN host State may deprive an investment of its protection, where the investment project has been declined by the host State’s authority, as if such investment has never been constituted a “covered investment”.

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<sup>203</sup> For example, pursuant to the regulation MFA/0704/1/2546, investments admitted in accordance with relevant laws and regulations have to be “specifically approved in writing” to enjoy treaty protection, known as the Certificate of Approval for Protection (CAP). Investments admitted under Foreign Business Act B.E. 2542, investments admitted under the promotion scheme of the Board of Investment, and investments under concession contracts are deemed as “specifically approved investments”. See Announcement of the Committee on the Approval for the Protection of Investment between Thailand and Other Countries, No.MFA 0704/1/2003 concerning Foreign Investment Protection under the Agreements on the Promotion and Protection of Investments between the Government of the Kingdom of Thailand and Foreign Governments. <http://www.mfa.go.th/business/contents/files/cooperation-20120412-163557-790680.pdf> (Last accessed: 19 August 2015).

<sup>204</sup> ACIA article 20, Special Formalities and Disclosure of Information. The similar provision is found in NAFTA article 1111.

The insertion of a particular phrase “where applicable” in ACIA article 4(a) is the correction of the difficult application of the specific approval in writing, previously required in the IGA. IGA article II covered only investments “which are specifically approved in writing and registered by the host country”.<sup>205</sup> The IGA was rigid, requiring evidence of both approval in writing and national registration. However, in the 1990s, apart from Singapore, none of the ASEAN Member States had a specific approval procedure. “There is also nothing in the practice of the ASEAN States Parties to the Agreement that might substantiate such an additional requirement”.<sup>206</sup> The question was raised whether an investment would be protected, in the absence of specific procedure.

In the *Yaung Chi Oo (YCO) v. Myanmar* case,<sup>207</sup> the tribunal recognised that “the conditions for a direct foreign investment to receive the more favourable protection envisaged in Article VI(1) of the 1987 ASEAN Agreement include specific approval in writing and registration for the purposes of the Agreement.” Myanmar refused to give protection to YCO. It argued that article VI(1) required approval specifically “for the purposes of this Agreement”, but “at no stage did the Claimant seek or receive approval of its investment for the purposes of the 1987 Agreement”.<sup>208</sup> Besides, the Agreement does not oblige Myanmar to set up such a special procedure.<sup>209</sup>

Nonetheless, the tribunal rejected the argument of the Myanmar authority and found that lawful investments in a host State would be treated as “approved” unless that host State published specific prerequisites. In effect, they must have been “specifically approved in writing and registered by the host country and upon such conditions as it deems fit for purposes of this Agreement subsequent to its entry into force.”<sup>210</sup> “In the Tribunal’s view, if a State Party to the 1987 ASEAN Agreement unequivocally and without reservation approves in writing a foreign investment proposal under its internal law, that investment must be taken to be registered and approved also for the purposes of the Agreement”.<sup>211</sup>

The ASEAN Member States takes account of the YCO tribunal’s reasoning, and adds the phrase “where applicable” in the ACIA. Where there is a specific requirement to have an approval in writing for any particular sub-sector of investment or in any particular

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<sup>205</sup> IGA article II Applicability or Scope

<sup>206</sup> The situation in Singapore is different because foreign investments can be made freely there without any requirement of approval or registration. *Yaung Chi Oo v. Myanmar*, ASEAN I.D. Case No.ARB/01/1, Award, 31 March 2003, para.54.

<sup>207</sup> *Yaung Chi Oo v. Myanmar* (2003).

<sup>208</sup> *Idem*, para.55.

<sup>209</sup> *Idem*, para.55.

<sup>210</sup> *Idem*, para.22.

<sup>211</sup> *Idem*, para.59.

zone, the investment must possess such approval in order to be covered under the ACIA. In contrast, investors are ensured that where a host State does not specifically require approval in writing, a normal lawful investment is, as a general rule, covered.

Approval in writing can be evidence of a State's acknowledgement of a particular investment. It increases not only legal certainty for investors, but also can be a sign to determine a State's consent to arbitration. In other words, approval in writing may make it easier for a tribunal to determine its jurisdiction. The first task of the tribunal is to check if there is an approval in writing requirement, and if that investment has retained such proof.<sup>212</sup> Otherwise, the tribunal may need to further consider whether the investment had actually been made according to the other requirements, discussed *supra*.

The ACIA requires legality of investment for the admission phase, whereas it does not require the same in the post-establishment phase. It is then doubtful whether an investment which has breached laws after its admission is still regarded as a qualified investment and may be protected under the ACIA. Some scholars and tribunals posit that the legality may be used to deprive the investor of its treaty protection for serious violations of host country law during the life of an investment.<sup>213</sup> Even though the ACIA does not spell out the legality requirement of investment in the post-establishment phase, an admitted investment "in operation" must remain "lawful" at all times. Otherwise, it would be unreasonable to grant protection to an investment which had pretended to comply with the host State's rules at the admission stage and would break them afterward. The ACIA allows an ASEAN host State to decide this question, as: ACIA article 19(2) provides for the States denying the ACIA's benefits to the investors, "where it establishes that such investor has made an investment in breach of the domestic laws of the denying Member State by misrepresenting its ownership in those areas of investment which are reserved for natural or juridical persons of the denying Member State".<sup>214</sup>

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<sup>212</sup> See *Grueslin v. Malaysia*, Award 27 Nov 2000, ICSID Case No.ARB/99/3, para.17.

<sup>213</sup> Indeed, it is not a common trend to have this requirement in the BITs, but even in the absence of the text, tribunals always interpret in favour of the States. The Tribunal in the *Salini v. Morocco* case explains that the purpose of such provisions is "to prevent the Bilateral Treaty from protecting investments that should not be protected, particularly because they would be illegal". See Kriebaum, U. (2010), "Investment Arbitration - Illegal Investment" in Klausegger, C., Klein, P. et al. (eds), *Austrian Arbitration Yearbook 2010* (Beck, C.H., Stämpfli, Manz) (2010), pp.307-335.

<sup>214</sup> See a discussion of other situations where the denial-of-benefits clauses may apply in section 3.2.2.2.

## Section 3.2 Investor

Investing in ASEAN depends not only on the definition of “covered investment”, but also the definition of “investor”. The definition of the term “investor” is critical to determine the scope of the ACIA. Pursuant to ACIA article 4(d), “investor” means a natural person of a Member State or a juridical person of a Member State that is making, or has made an investment in the territory of any other Member State”.

The ACIA approach regarding investors is very unusual for BITs in general, because it is particularly designed in the expectation of investments from both ASEAN and non-ASEAN sources. The ACIA desires to encourage investors to invest in a newly open single market and production base under the coming AEC. Due to its particular definition of “investor”, ASEAN Member States may envisage subjecting themselves to international arbitration with ASEAN and non-ASEAN investors. This selection of investors is fundamental to the structure and strength of the ASEAN investment regime.

### 3.2.1 Natural Investor

The ACIA provides two alternative criteria for ASEAN natural investors. According to ACIA article 4(g), “natural person” means any natural person possessing the nationality or citizenship of, or right of permanent residence in the Member State in accordance with its laws, regulations and national policies”.

#### 3.2.1.1 General Criterion: Nationality or Citizenship

Nationality or citizenship is the first criterion used in the ACIA which is commonly found in BITs. In accordance with general international law, it has been firmly established that the nationality of investor as a natural person is determined by the national law of the State whose nationality is claimed,<sup>215</sup> and in this case, ASEAN Member States’ domestic laws.

#### 3.2.1.2 Alternative Criterion: Right of Permanent Residence

The second alternative is the right of permanent residence in a Member State, which refer to laws, regulations and national policies of a relevant ASEAN host State. This criterion is not usually found in BITs, rather it is notably found in multilateral

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<sup>215</sup> OECD (2008), *International Investment Law: Understanding Concepts and Tracking Innovations*, p.10.

agreements.<sup>216</sup> The right of permanent residence may be used as additional requirement to nationality or citizenship.<sup>217</sup> The ACIA provides for right of permanent residence as an alternative criterion, similar to the ECT,<sup>218</sup> the Protocol of Colonia of MERCOSUR,<sup>219</sup> and some BITs of countries with a high rate of immigration.<sup>220</sup>

The practice to extend protection to investors with a right of permanent residence has a far-reaching effect in a sense that non-ASEAN investors may be treated as national investors through this channel. Legitimising permanent residence in this respect creates a more favourable investment climate, and may effectively attract the influx of extra-ASEAN investment, which corresponds to the objective of deeper integration of the AEC. At the time of conclusion of the ACIA, ASEAN Member States were still discussing a mutually agreed solution on the treatment of “permanent residents” of a Member State as investors. ASEAN Member States have used several temporary solutions regarding the issue of permanent residence. Cambodia, Indonesia, Myanmar, Philippines, Thailand, and Viet Nam reserve obligations which would otherwise apply to, or be claimed upon, any natural person possessing the right of permanent residence in a Member State as investor under the ACIA.<sup>221</sup> In the case of Brunei where the investor is a Brunei “permanent resident” and also non-national of any country, the other Member States concerned may mutually agree to enter into bilateral consultations, on a case-by-case and non-prejudicial basis, on the issue of whether to recognise the status of such a natural person as an investor of Brunei. For the issue of permanent residence, ASEAN Member States may deliberate on enactment or amendment of an immigration act in order to include permanent residence; for example, by formation of a scrutiny supervisory committee for the residence grant.

### 3.2.2 Juridical Person

The matters of nationality of juridical persons are more complicated than nationality of natural persons, because today companies operate their business in a way which sometimes makes it very difficult to determine their nationality.<sup>222</sup> It is quite

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<sup>216</sup> UNCTAD (2011), *Scope and Definition*, p.74-75.

<sup>217</sup> See *e.g.* 1976 Germany-Israel BIT, article 1(3)(b).

<sup>218</sup> ECT article 1(7)(a)(i).

<sup>219</sup> MERCOSUR article 2(a)2(a).

<sup>220</sup> See *e.g.* 1995 Argentina-Australia BIT, article 1(c).

<sup>221</sup> Headnote to the Schedule to the ACIA (Reservation list).

<http://www.asean.org/communities/asean-economic-community/item/asean-comprehensive-investment-agreement-reservation-list> (Last accessed: 18 August 2015)

<sup>222</sup> See generally on nationality of the legal person in *Barcelona Traction* Judgment, ICJ, Report 1970, p.3. See also Sinclair, A.C. (2005), “The Substance of Nationality Requirements in Investment Treaty Arbitration”, *ICSID Review*, Foreign Investment Law Journal, Vol.20, Issue 2, pp.357-388; UNCTAD

common that a company is established under the laws of ASEAN country A, has its centre of control in ASEAN country B, and does its main business in ASEAN country C. Generally, the ACIA defines specific objective criteria for a legal person to be an ASEAN national, rather than to simply rely on the term “nationality” pursuant to customary international law, as previously described the practice of defining natural persons. ACIA article 4(e) provides that:

“juridical person” means any legal entity duly constituted or otherwise organised under the applicable law of a Member State, whether for profit or otherwise, and whether privately-owned or governmentally-owned, including any enterprise, corporation, trust, partnership, joint venture, sole proprietorship, association, or organisation”

The ACIA has a broad approach to ASEAN investors, in accordance with a broader objective of investment integration. It provides for several alternative tests to determine the ASEAN nationality of investors. However, the ACIA specifically allows ASEAN Member States to deny ACIA protection to ASEAN investors on several grounds pursuant to ACIA article 19.

### 3.2.2.1 General Test: Alternative Formal Tests for ASEAN Nationality

According to the definition, the ACIA recognises place of constitution or incorporation as two alternative criteria to determine a juridical person’s nationality.<sup>223</sup> First, the “place of constitution” test provides that a juridical person constituted in accordance with the laws of a Member State will be considered an investor of that State.<sup>224</sup> Second, the “place of incorporation” or “registered office” test requires that a juridical person must be organised under the applicable law of a Member State.<sup>225</sup>

The ACIA follows the traditional “Barcelona Traction” approach, by applying only “formal” tests and ignoring the “corporate veil” doctrine.<sup>226</sup> The advantage of using the country-of-constitution or country-of-organisation test is ease of application, because it is

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(2011), The impact of complex corporate group structures, *Scope and Definition*, UNCTAD Series on Issues in IIAs II, pp.12-13.

<sup>223</sup> At least four main tests can be distinguished: place of constitution, place of incorporation or registered office, effective management, and country of control. UNCTAD (2011), *Scope and Definition*, pp.81-84.

<sup>224</sup> This test is also found in the 2012 US Model BIT, NAFTA Agreement, Canada Model FIPA, and draft MAI.

<sup>225</sup> See *e.g.* ECT article 1(7).

<sup>226</sup> The arbitrators shall remarkably give consideration based on the effective control test only if the investment agreements had provided explicitly. The clear treaty language could only be avoided and the corporate veil doctrine applied only if there was a showing of “abuse” or “fraud”. *Barcelona Traction (Belgium. v. Spain)*, 1970, ICJ, Report, p.3.; See the analysis of the case by Hamida, W.B. (2005), “La notion d’investisseur”, *La Gazette du Palais*, December; Schreuer, C.H. (2009), para.465.

unlikely to doubt on the country under whose law a company is constituted or organised.<sup>227</sup> Hence, the ACIA accepts that the relationship between direct investor and its direct investment enterprises to the management structures can be remote. It declines to incorporate the two additional tests that have been recognised in the previous IGA/AIA regime: the “place of effective management”<sup>228</sup> and the “effective ASEAN equity” tests.<sup>229</sup> These approaches are considered too restrictive for the current open-door policy.

### 3.2.2.2 Specific Test: Substantial Business Operations Test in Denial of Benefit Clauses

Compared to the previous regime, the ACIA has broader definition of investors, as it has lightened the qualification of investors, by not requiring an effective management of investment and an effective ASEAN equity. The ACIA seeks to attract foreign investment regardless of its origin, since ASEAN Member States are convinced that it would make economically little sense to discriminate between investors of different foreign nationalities. As mentioned in Chapter 2, ASEAN Member States have relied on extra-ASEAN foreign investment flows. Consequently, the ACIA definition of investor possibly extends the ACIA benefits to the assets owned by investors of non-ACIA parties which are based in the ASEAN Member States’ territory, thereafter “foreign-owned ASEAN-based” (FOAB) investment.

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<sup>227</sup> UNCTAD (2011), *Scope and Application*, p.82.

<sup>228</sup> IGA article I(2) provides that a “company” shall not only be incorporated or constituted under the laws in force in the territory of any Contracting Party, but also it shall have the place of effective management in that State. This requirement had been scrutinised in *Yaung Chi Oo v. Myanmar*. The fact that the claimant’s management spent considerable time in Myanmar attending to its investment prompted Myanmar to claim that the claimant’s place of “effective management” had shifted to Myanmar. But the tribunal finally held that the claimant was a company of a contracting State other than Myanmar. Unless some indication of improper protection shopping exists, the company would be a company of the State of incorporation when the legal requirements of that State on this issue are satisfied and there are some other indicia of management in that state. The requirements were then satisfied: *i*) the claimant had a resident director in Singapore; and *ii*) the claimant also conducted certain business activities from Singapore. The nationality of the company’s shareholders was irrelevant, as was the source of the capital. The definition of “investment” in the 1987 Agreement focuses on local incorporation and effective management, and pays no regard to the ultimate source of the funds used. See *Yaung Chi Oo v. Myanmar*, ICSID AFR Case No.ARB/01/1, 31 March 2003, 42 ILM 540 (2003), paras.49, 62, 82.

<sup>229</sup> AIA Article 1, “ASEAN investor” means:

(i) a national of a Member State; or  
(ii) any juridical person of a Member State, making an investment in another Member State, the effective ASEAN equity of which taken cumulatively with all other ASEAN equities fulfills at least the minimum percentage required to meet the national equity requirement and other equity requirements of domestic laws and published national policies, if any, of the host country in respect of that investment.  
“Effective ASEAN equity” in respect of an investment in an ASEAN Member State means ultimate holdings by nationals or juridical persons of ASEAN Member States in that investment. Where the shareholding/equity structure of an ASEAN investor makes it difficult to establish the ultimate holding structure, the rules and procedures for determining effective equity used by the Member State in which the ASEAN investor is investing may be applied. If necessary, the Co-ordinating Committee on Investment shall prepare guidelines for this purpose.



Under the formal tests mentioned above, a company may take benefits from the ACIA without genuinely enriching the ASEAN Investment Area. Investors may try to build their legal structure in their favour and generates the risk of “treaty shopping” which may result in “forum shopping”. In response, the ACIA offsets the minimum formal tests by granting ASEAN Member States power to deny, and to avoid claims from certain entities to which they did not intend to offer the ACIA’s protection.

The ACIA has created a mechanism of denial of benefits.<sup>230</sup> Pursuant to ACIA article 19(a) and (b), an ASEAN Member State may deny the benefits of the ACIA affording to an otherwise qualifying juridical person, where an investor of a non-Member State and of a home State “owns”<sup>231</sup> or “controls”<sup>232</sup> the juridical person in question and that person has “no substantive business operations (SBO) in the territory”<sup>233</sup> where it is firstly established. This signifies that a company, which has substantial business operation in the host State, even if owned or controlled by a national of the denying Member State or by a foreigner, may benefit from the ACIA protection. For illustration, Thailand cannot deny benefits under the ACIA to a Malay automobile company investing in Thailand, even though the majority of shareholders are Thai nationals. It is explicit that the investment source, either ASEAN or foreign, does not matter, as long as such investment flows through a non-national company with real business operations.

This mechanism is powerful in a sense that it can rebut the qualification of investor and investment according to the criteria, discussed *supra*. However, this test does not aim to determine if a juridical person is an ACIA investor like the formal tests in the admission phase. Rather, it will be used only in the post-establishment phase where States respond to investors without SBO. This signifies that State may not deny benefits to juridical investors if the State deems proper to allow such juridical person to invest in its territory. Logically, it follows that the right to deny is required to be exercised through positive action taken by

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<sup>230</sup> The denial of benefits clause has been found in several investment agreements, *e.g.* ECT article 17, Draft MAI article 12 Final Provisions, NAFTA article 1113, US Model BIT article 17, Canada FIPA article 18, in the BITs concluded by ASEAN Member States and other contracting parties contain similar language with some variation. See Mistelis, L.A., Baltag, C.M., (2009), “Denial of Benefits and Article 17 of the Energy Charter Treaty”, *Penn State Law Review*, Vol. 113, Issue 4, pp.1301-1321; UNCTAD (2011), *Scope and Definition*, pp.92-98; OECD (2008), *International Investment Law: Understanding Concepts and Tracking Innovations*, pp.28-33.

<sup>231</sup> ACIA article 19(3)(a) “Owned” by an investor in accordance with the laws, regulations and national policies of each Member States.

<sup>232</sup> ACIA article 19(3)(b) “Controlled” by an investor if the investor has the power to name a majority of its directors or otherwise to legally direct its actions.

<sup>233</sup> ACIA article 19(a) and (b).

the relevant ASEAN host state, because “the existence of a ‘right’ is distinct from the exercise of that right”.<sup>234</sup>

The ACIA does not provide specific recourse for the question of substantial business operations, whereas some treaties have provided for recourse to prior notification and prior consultations to seek a mutually satisfactory resolution to the matter.<sup>235</sup> However, investor-State may use the consultation procedures available under ACIA article 31, which are *a fortiori* obligatory in the event where an investment dispute has occurred. The ACIA leaves the formality to the denying State to decide. For instance, a State may deny investors by a general declaration in an official gazette, a statutory provision in investment or other laws, or even an exchange of letters with a particular investor or class of investors. The burden of proof to establish the lack of SBO may fall with the ASEAN State authorities, because not only they are the ones who invoke the right to deny, they also have had in the first place the right to request supporting documents from the investors for the approval of investments.

The question of what constitutes “substantial business operations” remains worrisome. Due to the lack of a clear legal definition, it is possible that a State may abuse its power by denying benefits to a decent investor, or contrarily, an investor may take profit of the ACIA without contribution to the States. Despite the diversity of the business nature of individual enterprises, a concept of “centre of economic interest”, akin to the concept of rules of origin, or performance requirement, may be of interest.<sup>236</sup> A Working Group on “substantive business operation” has been assigned to settle the issue.<sup>237</sup>

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<sup>234</sup> *Plama v. Bulgaria*, ICSID Case No. ARB/03/24, Awarded 27 Aug 2008, paras.155-165.

<sup>235</sup> See *e.g.* NAFTA article 1113.

<sup>236</sup> Fink, C., Nikomborirak, D. (2007), *Rules of Origin in Services: A Case Study of Five ASEAN Countries*, World Bank Policy Research, WP 4130.

<sup>237</sup> The Working Group may try to give a list of reference, such as business operations; volume/ intensity/ percentage of business operations; capital investment; number of employees; information on customer/ clients; minimum duration of establishment of the company at the time of loan application; business or correspondence address; information/ assessment by relevant financial and professional institutions, payment of local profit taxes, owning or renting of premises, etc.

## Conclusion to Part II

The definitions of “investment” and “investor” are the most important elements in the ACIA, as they determine the beneficiaries of the ACIA. ASEAN drafters have tried hard to balance the goal of protection and achievement of liberalisation in the ASEAN Investment Area through these terms. The ACIA has adopted a broad asset-based definition of investment, with specifying substantive investment characteristics as well as investment forms.

The term “investment” covers not only direct investment but also it takes into account the contemporary economic evolution, and expressly includes portfolio investments. Given the fact that portfolio investments have not been customarily protected under BITs, combined with the fact that most of ASEAN Member States are developing countries who have suffered from the Asian Economic Crisis, it is quite astonishing that the ACIA adopts such a liberal and ambitious approach. The ACIA has become bold and innovative among existing IIAs.

Nevertheless, the liberal definitions of investments under the ACIA are subject to the specific requirements. In order to be “covered” under the ACIA, an “investment” must be an existing or future investment in an ASEAN Member State’ territory which is admitted in accordance with national laws, as well as specifically approved in writing, when national laws so demand. In this regard, ASEAN Member States retain the power to issue the eligibility criteria in order to regulate the admission and operation of investments. This, in turn, improves the transparency for both States and investors as to who are entitled to the ACIA privileges.

By the same token, the ACIA has opted for a broad and liberal definition of ASEAN investors. It includes a natural person who holds an ASEAN State’s nationality or a right of permanent residence, and requires only a formal test to attribute the nationality of juridical person. It also gives the green light to non-ASEAN entities to invest and expand their business through an ASEAN-based company. This stratagem is provocative in a way that it simultaneously stimulates deeper and more rapid liberalisation of the intra-ASEAN market and broader extra-ASEAN investment flows, regardless of its provenance. Owing to the FOAB construction, the ACIA has responded to the “ASEAN Open Regionalism”, and become an ASEAN “shortcut” to the World.

While this definition of investor conveys a risk of “ACIA shopping”, the ACIA has created a defensive mechanism to circumvent unfortunate scenario, *e.g.* a denial of benefits mechanism by which an ASEAN host State may deny benefits to a foreign-owned or a

national-owned ASEAN based entity which has no “substantive business operations” in the territory of the denying State.

In conclusion, while many improvements have been made, the ACIA suffers from some drawbacks. A positive is that definitional provisions of the ACIA and procedures for obtaining specific approval in writing are written in a more detailed manner, which means more legal certainty and transparency for States and investors. However, while the classic definitions and their relevant application and interpretation have conventionally been firmly set, most of the new additional elements still lack application in real cases and remain weak, *e.g.* portfolio investment, right of permanent residence, and substantive business operations. Also, the very broad definition of investment under the ACIA, altogether with several unsettled issues, may lead to multiple claims by investors. These shortcomings have greater impact as they concern not only protection but also liberalisation. ASEAN Member States must sincerely implement the ACIA in order that its objectives can be finally realised.

## Part III Core Protection Standards

Following Chapter 3 on definitions of investment and investors which provides the scope of application of the ACIA in Part II, Part III focuses on the key standards constituting the body of the ASEAN investment protection regime. These standards are divided into substantive and procedural standards. Under the ACIA, ASEAN Member States must accord ASEAN investors substantive standards of protection. The ACIA also provides dispute settlement mechanisms (DSM) which allow ASEAN investors to enforce these standards.

BITs from the 1980s usually have had simple and short provisions of both substantive and procedural standards, leading to extensive, inconsistent and uncertain interpretation and application by arbitral tribunals. In response, IIAs in the 2000s include more detail in order to clarify the content of protective standards. This detailed approach allows States to have more control over the use of the IIAs. Currently, mega-regional IIAs negotiations address several key issues of investment protections, including investor-State dispute settlement (ISDS). The main concern is how to balance the interests of investors and of States: how to create an investment-friendly environment while preserving policy space for States to exercise their sovereign power for public interests?

Striking this balance is most important in the ASEAN context. As most ASEAN Member States are developing countries, they need foreign investments for their development. However, these countries may not wish to accept harmful foreign investments just for the sake of economic growth, as they had done in past decades. For the promotion of the new era of the intra-ASEAN investment, ASEAN Member States realise that the ACIA should be perceived as an instrument to achieve a greater objective, *i.e.* the sustainable development of ASEAN Member States under the auspices of the ASEAN Economic Community (AEC). Therefore, it is important to ascertain that, while encouraging regional investment flows, ASEAN Member States retain their policy space to regulate matters of public interests, such as environment, labours, or health.

During the last decade, when the debate of the IIAs practice regarding regulatory power of States was not as intense as it is currently, ASEAN Member States were already clear about the balance of interests that they were attempting to strike. To understand the actual ACIA balance, a comprehensive reading of both substantive and procedural standards is required.

Generally, the standard provisions discussed in Part III follow the global trend of this current detailed approach. Nevertheless, the ACIA has specific features due to the ASEAN-specific context. Some of its interpretations of protection standards may be considered original and innovative solutions to solve the issue of balance of interests. Part III of this thesis scrutinises the elements of the ACIA standards in a view to understand the choices made by ASEAN Member States. These choices altogether frame the “ASEAN Way” of investment protection under the ACIA.

Accordingly, chapters 4, 5 and 6 are organised into two parts: first, the IIAs general practice, second, the ASEAN-specific features. Chapters 4 and 5 address substantive standards: absolute and relative standards, respectively. An “absolute” or “non-contingent” standard of treatment is one by which the treatment is precisely determined in the treaty, by reference to given circumstances of application, as opposed to “relative” standards which define the required treatment by reference to that accorded to other investments.<sup>238</sup>

Chapter 4 discusses the tension which makes the ACIA a battle ground of the economic interests of ASEAN investors and the public interests of ASEAN host States. This chapter attempts to strike the right balance between ASEAN investment protection and the preservation of the freedom of ASEAN host States regarding their legitimate actions. Three substantive standards are selected to illustrate the “ASEAN Way” of investment protection. First, the ACIA addresses the debate of indirect expropriation and regulatory measures, mainly in the expropriation and compensation provision. Second, the ACIA has an unusual approach to the fair and equitable treatment (FET). Third, while guaranteeing investors’ right to transfers, the ACIA expressly allows ASEAN host States to control transfers in extraordinary circumstances. Given the “ASEAN Way”, it is not surprising that the ASEAN Member States prefer to retain some legitimate control over investment regulations by a narrower than usual interpretation of the content of the standards.

Chapter 5 deals with ACIA relative rights. They closely connect to and affect the content of absolute rights. This effect is far-reaching in terms of intra- and extra-ASEAN investment integration. This chapter examines the development of the ASEAN approach regarding two important standards of non-discrimination, namely most-favoured nations and national treatments. Lastly, chapter 6 treats procedural standards or dispute settlement mechanisms under the ACIA.

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<sup>238</sup> UNCTAD (1998), *BITs in the Mid 1990s*, UN Publication.

These ACIA standards are examined as to their scope and content through the lens of international practices, both treaty practices and arbitration practices, in order to see how far the ACIA shares common elements with other contemporary IIAs. The findings in Part III lead to a discovery of the “ASEANised” elements or specialities of the ACIA in an ASEAN-specific context. Part III demonstrates that the ACIA standards are unique but interconnected in a sense that their comprehensive reading eventually allows an answer to the question of whether the ACIA is landmarked as an ASEAN practice of investment protection by better balancing the legitimate interests of all stakeholders.

## Chapter 4. Absolute Rights

In an ASEAN-specific context, the first question is whether the ACIA guarantee investors' absolute rights as the other IIAs. If the answer is positive, the next question is to what extent the ACIA follows the conventional line. In case that the ACIA are different from the others, why is it so? The following discussion infers that the articulation of investment protection rules in the ACIA is inevitably underlined by a consciousness of the importance of preserving regulatory powers. The negotiation process attested the delicate attempt to strike a balance between these two objectives.

Generally compared to old-fashioned BITs, the ACIA's provisions are modernised and becomes clearer, which enables the Member States to identify the boundaries of their obligations and to provide a more realistic level of protection to investors. While the ACIA maintains all investor's rights existing previously in the IGA/AIA regime, it gives more indications and inserts more channels where State can exercise its regulatory rights, not only in exceptional circumstances but also in normal circumstances.

In the light of the current jurisprudence and recent treaty practice, the ultimate question is to test whether the ACIA approach conceptualises the phenomenon of a paradigm shift from a conventional pro-investor paradigm towards a more "regulatory State paradigm".<sup>239</sup> However, it is cautioned that this particular balance possibly makes the ACIA less attractive in the investors' eyes. It remains to be answered whether decent investors prefer more concrete legal certainty that the ACIA offers in the exchange of their seem-to-be more protective but abstract rights existing in the common BITs.

In this chapter, three particularly important standards are chosen to be scrutinised. Section 4.1 deals with the expropriation provisions which embed the most obvious power-struggling issues. The standard is particularly detailed in ACIA article 14 and Annex 2 on expropriation and compensation. In addition, the expropriation discussion covers also the analysis on legitimate expectation of legal stability, generally debatable under the FET issue. Section 4.2 addresses the ACIA FET provision. The FET is remarkably useful for a denial of justice of in judicial and administrative proceedings. This FET approach composes the ASEAN-specific elements which are not commonly found elsewhere.

Section 4.3 continues to address the transfer of fund standard. It specifically tackles ACIA economic exceptions. Where every investment treaty has general exceptions and security exceptions provisions to disable investment rights under extraordinary

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<sup>239</sup> K. Yeung (2010), "The Regulatory State", in Baldwin, R., Cave, M., Lodge, M., *The Oxford Handbook of Regulation*, Oxford, OUP, pp.64-85.



circumstances, the ACIA contains distinctive exceptions under financial crisis, particularly regarding the balance-of-payments. This specific clause originated from the ASEAN economic crisis at the end of the last century, and therefore merits particular attention.

## Section 4.1 Expropriation and Compensation

The protection of ASEAN investors from unlawful expropriation has traditionally been the main guarantee in the ASEAN investment treaties.<sup>240</sup> ACIA article 14 enshrines one of the most important absolute rights, namely compensation for expropriation. The main issue is the balance between the protection of private property rights of ASEAN investors and the legitimate exercise of sovereign power of the ASEAN Member States. The ACIA recognises that an ASEAN Member State has the sovereign right to expropriate ASEAN investments situated within its territory, subject to conditions. Article 14(1) states that expropriation is lawful provided that the State fulfils the following criteria.

A Member State shall not expropriate or nationalise a covered investment either directly or through measures equivalent to expropriation or nationalisation (“expropriation”), except:

- (a) for a public purpose
- (b) in a non-discriminatory manner;
- (c) on payment of prompt, adequate, and effective compensation; and
- (d) in accordance with due process of law.

The ACIA recognises both direct and indirect expropriation. Direct expropriation is easy to determine. It is an open, deliberate and unequivocal intent, as reflected in a formal law or decree or physical act, to deprive the owner of his or her property through the transfer of legal title or outright seizure of the investment of the ASEAN foreign investors.<sup>241</sup> The expropriatory measures must be for a public purpose, in a non-discriminatory manner, and in accordance with due process of law. Furthermore, the compensation is immediately due to an investor who is directly expropriated.<sup>242</sup> At present, issues regarding direct expropriation or nationalisation are relatively rare.

Since the late 1990s, indirect expropriation has become one of the most important issues in international investment law. Concern has rather been raised over the significant number of indirect forms of expropriation, or “measures tantamount” or “having an equivalent effect to” expropriation. Due to the lack of definition of indirect expropriation in investment treaties, determination of indirect expropriation is very difficult. Tribunals are required to improvise their own criteria and definitions, which differ from one to

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<sup>240</sup> See, generally on expropriations, Lowe, V. (2004), “Regulation or expropriation”, *Transnational Dispute Management*, Vol.1(3), p.4; Brownlie, I. (2008), *Principles of Public International Law*, p.532; Sornarajah, M. (2010), *The International Law on Foreign Investment*, 3<sup>rd</sup> ed., Cambridge, CUP; Newcombe, A. (2005), “The Boundaries of Regulatory Expropriation in International Law”, *ICSID Review: Foreign Investment Law Journal*, Vol.20(1), p. 23

<sup>241</sup> ACIA Annex 2, 2(a).

<sup>242</sup> Newcombe, A., Paradell, L. (2009), *Law and Practice of Investment Treaties: Standards of Treatment*, The Hague, Kluwer Law International, p.506.

another.<sup>243</sup> In general, indirect expropriation could occur even without formal transfer of title or outright seizure, yet may have an effect equivalent to direct expropriation. In other words, short of an actual taking, such measures may “result in the effective loss of management, use or control, or a significant depreciation of the value of the assets of a foreign investor”.<sup>244</sup>

The concept of indirect expropriation is much broader than that of direct expropriation because those property rights may have been expropriated even though the State in question has not purported to expropriate.<sup>245</sup> The determination of indirect expropriation is complicated by the fact that it can result from a “series of related actions”.<sup>246</sup> In contrast to direct expropriation which usually results from a single act of deprivation of a property right, indirect expropriation is rather found on the basis of the accumulation of acts or omissions. This term includes expropriation formed “over a period of time”.<sup>247</sup> In practice, the term is variously called “*de facto*”, “consequential”, “creeping”,<sup>248</sup> or “constructive” expropriations.<sup>249</sup>

Despite the non-conformity of the terminology, the term “may be defined as the slow and incremental encroachment on one or more of the ownership rights of a foreign investor ... The legal title to the property remains vested in the foreign investor but the investor’s rights of use of the property are diminished as a result of the interference by the State”.<sup>250</sup> Several individual actions or omissions of a State, analysed in isolation seem “innocuous vis-à-vis a potential expropriation”.<sup>251</sup> Only being retrospectively overviewed, would those acts constituent part of an expropriation of an ASEAN investor’s property rights.<sup>252</sup>

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<sup>243</sup> For example, *Ethyl Corporation v. USA*, Award, 24 June 1998; *SD Myers v. Canada*, award 13<sup>th</sup> November 2000; *Pope & Talbot v. Canada*, Award, 26 June 2000.

<sup>244</sup> UNCTAD (2000), *Taking of Property*, New York, UN Publication, p.4.

<sup>245</sup> Christie, G.C. (1962), “What constitutes a taking of property under international law?”, *BYIL*, Vol.38, pp.307-338. See *Case concerning certain German interests in Polish Upper Silesia (The Merits)*, *Germany v. Poland*, PCIJ, Judgment, 25 May 1925; *Norwegian Ship owners’ Claims, Norway v. USA*, PCA, Award, 13 October 1922, *Starrett Housing v. Iran*, Interlocutory Award, 19 December 1983, 4-US Claims Tribunal Reports 122, p.154.

<sup>246</sup> ACIA Annex 2(1).

<sup>247</sup> *Generation Ukraine v. Ukraine*, Award, 16 September 2003, para.20.22.

<sup>248</sup> *Tecmed SA v. Mexico*, ARB(AF)/00/2, Award, 29 May 2003, para.114; *Biloune v Ghana*, UNCITRAL *ad hoc* Tribunal, Award on Jurisdiction and Liability, 27 October 1989, 95 ILR183, p.209.

<sup>249</sup> See Weston, B.H. (1976), “Constructive takings under international law: a modest foray into the problem of creeping expropriation”, *Virginia Journal of International Law*, Vol.16, pp.103-175; Stern, B. (2008), “In search of the frontiers of indirect expropriation”, in Rovine, A.W. (ed.) (2007), *Contemporary Issues in International Arbitration and Mediation*, The Fordham Papers, Leiden, Martinus Nijhoff, pp.29-52.

<sup>250</sup> UNCTAD (2000), *Taking of Property*, p.11.

<sup>251</sup> Reisman, W.M., Sloane, R.D. (2003), “Indirect Expropriation and its Valuation in the BIT Generation”, 74 *BYIL*, Vol.115, p.123.

<sup>252</sup> See *Metalclad Corp v. Mexico*, ARB(AF)/97/1, Award, 30 August 2000, 16 ICSID Rev-FIL J168, 195 (2001), para.107.

Newer and more difficult legal issues occur regarding “regulatory takings”, especially where ASEAN Member States need more space to regulate foreign investments in the ASEAN investment Area, “for exercising the police powers of a State or otherwise arise from State measures like those pertaining to the regulation of the environment, health, morals, culture or economy of a host country”.<sup>253</sup> While tribunals have long explored differing approaches, this section considers the two main theories that have been proposed to resolve these issues the sole effects doctrine and the police powers doctrine. It seeks to situate the ACIA amidst the investment treaty practices.

The adoption of a broad approach of indirect expropriation may cover all measures taken by authorities that have an adverse effect on the total value of a private foreign investment, irrespective of any other consideration.<sup>254</sup> This exclusive approach, considered pro-investor, is known as the “sole effects” doctrine.<sup>255</sup> Apparently, if a tribunal considers regulatory measures amount to indirect expropriation, the State must compensate the expropriated investors.

As a result, the sovereign power and policy space of the host States are restricted by the broad interpretation of the treaty obligation. This may happen in the case where a tribunal interprets undefined indirect expropriation under the IGA. Under the IGA or other traditional BITs, it is possible that States develop “extremely timid behaviour when adopting measures to implement human rights,” which may lead them “to subordinate collective choices in the general interest to the rights of private foreign investors”.<sup>256</sup>

In fact, it is sometimes inevitable that, in pursuing public interest objectives such as public health, environment and labour protection, States’ measures may have some adverse impact on the existence or profitability of ASEAN investments. It would be unreasonable if a State needed to compensate an investor for the fulfilment of its sovereign duties. In this regard, the overwhelming majority of doctrinal opinions<sup>257</sup> and international texts<sup>258</sup>

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<sup>253</sup> UNCTAD (2000), *Taking of Property*, p.12.

<sup>254</sup> *Starrett Housing v. Iran*, Interlocutory Award No.ITL 32-24-1, 19 December 1983, 4-US Claims Tribunal Reports; *Tippetts, Abbott, McCarthy, Stratton v TAMS-AFFA Consulting Engineers of Iran*, 6 Iran-USCTR paras.219, 225, 29 June 1984. The tribunal states that the “intent of the government is less important than the effects of the measures on the owner”, and “the form of the measures of control or interference is less important than the reality of their impact.”; *Santa Elena v. Costa Rica*, Award, 17 February 2000, ICSID Reports 153, para.192; *Tecmed v. Mexico*, ARB(AF)/00/2, Award, 29<sup>th</sup> May 2003, 43 ILM 133 (2004) para.121.

<sup>255</sup> Schefer, K.N. (2013), *International Investment Law: Text, Cases and Materials*, Cheltenham, Edward Elgar, pp.209-210; Reinisch, A. (2008), “Expropriation”, in Muchlinski, P., Ortino, F. Christoph Schreuer, C. (Eds.), *The Oxford Handbook of International Investment Law*, Oxford, OUP, pp.444-446; Dolzer R., Schreuer, C. (2012), pp.112-114.

<sup>256</sup> Bachand, R., Gallie M., Rousseau S. (2003), “Investment Law and Human Rights in the Americas”, *AFDI*, p.592, pp.601-602.

<sup>257</sup> Lowe, V. (2004), “Regulation or expropriation”, *Transnational Dispute Management*, Vol.1, Issue 3, p.4; Brownlie, I. (2008) *Principles of public international law*; Sornarajah, M. (2010); Newcombe, A. (2005);

recognise that States possess the power to regulate and therefore all their laws and regulations are presumed valid.<sup>259</sup>

Tribunals have increasingly understood the need of States to maintain regulatory space. Hence, in lieu of accepting the exclusive criteria of the injurious effect, they have referred these public-purpose regulations to the “police power” doctrine,<sup>260</sup> according to which a legitimate objective would justify these measures. In order to determine whether an action or series of actions by a State constitutes an indirect expropriation, an arbitral tribunal shall not totally disregard the intention and purposes of national legislators and count only the effect of such measures. According to the narrow approach, not every State regulation, harmful to investments, constitutes indirect expropriation; therefore, compensation is not always due. This approach provides States more regulatory space.

In contrast to the majority of 1990s BITs, the ACIA follows the narrow approach and gives more details to help tribunals define the threshold of indirect expropriation. On top of the common provision found under article 14(1), Annex 2 is added to the ACIA. Annex 2 is based on the NAFTA model. It clarifies the concepts of direct and indirect expropriations, determines the types of investment at stake and gives indicators of indirect expropriation:

1. An action or a series of related actions by a Member State cannot constitute an expropriation unless it interferes with a tangible or intangible property right or property interest in a covered investment.
2. Article 14(1) addresses two situations:
  - (a) the first situation is where an investment is nationalised or otherwise directly expropriated through formal transfer of title or outright seizure; and
  - (b) the second situation is where an action or series of related actions by a Member State has an effect equivalent to direct expropriation without formal transfer of title or outright seizure.
3. The determination of whether an action or series of actions by a Member State, in a specific fact situation, constitutes an expropriation of the type referred to in sub-paragraph 2(b), requires a case-by-case, fact-based inquiry that considers, among other factors:

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Weston, B.H. (1976), “Constructive takings under international law: a modest foray into the problem of creeping expropriation”, *Virginia Journal of International Law*, p.121.

<sup>258</sup> Article 10(5) Harvard Draft Convention on International Responsibility of States for Injuries to Aliens (1961); Interpretative note to Draft MAI Article 5 “Expropriation and Compensation”; MIGA Article 11(a)(ii).

<sup>259</sup> UNCTAD (2012), *Expropriation*, pp.79-81.

<sup>260</sup> *Parker v. Lithuania*, Award, 11 Sept 2007, paras.327-328; *BG Group v. Argentina*, Final award, 24 Dec 2007, paras.292-310; *Plama v. Bulgaria*, award 27 Aug 2008, paras.177, 219; *AES v. Hungary*, Award, 23 Sept 2010, paras.9.3.27-9.3.35; *Merrill & Ring Forestry v. Canada*, 2010, paras.148-149, *Total v. Argentina*, Decision on Liability, 27 Dec 2010, paras.123-124, *El Paso v. Argentina*, Award 31 Oct 2011, para.358.

- (a) the economic impact of the government action, although the fact that an action or series of actions by a Member State has an adverse effect on the economic value of an investment, standing alone, does not establish that such an expropriation has occurred;
- (b) whether the government action breaches the government's prior binding written commitment to the investor whether by contract, licence or other legal document; and
- (c) the character of the government action, including, its objective and whether the action is disproportionate to the public purpose referred to in Article 14(1).

4. Non-discriminatory measures of a Member State that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute an expropriation of the type referred to in sub-paragraph 2(b).

From the text, the ACIA explicitly rejects the “sole effects” doctrine. It asserts that the requirement of legal stability is not absolute and cannot affect an ASEAN Member State's right to exercise sovereign power to legislate and adapt its legal system to changing circumstances; customary international law commonly accepts that this right is within the police power of States.<sup>261</sup> Even though these regulatory measures may lead to effects similar to indirect expropriation, they are not categorised as expropriation and do not give rise to the obligation to compensate ASEAN investors who are allegedly affected by such measures.

Having based its model on NAFTA and the US Model BIT, the ACIA provisions are very detailed. It reaffirms the right to regulate and attempts to increase predictability for the determination of indirect expropriation. In doing so, the ACIA has used three techniques: (1) exception provisions, (2) an explanatory annex, and (3) exclusion of some measures out of the scope of ACIA article 14. It is worth noting that the ACIA is one among a relatively small number of investment treaties which have combined all three techniques. Compared to NAFTA model, the ACIA provisions are even more innovative and effective. The ACIA proposes specific details which give tribunals more concrete guidelines, concretise the concept of the ASEAN investor's expectations, and relieve ASEAN Member States from the fear of broad regional obligations.

Section 4.1.1 examines aspects of the ACIA approach that are similar to expropriation provisions of other agreements, *i.e.* scope of article 14, types of expropriation, and conditions of a lawful expropriation. Subsequently, section 4.1.2 tracks specifically the ASEAN-specific techniques used for the determination of indirect expropriation proposed by the ACIA. This chapter investigates how the “ASEAN Way” of

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<sup>261</sup> *Saluka (The Netherlands) v. Czech Republic*, UNCITRAL Partial Award, March 2006, para.263.

investment protection approaches the question of the balance between the investors' and States' rights and obligations regarding expropriation.

#### 4.1.1 General Practice: Investors' Right to Lawful Expropriation and Compensation

An ASEAN Member State does not incur any international liability by carrying out expropriation. In the event of expropriation, the primary obligation of States lies not in the act of expropriation, recognised as sovereign right of States, but in the conditions for its lawful implementation.<sup>262</sup> Therefore, liability only attaches if the State fails to meet the conditions for lawful expropriation set out in ACIA article 14. These conditions were previously found in the IGA, and are generally found in the majority of IIAs. In order to file an expropriation claim, an investor must, first of all, demonstrate that the asset is susceptible to be expropriated. An expropriation act or omission of an ASEAN governmental authority which does not fulfil one of the four criteria set out in the ACIA becomes an unlawful expropriation. A finding of an unlawful expropriation will trigger a compensation mechanism.

##### 4.1.1.1 Expropriation of Property Rights

Not all investments fall within the scope of expropriation provision. ACIA article 14 denotes a narrower notion of the term "covered investment", and limits expropriation claims only to property right or property interest. The domestic laws of the ASEAN host States are decisive in determining the definition of "property".<sup>263</sup> The ACIA only recognises and protects them so determined in the ASEAN Investment Area.

Following a number of modern investment disputes of the US-Iran Claims Tribunals, the UNITRAL or ICSID tribunals,<sup>264</sup> the ACIA clearly supports a wide conception of property rights. These rights include both tangible and intangible rights. The intangible rights include the rights under contracts, concession agreements, as well as shareholder rights. The property rights also include intellectual property rights (IPRs),

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<sup>262</sup> Nikièma, S. H. (2013), *Compensation for Expropriation*, IISD Best Practices Series, p.2.

<sup>263</sup> McLachlan, C., Shore, L., Weiniger, M. (2007), pp.181-183.

<sup>264</sup> *Case concerning certain German interests in Polish Upper Silesia* (Germany v. Poland), Judgment, 25 May 1926, PCIJ. Series A, No.7 (1926); *Phillips Petroleum v. Iran*, Award no.425-39-2, 29 June 1989, para.76; *Starrett Housing v. Iran*, Interlocutory Award no.ITL 32-24-1, 19 December 1983, 4 Iran-US Claims Tribunal Reports 122, p.156; *Wena Hotels v. Egypt*, Award, 8 December 2000, para.98; *SPP v. Egypt*, Award, 20 May 1992, para.164; *SD Myers v. Canada*, Partial award, 13 November 2000, para.281; *Bayindir v. Pakistan*, Award, 27 August 2009, para.255; *Methanex v. USA*, Final award, 3 August 2005, Part IV, Chapter D, para.17. *SPP v. Egypt*, Award, 20 May 1992, 3 ICSID Reports 189, at 228, para.164; *CME Czech Republic BV v. The Czech Republic*, UNCITRAL, Partial award, 13 September 2001, para.591.

except for the compulsory licences granted in accordance with the TRIPS Agreement.<sup>265</sup> This exception ensures coherence between the ACIA and WTO law.<sup>266</sup> On the contrary, the formulation excludes non-property rights, such as the right to admission, and economic interests, where they do not create property rights, such as goodwill, customer base, and market share.<sup>267</sup> In fact, these non-property rights can also be taken away but no compensation is due under ACIA article 14.

Questions may be raised regarding types of measures which can be challenged. The range of measures which may give rise to expropriation claims is remarkably broad.<sup>268</sup> A tribunal needs to verify whether the acts concerned are attributable to the respondent State. The conduct of an ASEAN Member State is considered an act of that State under international law “whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State, and whatever its characterization as an organ of the central Government or of a territorial unit of the State”.<sup>269</sup>

Questions of attribution may arise in connection with the expropriation of contractual rights.<sup>270</sup> “Not every failure by a government to perform a contract amounts to an expropriation even if the violation leads to a loss of rights under the contract”.<sup>271</sup> The mere breach of a contract by an ASEAN host State does not by itself lead to a breach of the ACIA – what is required is a use of governmental prerogative. Expropriation occurs solely in the case that a State exercises its governmental or public power or in its sovereign capacity, known as “*acta iure imperii*” or “*puissance publique*”.<sup>272</sup>

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<sup>265</sup> ACIA article 14 (5).

<sup>266</sup> The exclusion of compulsory licences is especially important for medicines that most of developing States need for their public health situation. According to the WTO, compulsory licensing is when a government allows someone else to produce the patented product or process without the consent of the patent owner. FAQ Compulsory licensing of pharmaceuticals and TRIPS, [http://www.wto.org/english/tratop\\_e/trips\\_e/public\\_health\\_faq\\_e.htm](http://www.wto.org/english/tratop_e/trips_e/public_health_faq_e.htm) (Last accessed: 20 August 2015)

<sup>267</sup> *Pope & Talbot v. Canada*, Interim Award, 26 June 2000, paras.98, 102. *Methanex v. USA*, Final Award, 3 August 2005, part IV, chapter D, para.17. See UNCTAD, (2012), *Expropriation*, Issues in IIAs II, New York, Geneva, p.19.

<sup>268</sup> Coe, J., Rubins, N. (2005), “Regulatory Expropriation and the Tecmed Case: Context and Contributions, in Weiler, T. (Ed.), *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law*, London, Cameron May Ltd, pp.607-608.

<sup>269</sup> ILC Articles on Responsibility of States for Internationally Wrongful Acts, 2001, Article 4. See Dolzer, R., Schreuer, C. (2012), *Principles of International Investment Law*, pp.216-227; UNCTAD (2012), *Expropriation*, pp.14-16.

<sup>270</sup> See Dolzer, R., Schreuer, C. (2012), *Principles of International Investment Law*, pp.126-129.

<sup>271</sup> Salacuse, J. W. (2010), *The Law of Investment Treaties*, p.331; Dolzer, R., Schreuer, C. (2012), *Principles of International Investment Law*, p.218. See *Waste Management v. Mexico*, ARB(AF)/00/3, Award, 30 April 2004. See also Cremades, B.M., Cairns, D., “Contract and Treaty Claims and Choice of Forum in Foreign Investment Disputes”, in Horn, N. (2004) (Ed.), *Arbitrating Foreign Investment Disputes*, The Hague, Kluwer Law International, pp.325-351.

<sup>272</sup> Reinisch, A. (2008), “Expropriation”, p.420.



It is a delicate matter to distinguish between *acta iure imperii* and *acta iure gestionis*.<sup>273</sup> For instance, in the *Jalapa Railroad* case, the tribunal needed to consider whether the nullification of a contractual clause by the Mexican Government was “effected arbitrarily by means of a governmental power illegal under international law”.<sup>274</sup> An ASEAN State’s behaviour may go beyond that which an ordinary contracting party could adopt; for example, an issuance of legislative acts or administrative decrees, revocations of licences and authorisations by State organs that are necessary for the operation of a business.<sup>275</sup>

This distinction relates to the jurisdiction over contract claims or treaty claims. In this regard, an ordinary breach of contract may give rise to legal action under the applicable domestic law, whereas the expropriation of contractual rights may entail consequences under the ACIA. However, while the distinction between *acta iure imperii* and *acta iure gestionis* may be helpful for the determination of an expropriation, it is noted that “one could envisage conduct tantamount to an expropriation which consisted of acts and omissions not specifically or exclusively governmental”.<sup>276</sup> Besides, an opposite view, supported at least by two arbitral tribunals, considers that termination of contracts by States violates the principle of *pacta sunt servanda* and thus is internationally unlawful.<sup>277</sup>

Presumably, expropriation means that assets or property-related interests of an investor are wholly sequestered or substantially deprived.<sup>278</sup> The disability of an individual treatment of those items or discrete economic right, functioning as part of an integral business operation, is not sufficient to viably ground an expropriation claim. In other words, the question is whether such interests or assets are independent of economic exploitation.<sup>279</sup> Several tribunals require the whole business enterprise to be qualified as an investment, and not just its constituent parts.<sup>280</sup> However, in certain cases, different interests attached to the same business have been individually treated.<sup>281</sup>

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<sup>273</sup> *Suez et al. v. Argentina*, Decision on Liability, 30 July 2010, para.142. See also *Consortium R.F.C.C. v. Morocco*, Award, 22 December 2003, para.65, quoted with approval in *Azurix v. Argentina*, Award, 14 July 2006, para.315.

<sup>274</sup> *Jalapa Railroad and Power Co.*, American-Mexican Claims Commission (1948), 8 Whiteman, Digest of International Law (1976), paras.908-909.

<sup>275</sup> See, e.g. *Siemens v. Argentina*, Award 6 February 2007, paras.248, 253; *Impregilo SpA v. Pakistan*, ICSID Case No.ARB/03/3, Decision on Jurisdiction, 22 April 2005, para.260.

<sup>276</sup> *Water Management v. Mexico*, Award 30 April 2004, para.175.

<sup>277</sup> See *Texaco v. Libya*, Award (1979) 53 ILR 389, *AGIP v. Congo*, ICSID Award, 30 Nov 1979. See also Ripinsky, S., Williams, K. (2008), *Damages in International Investment Law*, London, BIICL, pp.70-71.

<sup>278</sup> OECD (2004), “*Indirect Expropriation*” and the “*Right to Regulate*” in *International Investment Law*, OECD Working Papers on International Investment, 2004/04, OECD Publishing, p.11.

<sup>279</sup> Kriebaum, U. (2007), “*Partial Expropriation*”, *Journal of World Investment and Trade*, Vol.8(1), p.83.

<sup>280</sup> *Telenor v. Hungary*, Award, 13 September 2006, para.67; *Waste Management v. Mexico* (No.2), ICSID Case No.ARB(AF)/00/3, Award 30 April 2004, para.141.

<sup>281</sup> Dolzer, R., Schreuer, C. (2012), p.119.

Given the transitional stage of the ASEAN Member States, tribunals – while interpreting the ACIA – may consider adopting the approach of whole expropriation. Otherwise ASEAN Member States may be faced with numerous trivial claims. A partial expropriation should be possible only if: (a) an overall investment project can be disaggregated into a group of individual rights; (b) each right is considered a “covered investment” under the ACIA; and (c) such a right is capable of economic survival independently. For example, a loss of business future incomes or a refusal of a VAT refund<sup>282</sup> would not be regarded as detached investments exposed to expropriation.

#### 4.1.1.2 Conditions of Lawful Expropriation

Liability only attaches if an ASEAN Member State fails to meet these four conditions: (1) public purpose, (2) non-discrimination, (3) payment of prompt, adequate, and effective compensation, and (4) due process of law. Similar to many recent IIAs,<sup>283</sup> the ACIA includes a reference to “due process of law” as a condition for a lawful expropriation. Tribunals must check serious procedural violations that may occur at several points of the proceedings, in the adoption or substance or scope of the measure. Similarly, irregularity may be found in the application of a general regulation to a particular ASEAN investor, *e.g.* denials, cancellations or revocations of contracts, licences, permits or concessions.

However, minor procedural deviations should not change a lawful measure into an unlawful expropriation. As a consequence, an expropriation is found unlawful when it has not been undertaken in accordance with due process of law. An ASEAN host State may also breach the FET, if, subsequent to the depriving action being taken, the affected ASEAN investor is denied access to justice in that the case is not reviewed before an independent and impartial body.

For non-discrimination, a tribunal should distinguish the non-discrimination for expropriation purpose from relative non-discriminatory standards, *i.e.* most-favoured-nation or national treatment.<sup>284</sup> Regarding absolute standards, the element of discriminatory intent is particularly stressed.<sup>285</sup> The doctrine of “good faith” precludes State authorities from exercising their rights or police powers “for an end different from

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<sup>282</sup> *Occidental Exploration v. Ecuador*, LCIA No.UN3467, Award, 1 July 2004, para.89

<sup>283</sup> For example, IGA article VI, NAFTA article 1110 (1)(c), ECT article 13, 2012 US Model BIT article 6, 2014 EU-Singapore FTA article 9.6.

<sup>284</sup> See detailed discussion in Chapter 5.

<sup>285</sup> *Methanex Corporation v. US*, NAFTA Arbitral Tribunal, Final award, 3 August 2005, Part 3 Chapter A-51, para.102.

that for which the right has been created”.<sup>286</sup> If the host State generally adopts any measure in good faith but such measures result in targeting a particular ASEAN investor, the measure may not be considered discriminatory. In contrast, a regulation is discriminatory if it is intentionally based on, linked to or taken for reasons of, certain investors, or to exclude foreign control from the host State market.<sup>287</sup> In this case, the true intention of the State is not consistent with the alleged public purpose, such measure may constitute an “abuse of rights”, also known as “*détournement de pouvoir*”.<sup>288</sup>

Provided that the evidence of such intent of the State is not easy to determine, the discriminatory effect of an intended public measure may become merely a subsidiary or additional element to prove indirect expropriation.<sup>289</sup> These conditions of public purpose and non-discrimination need to be further examined in connection with the test of proportionality set out in Annex 2.<sup>290</sup> Meanwhile, the compensation issues are discussed in the following sub-section.

#### 4.1.1.3 Compensation

Similarly to a significant number of BITs, the ACIA adopts the standard of “Hull formula”,<sup>291</sup> guaranteeing that the right of ASEAN investors must not be expropriated without “payment of prompt, adequate, and effective compensation”.<sup>292</sup> ACIA article 14(2) gives more explanation on this formula, that an expropriation is lawful only if a payment of compensation is processed in the following manner:

- (a) be paid without delay;
- (b) be equivalent to the fair market value of the expropriated investment immediately before or at the time when the expropriation was publicly announced, or when the expropriation occurred, whichever is applicable;
- (c) not reflect any change in value because the intended expropriation had become known earlier; and
- (d) be fully realisable and freely transferable in accordance with Article 13 (Transfers) between the territories of the Member States.

Firstly, by “prompt”, the compensation must be granted to an ASEAN investor as soon as the expropriation is made. The State has an obligation to pay without delay.

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<sup>286</sup> See Bin, C. (1953). *General Principles of Law as Applied by International Courts and Tribunals*, Cambridge, CUP, p.121.

<sup>287</sup> *Eureko BV v. Poland*, Partial Award, 19 August 2005, para.242.

<sup>288</sup> UNCTAD (2012), *Expropriation*, p.102.

<sup>289</sup> A. Reinisch, “Expropriation”, in Muchlinski, P., Ortino, F., Schreuer, C. (2008), p.451. See e.g. *Methanex v. USA* (2005), para.102; *Saluka v. Czech Republic* (2006) para.307.

<sup>290</sup> See section 4.2.2.3(3).

<sup>291</sup> This is the famous formula of U.S. Secretary of State, Cornell Hull, in his note of 21<sup>st</sup> July 1938 in response to the Mexican nationalisations in 1917.

<sup>292</sup> ACIA article 14(1)(c).

The ACIA does not set a specific time by which the payment must be made. In most cases, a common time to process such payment would be expected between three and six months.<sup>293</sup> Secondly, by “adequate”, the ACIA refers to the fair market value of expropriated investment to calculate compensation. Among various methods of valuation, the fair market value is the most favourable method for the investors.<sup>294</sup> Thirdly, by “effective”, the ACIA requires that such money must be fully realisable and in a freely transferable and exchangeable currency. The ACIA opens the choice to investors to receive the compensation and its interests either in the currency in which the investment was originally made or in a freely usable currency.<sup>295</sup>

Compensation upon expropriation serves a different function than damages after an unlawful act. With respect to lawful expropriation, an unfavourably affected investor is entitled to “compensation” figuring to the *damnum emergens*, i.e. the losses of the objective value suffered upon the announcement of expropriation. According to the principle of “full reparation” recognised in the *Chorzów Factory* case,<sup>296</sup> which further codified in the 2001 ILC’s Draft Articles on Responsibility of States for Internationally Wrongful Acts,<sup>297</sup> the investor must be put in the position pertaining before the investment was made.

Unlawful expropriation gives rise to State’s responsibility and attracts “reparation” which goes beyond “compensation”. Hence, the sum includes not only actual losses but may also include *lucrum cessans*, or loss of profits,<sup>298</sup> aiming at providing “reparation” for the damage caused by the unlawful act.<sup>299</sup> A case where the difference between the parties is restricted to the amount of compensation awarded may be classified as lawful expropriation, because the State has already agreed to pay the aggrieved investor in accordance with ACIA obligations, but only the amount offered or schedule of payment is disputed.

For indirect expropriation, the obligation to pay compensation arises only after the measure is found as an expropriation by a tribunal, because the lawfulness of regulatory

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<sup>293</sup> UNCTAD (2012), *Expropriation*, p.49.

<sup>294</sup> There are four methods of valuation according to the World Bank: “discounted cash flow value”, “liquidation value”, “replacement value”, “book value”. Each may lead to different results. See World Bank (1992), *Guidelines on the Treatment of Foreign Direct Investment*.

<sup>295</sup> ACIA article 4(b), Definitions: “freely usable currency”.

<sup>296</sup> *The Chorzów Factory Case* (Germany v. Poland), PCIJ, 13 September 1928, Series A, No.17 (substantive issue), *Amoco International Finance Corp. v. Iran*, 15 Iran-US CTR (1987-II), pp.189 et seq.

<sup>297</sup> ILC Draft Articles article 31 Reparation, article 34 Form of Reparation, article 35 Restitution, article 36 Compensation.

<sup>298</sup> Draft Articles on Responsibility of States for Internationally Wrongful Acts, ILC, 2001, section 36.2.

<sup>299</sup> See Marboe, I. (2009), “The Function of Compensation and Damages”, in *Calculation of Compensation and Damages in International Investment Law*, Oxford International Arbitration Series.

measures is presumed.<sup>300</sup> In case a breach has been found, the ASEAN host State has an obligation to pay compensation. The ASEAN host State has no obligation to make any change or to revoke the relevant measures. The fact that the State compensates the wronged investors will bring the unlawful measure of indirect expropriation in conformity with the obligation of lawful expropriation.

As the ACIA does not provide a particular rate or method of calculation for indirect expropriation, tribunals should apply the same method as for direct expropriation, *i.e.* fair market value. However, the existence of a single “uniform standard” for both lawful and unlawful expropriation seems not to have been fully appreciated by tribunals in investment cases.<sup>301</sup> Three awards – *ADC v. Hungary*, *Siemens v. Argentina*, and *Vivendi v. Argentina*<sup>302</sup> illustrate a departure from the treaty standard of compensation in the case of a breach of the applicable treaty. Likewise, the compensation standard in the ACIA, which applies expressly to lawful expropriation, may not preclude additional damages in the case of unlawful expropriation.<sup>303</sup>

Particularly on the fact of the *ADC v. Hungary* case, the tribunal noted that the investment’s value had risen considerably after the expropriation, and therefore considered that “the application of the *Chorzów* standard requires that the date of valuation should be the date of the Award and not the date of expropriation, since this is what is necessary to put the Claimants in the same position as if the expropriation had not been committed”.<sup>304</sup> This approach, however, could not be adopted in the context of a lawful taking where the ACIA require that the investment be valued at the date immediately before the taking.<sup>305</sup>

In *Siemens v. Argentina*, the tribunal rejected the claim for lost profits as it considered that “the amount claimed on account of lost profits [was] very unlikely to have ever materialized”.<sup>306</sup> Rather, the tribunal turned to the claim on account of post-expropriation costs, which it considered “justified in order to wipe out the consequences of the expropriation”.<sup>307</sup> Also, in *Vivendi v. Argentina case*, where the Tribunal took into

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<sup>300</sup> See p.84.

<sup>301</sup> See Bienvenu, P., Valasek, M.J. (2009), “Compensation for Unlawful Expropriation, and Other Recent Manifestations of the Principle of Full Reparation in International investment Law”, in Albert Jan van den Berg (ed.), *50 Years of the New York Convention: ICCA International Arbitration Conference*, ICCA Congress Series, Dublin Volume 14, Kluwer Law International 2009, pp.231-281.

<sup>302</sup> *ADC v. Hungary*, ICSID case No.ARB/03/16, Award 2 Oct 2006; *Siemens v. Argentina*, ICSID case no.ARB/02/8, Final Award 6 Feb 2007; *Vivendi v. Argentina*, ICSID case No.ARB/97/3, Award in the resubmitted case, 20 August 2007.

<sup>303</sup> See Ripinsky, S., Williams, K. (2008), *Damages in International Investment Law*, pp.244-245.

<sup>304</sup> *ADC v. Hungary*, Award, 2 October 2006, para.497. The *ADC v. Hungary* case is exceptional because the value of the property rarely increases after the expropriation.

<sup>305</sup> ACIA article 14(2)(b). See UNCTAD (2012), *Expropriation*, p.116.

<sup>306</sup> *Siemens v. Argentina*, p.122, para.379.

<sup>307</sup> *Idem*, p.123, para.387.

account not only the amounts invested up to date of expropriation, but also the loans made after that date,<sup>308</sup> considered as “incidental expenses”.<sup>309</sup> In order to give better protection to ASEAN investors, tribunals may adopt the same line of reasoning as the three awards discussed above on the issue of the applicable standard of compensation.

Some agreements currently take into account other relevant factors for calculation of indirect expropriation compensation. For example, SADC Model article 6.2 introduces an innovation of “fair and adequate” compensation, “based on an equitable balance between the public interest and interest of those affected”. It provides an indicative list, such as earlier misconduct of investors, cleaning costs associated with damage to the environment, current and past use of the property, history of its acquisition, fair market value of the investment, purpose of the expropriation, extent of previous profit made by the foreign investor through the investment, and duration of the investment. COMESA CIA article 20(2)<sup>310</sup> also provides for this: “compensation may be adjusted to reflect the aggravating conduct by a COMESA investor or such conduct that does not seek to mitigate damages.” As a result, all relevant circumstances will be taken into the calculation of compensation. The arbitrators may assess compensation beyond fair market value and purely financial factors, by including non-financial factors.

This approach posits clearly a presumption in favour of fair market value as one factor of assessment of indirect expropriation among others. It seems to strike a better balance of public and private interests, because it gives tribunals more discretion to survey other relevant factors. However, the ACIA does not adopt this approach and leaves to tribunals to apply the principle of “full” or “fair” reparation, according to the new interpretation of the *Chorzów Factory* case, in combination with other relevant non-financial factors. Supposing that these formulations provide a useful indication, they ultimately leave the choice of an appropriate valuation method to arbitrators before a concrete case with the assistance of experts.

Even though the ACIA imposes four conditions that States have to fulfil, their effectiveness should be questioned. The public purpose condition is largely subject to a State’s discretion to prioritise its affairs, and any hidden discriminatory intent is very difficult to determine. The tribunal has to limit itself to a supplementary role for these first two criteria. However, while the tribunal may have more exercise on the examination of compensation and due process of law, the amount of compensation and the compliance

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<sup>308</sup> *Vivendi v. Argentina*, Award 20 August 2007, para.8.3.19. See also paras.8.2.3, 8.2.5, 8.2.7.

<sup>309</sup> See detailed discussion of “incidental expenses” in Ripinsky, S., Williams, K. (2008), *Damages in International Investment Law*, pp.299-306.

<sup>310</sup> COMESA CIA article 20(2).

with due process of law depend basically on the State's legislation. The more pressing concern is that investors tend to base their claims on undefined indirect expropriation and yet tribunals do not have guidelines to determine whether the State's measure is, in the first place, an expropriation.

#### **4.1.2 Specificity: Increased-Predictability Model and Reaffirming the Right to Regulate**

ASEAN host States need to protect the public interest by maintaining their regulatory space within which they will not be pursued for compensation, even though their measures may harm ASEAN investments. Nonetheless, this does not mean that ASEAN Member States are permitted to harm investments as they wish. Therefore, several techniques are designed to differentiate indirect expropriation from regulatory measures. The challenge is to achieve the right balance between public and private interests.

The assessment of indirect expropriation involves a case-by-case factual inquiry, requiring a balancing of factors. Similar to most IIAs, the ACIA rarely tries to define concrete cases of outrageous acts of indirect expropriation. It has rather attempted to define indirect expropriation in a negative way, by describing regulatory measures that must not be considered indirect expropriation. The ACIA has opted three techniques used in recent investment treaties: (1) general exceptions and security exceptions; (2) exclusion of specific matters, and (3) explanatory annex to expropriation provision. These techniques are not usually found in old-fashioned BITs. As mentioned *supra*, the ACIA is unusual in that it has combined all three techniques in its text, while some IIAs have only one or have combined only two techniques.

Some significant differences are found in the actual techniques used in the ACIA. These differences, further examined below, denote the "ASEAN Way" of investment protection. These ASEAN specific elements illustrate more concern for ASEAN host States. The ACIA uses these techniques in order to advise tribunals in the interpretation, which, in turn, leaves less room for tribunals to create their own criteria. These techniques are used to provide more margin of manoeuvre for ASEAN host States. Annex 2 demonstrates that ASEAN Member States concerns protection of their regulatory power, resulting in a precautionary approach regarding expropriation and compensation.

Pursuant to the indicators set out in Annex 2, tribunals will decide whether the threshold has been crossed from legitimate regulatory action to compensable expropriation. However, as these criteria give a wide margin of manoeuvre to the ASEAN host States, there is less chance that the tribunal will find a non-discriminatory regulatory measure to

be in breach of an expropriation standard. As the nature of indirect expropriation is not as visible as that of direct expropriation, it will only be found when the tribunal decides it to be so. Once an act or omission of an ASEAN Member State is considered an act of expropriation, the tribunal will continue to determine whether the expropriation is lawful, discussed in Section 4.1.1.2. In addition, while the ACIA has attempted to maintain the general conditions and formula, as discussed in 4.1.1.3, it gives specific details on compensations and “appropriate interest” in case of delay.

#### **4.1.2.1 Specific Details on Compensations**

ASEAN host States are required to compensate ASEAN investors only to a no less favourable degree than that it accords, in like circumstances, to their nationals. Footnote 10 provides that any measure of expropriation relating to land and its payment of compensation must be as defined in the Member States’ respective existing domestic laws and regulations.<sup>311</sup> This approach reflects the ASEAN Member States’ attempts to retain maximum sovereignty over sensitive matters. It underlines the importance of the ASEAN Member States’ laws in the interpretation of ACIA article 14.

Despite the formula of “prompt, adequate, and effective compensation”, “Member States understand that there may be legal and administrative processes that need to be observed before payment can be made”.<sup>312</sup> This approach reasonably gives some flexibility to the ASEAN host States and better responds to realities of their administrative system and financial resources. As a result, ASEAN investors may have to tolerate delay for some justifiable time. Some IIAs even allow a host State to pay the compensation yearly over a period agreed by the parties, in the case that the awards are significantly burdensome.<sup>313</sup>

Even though the ACIA does not fix a specific time of payment, ACIA article 14(3) imposes an obligation to pay “appropriate interest”<sup>314</sup> in case the payment of the principal amount of compensation is delayed. Arbitral tribunals should take into account specific facts and laws of the case in order to determine the date from which the payment is considered delayed, and the interest begins to accrue. These specific details given in the ACIA illustrate the ACIA’s attempts to strike a balance between investors’ and host States’ interests and concerns.

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<sup>311</sup> ACIA footnote 10.

<sup>312</sup> ACIA footnote 11.

<sup>313</sup> COMESA CIA article 20(5), SADC Model BIT section 6.4.

<sup>314</sup> The term “appropriate interest” in the ACIA may be equivalent to the term “commercially reasonable interest” found in other modern IIAs, for example, COMESA CIA article 20(3). Pursuant to ACIA article 14(3), the “appropriate interest” is calculated “in accordance with the laws and regulations of the Member State making the expropriation”.



#### 4.1.2.2 General Exceptions and Security Exceptions

The ACIA provides “general exceptions” in its article 17 and “security exceptions” in its article 18. Exception provisions are rarely found in old-styled BITs, including the IGA. The “exception” is the first technique used to explicitly affirm the regulatory right of the States in order to protect certain public interests. The ACIA employs “general exceptions” in order to exclude every governmental measure considered necessary for public policy objectives from the scope of the treaty as a whole. Most of these general exceptions clauses are modelled on GATT article XX and GATS article XIV.<sup>315</sup>

Meanwhile, “security exceptions” may be invoked by an ASEAN Member State for the protection of its essential security interests, such as in time of war or other emergency in domestic or international relations; to protect critical public infrastructure, including communication, power and water infrastructures, from deliberate attempts intended to disable or degrade such infrastructure; or to take any action pursuant to its obligations under the United Nations Charter for the maintenance of international peace and security.<sup>316</sup>

The ACIA asserts that an ASEAN host State can exercise its regulatory power in normal circumstances. ACIA articles 17 provide that nothing in the ACIA can be construed to prevent the adoption or enforcement by any Member State of measures: necessary to protect public morals or to maintain public order; to protect human, animal or plant life or health; necessary to secure compliance with laws or regulations on a contract; relating to the protection of the privacy of individuals; safety; imposition or collection of direct taxes in respect of investments or investors of any Member State; national treasures of artistic, historic or archaeological value; natural resources.

The ACIA also provides “safety valves”<sup>317</sup> which ensure that the exceptions are not abused by ASEAN Member States. Other investment treaties that incorporate general exceptions include similar provisions.<sup>318</sup> Pursuant to ACIA article 17(1), the measures concerned must not be applied “in a manner which would constitute a means of arbitrary or unjustifiable discrimination between Member States or their investors where like conditions prevail, or a disguised restriction on investors of any other Member State and their investments.”

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<sup>315</sup> Canada Model BIT article 10 General Exception; US Model BIT article 18 Essential Security.

<sup>316</sup> ACIA article 18.

<sup>317</sup> UNCTAD (2012), *Expropriation*, p.89.

<sup>318</sup> See e.g. 2004 Canada FIPA, article 10.

Compared to other IIAs, the ACIA gives more clarification regarding the use of public order exception. Its footnote 12 emphasises that “the public order exception may be invoked by a Member State only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.” Nonetheless, the existence of a “serious threat” is primarily appreciated by an ASEAN host State, while tribunals consider characters of arbitrariness, discrimination or bad faith of measures concerned.

Articles 17 and 18 confirm the ASEAN Member States’ right to regulate within their sovereign power by excluding the measures that States may adopt or enforce as they deems necessary to public order or to protect essential security interests. These regulations are immune from being categorised as indirect expropriation. If a tribunal establishes that the challenged measures fall within one of these exceptions, it appears that the ASEAN Member State may not be held liable for violating any of the ACIA’s substantive protections. However, in case of a direct expropriation, existence of these exceptions presumably does not exclude payment of compensation.<sup>319</sup>

While the ACIA attempts to balance between States’ and investors’ interests by including these exceptions, this practice is limited in that these exceptions carve out only measures relating to public policy objectives which are specifically listed in the exceptions clauses. In fact, there may be some public-interest measures which are not on the list but which still can be considered non-expropriatory and non-compensable. Hence, the ACIA combines the exception technique with the exclusion and explanation techniques, discussed in the following sections.

#### **4.1.2.3 Exclusion of Legitimate Public Welfare Measures**

The ACIA also adopts the “exclusion” technique used in the 2004 US and Canada BIT Models. Annex 2(4) explicitly excludes measures taken by an ASEAN Member State with a legitimate public welfare objective from the definition of an indirect expropriation. A State is not obliged to pay compensation, even though the regulations may have harmful effects on an ASEAN investment. The tribunal may not categorise these regulations as an indirect expropriation, except where they are adopted or applied in a discriminatory manner.

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<sup>319</sup> Newcombe, A., Paradell, L. (2009), p.506.

Although the ACIA provisions are based on US and Canadian models,<sup>320</sup> there are some significant differences. US Model BIT Annex B(4)(b) provides an exclusion on specific matters but with room for exceptions:

*Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations. [Emphasis added.]*

Canadian Model FIPA Annex B.13(1) formulates exceptions with illustration:

*Except in rare circumstances, such as when a measure or series of measures are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good faith...[Emphasis added.]*

This “in rare circumstances” exception may allow a tribunal to rebut the presumption of non-expropriation of measures protecting legitimate public welfare objectives and find such State measures indirect expropriation. On the contrary, ACIA Annex 2(4) does not include this exception in its provision. It is written in an “unconditional” manner.<sup>321</sup> This means that the ACIA has taken more a robust position than its inspiring models, which grant more regulatory space to ASEAN Member States. Consequently, any non-discriminatory measures of an ASEAN Member State, designed and applied to protect legitimate public welfare objectives, do not constitute an indirect expropriation.

The term “legitimate public welfare objective” can cover a wide range of governmental aims.<sup>322</sup> The COMESA CIA explicitly refers to the customary international law principles on police powers, in order to guide the interpretation of the term “legitimate objectives”.<sup>323</sup> Although the ACIA does not refer to the customary international law on this matter, its provisions demonstrate the intention of ASEAN Member States to interpret this exclusion in a broad manner. The ACIA mentions, as examples, public health, safety and environment.<sup>324</sup>

This technique of exclusion is an effective solution for the determination of what does not amount to indirect expropriation. Yet there may be an area of uncertainty as to

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<sup>320</sup> 2004 US Model BIT Annex B.4.a, 2004 Canadian Model BIT.

<sup>321</sup> UNCTAD, *Expropriation*, p.130

<sup>322</sup> See e.g. *Marvin Feldman v Mexico*, ARB(AF)/99/1, 16 December 2002, 18 ICSID Rev-FILJ 488 (2003), para.103. The “governments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like”.

<sup>323</sup> COMESA CIA article 20(8).

<sup>324</sup> ACIA Annex II(4).

whether the measures in question intend to protect legitimate objectives. Hence, tribunal need to refer to the factors provided in ACIA Annex 2(3).

#### **4.1.2.4 Factors Establishing Indirect Expropriation**

ACIA Annex 2(3) contains a non-exhaustive list of factors or decisive criteria which serve as guidance in the assessment of whether a measure or a series of measures departs from the normal activity of the State and constitutes indirect expropriation, for which the ASEAN Member State owes compensation. Among other factors, the ACIA requires a tribunal to use, at least, three elements set out in Annex 2, on a cumulative basis. These three elements are: economic impact of the government action, the government's prior binding written commitment and the character of the government action.

##### **(1) Economic Impact of the Government Action**

The tribunal must consider the economic impact of the government action, *i.e.* assess whether it causes “persistent or irreparable obstacle to the claimant’s use, enjoyment or disposal of its investment”<sup>325</sup> or total or nearly total loss of control of the investment’s value.<sup>326</sup> In practice, the difficulty lies in establishing the exact level of deprivation of property rights of the investor. Nonetheless, although substantial and effective deprivation of the economic value of an investment is a necessary and an important condition, Annex 2(3)(a) emphasises that economic impact, “standing alone”,<sup>327</sup> does not suffice, to establish that an indirect expropriation has occurred. This ACIA approach clearly rejects the “sole effects” doctrine.

Arbitral tribunals should give due deference to the choices of ASEAN Member States when deliberating issues of priority of public purpose and suitability of the measure for achieving such a purpose. The ACIA has a specific mechanism for the determination of whether the taxation measure in question has an effect equivalent to expropriation or nationalisation.<sup>328</sup> In the case of dispute, upon request from the disputing Member State, the disputing Member State and the non-disputing Member State must hold consultations with a view to determining the existence of an expropriation within 180 days after the date of such referral. Investors are allowed to submit a claim to arbitration only if they have first referred to the competent tax authorities of both Parties in writing, and if the competent tax authorities of both Parties fail to agree that the taxation measure is not an

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<sup>325</sup> *Generation Ukraine v. Ukraine*, Award, 16 September 2003, para.20.32.

<sup>326</sup> See for example, *Sempra v. Argentina*, ICSID Case No.ARB/02/16, Award 28 Sept 2007, para.285.

<sup>327</sup> ACIA Annex 2(3)(a).

<sup>328</sup> ACIA article 36(7), Conduct of Arbitration. Similar mechanism of joint decision of tax authorities is found in the US Model BIT (2004, 2012), Canada FIPA, AANZFTA, ASEAN-PRC and ASEAN-Korea investment agreements.

expropriation.<sup>329</sup> The effect of the determination is such that a tribunal has to accord “serious consideration” to the decision.<sup>330</sup> In reality, if the Parties jointly determine that a measure does not constitute an expropriation measure, it is difficult for a tribunal to depart from such a joint declaration.

## **(2) Interference with Investor’s Expectations**

In the US or Canadian BITs, the term “legitimate expectations” figures in the provision and is read as “the extent to which the government action interferes with distinct, reasonable investment-backed expectations.”<sup>331</sup> The notion remains vague, even though the text adds the term “distinct” and “reasonable” to clarify it. On this issue, the ACIA proposes a more precise meaning of legitimate expectation, by concluding that an ASEAN investor can have legitimate expectation only in the case that he/she possesses “government’s prior binding written commitment”. As a result, the ASEAN Member States can avoid being liable due to “legitimate expectations” that do not derive from the host State’s legal obligations.

The legitimate expectation of the investor originates from the legal framework of the host State as it stands at the time the investor acquired the investments.<sup>332</sup> This notion is usually debated in the context of the FET standard.<sup>333</sup> Its application in the expropriation context is narrower than its application in the FET, because the scope of expropriation is limited to property rights. Hence, the question is how to balance between the legitimate expectation on the legal stability of investor’s property rights and the legitimate and reasonable regulatory right of the ASEAN Member States.

States have a right to regulate investments in their territory. At some point during an investment’s cycle, an ASEAN host State may change its laws based on governmental policies and evolving circumstances. This tension is particularly evident when the change of general legal frameworks impacts on an existing investor-State contract or quasi-contractual relationship, such as a permit, license or authorisation issued by the government to a private entity.

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<sup>329</sup> ACIA article 36(9). See also footnote 694.

<sup>330</sup> ACIA article 36(8).

<sup>331</sup> Annex B 13(1)(b) 2004 Canadian Model BIT. Also see Article 4 (b)(2) China-Colombia BIT (2008), Annex 10-B 3(a)(ii): Expropriation of the Australia-Chile FTA (2008), Annex 13: Expropriation of the China-New Zealand FTA (2008).

<sup>332</sup> See *e.g. Tecmed v. Mexico*, Award, 29 May 2003, para.154; *GAMI v. Mexico*, Award, 15 Nov 2004, paras.93-94; *BG Group Plc v. Argentina*, Final Award, 24 Dec 2007, para.298; *National Grid v. Argentina*, Award, 3 Nov 2008, para.173. See Schreuer, C, Kriebaum, U. (2009), “At What Time Must Legitimate Expectations Exist?”, in Werner, J., Ali, A.H., *A Liber Amicorum: Thomas Wälde - Law beyond Conventional Thought*, London, Cameron May, pp.265-276.

<sup>333</sup> More discussion in section 4.2 FET.

Arbitral tribunals and scholars have repeatedly pointed out that investment treaties may not serve as *de facto* insurance against ordinary commercial risks.<sup>334</sup> They cannot act to freeze the law unless those changes are contrary to a specific commitment made by the State to refrain from making such changes. In the same vein, the existence of the ACIA is not a guarantee of the immutability of the laws on foreign investments, or other general laws which affect investments of ASEAN investors.

Under the ACIA, “legitimate expectation” is not a sufficient factor to determine expropriation. ASEAN investors must legally rely on only the “government’s prior binding written commitment”.<sup>335</sup> Such written commitment can serve as a waiver of regulatory power regarding future regulatory treatment by restraining future use of its sovereign power for a period of time. The commitment can be by contract, license or other legal document, as well as by approval in writing in the case that an ASEAN Member State requires this at the admission of investment.<sup>336</sup> Accordingly, where an ASEAN host State has not originally provided any specific written commitment to the investor that it would renew the contract, the refusal to renew such a contract may not be deemed indirect expropriation.

From a broader perspective, the requirement of a written commitment improves the transparency of the ACIA, because the tribunal will investigate only whether there is a written commitment, and not the undefined notion of “legitimate expectation”. However, this requirement illustrates the restrictive approach of the protection of investor’s rights under the ACIA, as it obviously supports the regulatory capacity of the State for public interests. The assessment of legitimate expectations is by no means an exclusive test to be applied to an alleged indirect expropriation.<sup>337</sup> Particularly, legitimate expectations cannot be assessed in isolation from the character of the governmental action or its economic impact,<sup>338</sup> discussed *infra*.

The ACIA has set a highly objective and formal threshold relating to investor expectations for purposes of expropriation claims under the ACIA. As a consequence, some wronged investors may attempt to claim the breach of FET standard, as the FET

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<sup>334</sup> See *e.g. Oscar Chinn Case* (UK v. Belgium), Judgment, 12 December 1934, PCIJ Series A/B, No.63 (1934), para.88; *Marvin Feldman v Mexico*, ARB(AF)/99/1, 16 December 2002, 18 ICSID Rev-FILJ 488 (2003), para.112; *CME Czech Republic BV v. The Czech Republic*, UNCITRAL, Final Award, 14 March 2003, para.562; *AES v. Hungary*, ICSID Case No.ARB/07/22, Award, 23 Sept 2010, para.9.3.34. See Reinisch, A. (2008), “Expropriation”, p.433.

<sup>335</sup> ACIA Annex 2(3)(b).

<sup>336</sup> See details of requirement of “approval in writing” in Section 3.1.2.2.

<sup>337</sup> Paulsson, J, Douglas, Z. (2004), “Indirect Expropriation in Investment Treaty Arbitration”, in Horn, H., Kröll, S. (Eds.), *Arbitrating Foreign Investment Disputes*, the Hague, Kluwer Law International, p.157.

<sup>338</sup> Newcombe, A. (2005), p.38.

seems to be less exigent than the expropriation claim. However, from the discussion in chapter 4.2, the FET standard of the ACIA also has a narrow reading of legitimate expectations, and the investor may only base his or her claims on the lack of due process or the denial of justice.<sup>339</sup>

The ACIA emphasises that the unlawful expropriation standard and the FET standard are two distinctive standards. The finding of the breach of unlawful expropriation right is not equivalent to the breach of FET standard, and *vice versa*.<sup>340</sup> Nonetheless, it is also true for the ACIA that “the line separating indirect expropriation from the breach of FET can be rather thin”,<sup>341</sup> particularly if the breach of the FET standard is “massive and long-lasting”.<sup>342</sup> In most decisions where tribunals find a breach of lawful expropriation obligations, they also find a breach of FET. In practice, the amount of compensation may not be different, whether the State’s conduct is held in breach of one or two obligations. The tribunal, however, must not concern itself only with compensating losses, but must also specify which right has been breached.

### **(3) Character of the Government Action: Question of Proportionality**

ACIA Annex 2(3)(c) requires that tribunals take into account the “character of the government action” as a third factor for determination of indirect expropriation. In the US or Canadian Model BITs, the term “character” is not defined. Compared to the lack of clarity of its models, the ACIA has the advantage of specifying that the character of the action relates to its objective and its proportionality *vis-à-vis* public purposes referred to in article 14(1), discussed *supra*.

Among the three factors, the “character of the government action” is the most difficult to use, because character is less concrete than economic impact or a writing commitment. Generally, the ACIA gives ASEAN Member States a wide margin to determine their action in public interests. It has recognised that national authorities are the ones who make an initial assessment of the existence of a public concern underlining such dispossessing measures.<sup>343</sup> After a tribunal finds that measures taken by an ASEAN host State have totally deprived of the value of an investment (factor 1) and it is satisfied with an evidence of a government’s prior written commitment (factor 2), the tribunal proceeds

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<sup>339</sup> ACIA article 11(2)(a). See detailed discussion in section 4.2.

<sup>340</sup> ACIA article 11(3).

<sup>341</sup> *Enron v. Argentina*, Award 22 May 2007, para.363.

<sup>342</sup> *Sempra v. Argentina*, Award 28 September 2007, para.301.

<sup>343</sup> OECD, (2004), *Indirect Expropriation” and the “Right to Regulate” in International Investment Law*, WP on International Investment, No.2004/4, Paris, p.17.

to test the expropriatory character of the government action,<sup>344</sup> in order to distinguish compensable expropriation from non-compensable regulation.

The principle of proportionality in the ACIA is a state-of-the-art feature in investment treaties. This principle has not been universally recognised in classic BITs as relevant in the expropriation context,<sup>345</sup> and it is also relatively unfamiliar to the ASEAN Way of investment protection. Nonetheless, investment arbitral tribunals have taken the principle of proportionality from the *TECMED v. Mexico* case onwards.<sup>346</sup> After finding that the deprivation had been total, the tribunal proceeded as follows:

...the Arbitral Tribunal will consider, in order to determine if they are to be characterized as expropriatory, whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account that the significance of such impact has a key role upon deciding the proportionality. ... There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure.<sup>347</sup>

The tribunal weighed the specific facts of the case and found that State's denial to renew the permit was disproportionate to the total deprivation of the investment's value. Therefore, it decided that an indirect expropriation had occurred. This approach has been followed in some subsequent cases.<sup>348</sup>

ACIA Annex 2(3)(c) specifically instruct tribunals to examine two issues: objective and proportionality. In this connection, tribunals must investigate whether the expropriation leaves out or goes manifestly beyond public purpose to the extent that the host State is discovered to be in *mala fide*. Firstly, the tribunal must investigate whether the cited purpose is genuine. For instance, the tribunal may find that the taking of the company's property, rights and interests violates public international law, if the measure "was made for purely extraneous political reasons and was arbitrary and discriminatory in character".<sup>349</sup> The public purpose character takes into account the time element. It must be realised before or at the time when the expropriation measure was implemented. The fact that State endorses such a measure *a posteriori* will not reflect genuine public purpose.

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<sup>344</sup> The character of the government action is designed for cases of direct expropriation where the taking itself is self-evident. See UNCTAD (2012), *Expropriation*, p.95.

<sup>345</sup> UNCTAD (2012), *Expropriation*, p.97.

<sup>346</sup> *Tecmed v. Mexico*, Award, 29 May 2003.

<sup>347</sup> *Idem*, para.122.

<sup>348</sup> *Azurix v. Argentina*, Award, 14 July 2006, para.312; *LG&E v. Argentina*, Decision on Liability, 3 October 2006, para.195.

<sup>349</sup> *BP v. Libya*, Award, 10 October 1973, 53 ILR (1979), p.329.



Secondly, tribunals must perform a proportionality assessment by finding a reasonable nexus between the intended public purpose and the effect of the measure. This second question does not aim to scrutinise the legitimacy of the measure. The questions are whether measures exceed normal regulatory powers and fundamentally modify the regulatory framework for the investment beyond an acceptable margin of change, whether the related measure is designed to achieve it,<sup>350</sup> or whether the State's action is obviously disproportionate to the need being addressed.<sup>351</sup> The expropriation takes place, *inter alia*, where "the misuse of otherwise lawful regulation" is found,<sup>352</sup> or where there is "unreasonable departure from the principles of justice" and "abuse of powers".<sup>353</sup>

A question has been especially raised to what extent arbitral tribunals may legitimately intervene in how States regulate their affairs. Deciding instead of the State will otherwise constitute far-reaching intrusion into governmental decision-making and, by that, interference with sovereign power. However, despite all critiques, the fact that the ACIA provides elements of clarification for arbitrators is a positive step towards achieving a more objective definition of indirect expropriation.

## Conclusion to Section 4.1

Compared to traditional BITs, the ACIA expropriation provision is a bold initiative. The ACIA has made an effort to strike a fairer balance between the property right of ASEAN investors and the sovereign right of ASEAN host States. On the issue of indirect expropriation, the ACIA denies the sole effect doctrine and reaffirms the police power doctrine, coupled with elements of proportionality analysis. The ACIA adopts three techniques to guide the interpretation of tribunals: general and security exceptions, exclusions of specific matters, and explanatory annex. The first technique is found in ACIA articles 17 and 18; the second and third techniques in Annex 2. The explanatory techniques are also used several times in footnotes.

Annex 2 offers novel solutions to the reading of the ACIA. It narrows down the extremely vague concept of the "legitimate and reasonable expectations" of the investor into "a government's prior binding written commitment". It also clarifies the "character" of government's actions. As a result, the ACIA may serve as a modern basis for on-going

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<sup>350</sup> See *e.g.* *El Paso v. Argentina*, Award 31 October 2011, para.402.

<sup>351</sup> *LG&E v. Argentina*, Decision on Liability, 3 October 2006, para.195.

<sup>352</sup> OECD Draft Convention on the Protection of Foreign Property (1967), article 3.

<sup>353</sup> Harvard Draft Convention on the International Responsibility of States for Injury to Aliens (1961), article 10(5).

investment treaty negotiations, and may clarify the undefined terms used in the treaties already signed.

The ACIA emphasises States' right to regulate for public purpose which differentiate regulatory measures from indirect expropriation. It ensures *bona fide* regulatory rights of ASEAN Member States and effectively places reasonable regulatory risks on ASEAN investors. It is the duty of any prudent investor to carefully examine laws and regulations before investing in a relevant State. Given the amount of compensation for investment arbitration, ASEAN Member States are relieved of the need to deliberate on the allocation of funds in their budget for the implementation of such regulatory measures,<sup>354</sup> provided that they are non-discriminatory and proportionate. The question remains as to whether ASEAN States' intervention, for economic, social, environmental and other development ends, is able to observe basic standards of good governance for the investment regime, or whether this makes the ACIA regime less attractive because foreign investors may not feel as protected as they previously were.

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<sup>354</sup> See for example, *Yukos v. Russia* (PCA Case No.AA227), Award, September 2014, where US\$50 billion have been awarded against Russia.

## Section 4.2 Fair and Equitable Treatment

Fair and equitable treatment (FET) has been a major battle ground between investors' and States' interests in modern investment treaties. Due to its vagueness, FET was a "Sleeping Beauty"<sup>355</sup> for decades, but now has been kissed awake. However, it is also because of its vagueness that investors can base most of their claims on FET. Tribunals have interpreted FET differently, and sometimes extensively. The most important question regarding FET is how to identify its content. Such content should reflect the right balance between ASEAN investment protection and preservation of freedom of legitimate ASEAN host States' actions.

The FET standard appeared at the same time as BITs.<sup>356</sup> It has gained a particular prominence among investment protection elements. FET has been regularly invoked by claimants in ISDS proceedings with considerable rate of success. However FET interpretation and application is a difficult task, apart from its vague definition, and despite a multitude of scholarly commentary, there is a growing volume of decision tied to the facts of each particular case.

FET is the clearest example of how dubious is the formulation of standard clauses in IIAs. There is a lack of clarity concerning its scope and normative concept. No international attempt has defined what "fair" and "equitable" mean. The prominent use of a FET clause in the context of IIAs can be traced back to Article I of the "Draft Convention on Investments Abroad" proposed by Hermann Abs and Lord Shawcross in 1959:

Each Party shall at all times ensure fair and equitable treatment to the property of the nationals of the other Parties. Such property shall be accorded the most constant protection and security within the territories of the other Parties and the management, use and enjoyment thereof shall not in any way be impaired by unreasonable or discriminatory measures.<sup>357</sup>

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<sup>355</sup> Schreuer, C., "FET Standard as 'Sleeping Beauty'", in Ortino, F. et al., (2007), *Investment Treaty Law: Current Issues Volume II: Nationality and Investment Treaty Claims, Fair and Equitable Treatment in Investment Treaty Law*, London, BIICL, p.92.

<sup>356</sup> FET clauses used in BITs and other IIAs appeared in early international economic agreements such as the Havana Charter for an International Trade Organization (1948) and the Economic Agreement of Bogotá (1948), as well as in the United States Friendship, Commerce and Navigation (FCN) treaties. UNCTAD (2012), *FET*, UNCTAD Series on Issues in IIAs II, New York, Geneva, UN, p.5. For more discussion, see Pinchis, M., "The Devil is in the Details: Using Historical Methodology to Investigate 'Fair and' 'Equitable Treatment' Clauses in Post-War United States' Commercial Treaties", in Hofmann, R., Schill, S., Tams, C. (eds), *International Investment Law and History*, (2016, Forthcoming).

<sup>357</sup> Abs, H., Shawcross, H. (1960), "The proposed convention to protect private foreign investment, *Journal of Public Law*, Vol.9, pp.115-124.

The term “FET” does not “connote a clear set of legal prescriptions”.<sup>358</sup>

Fair and equitable treatment does not have a consolidated and conventional core meaning as such nor is there a definition of the standard that can be applied easily. So far it is only settled that fair and equitable treatment constitutes a standard that is independent from national legal order and is not limited to restricting bad faith conduct of host States. Apart from this very minimal concept, however, its exact normative content is contested, hardly substantiated by State practice, and impossible to narrow down by traditional means of interpretative syllogism.<sup>359</sup>

The ACIA tries to redress this problem and to lessen tribunals’ difficulties of interpretation by designing the FET standard in a more concrete manner. This approach is a novelty and reflects the “ASEAN Way” of investment protection. While some arbitral decisions have tended to read FET extensively, the ACIA puts forward a narrower construction. The standard is found in ACIA article 11, along with the full protection and security treatment. While article 11(1) provides the usual vague principle, article 11(2) gives more detail for the precision of FET.

#### Article 11 ACIA, Treatment of Investment

1. Each Member State shall accord to covered investments of investors of any other Member State, fair and equitable treatment and full protection and security.
2. For greater certainty:
  - (a) fair and equitable treatment requires each Member State not to deny justice in any legal or administrative proceedings in accordance with the principle of due process; and
  - (b) full protection and security ...
3. A determination that there has been a breach of another provision of this Agreement, or of a separate international agreement, does not establish that there has been a breach of this Article.

Compared to the expropriation and transfers provisions under the ACIA, the FET language found in article 11 is minimalist, as it is short and does not contain any exceptions or conditions for its application. Generally, arbitral tribunals have related FET obligation with differing elements, taking into account the myriad of different specific factual contexts: legitimate expectations, manifest arbitrariness, denial of justice and due process, discrimination, abusive treatment.<sup>360</sup> ACIA article 11 requires only the obligation of non-denial of justice from the State. The denial of justice element should be considered the only element of FET to which ASEAN investors have rights. The ACIA practice

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<sup>358</sup> Vasciannie, S. (1999), “FET Standard in International Investment Law and Practice”, *BYIL*, Vol.70, p.101.

<sup>359</sup> Schill, S.W. (2009), *The Multilateralization of International Investment Law*, Cambridge, CUP, p.263.

<sup>360</sup> See generally UNCTAD (2012), *FET*; Dolzer, R., Schreuer, C. (2012), pp.130-160; Salacuse, J. W. (2010), *The Law of Investment Treaties*, pp.218-244; Newcombe, A., Paradell, L. (2009), pp.255-296.

proposes a solution to the vagueness of the FET standard by giving the exact content of FET. This precision solves the problem of extensive interpretation. Its stricter notion of fairness and justice also introduces an element of the “rule of law”<sup>361</sup> in ASEAN economic agreements, in accordance with the objective of a rules-based community.

In order to interpret the exact meaning of FET, ACIA article 11 should be assessed against a general background of FET debate and in conjunction with other potentially overlapping standards of the ACIA, *i.e.* unlawful expropriation provisions.<sup>362</sup> This reading may clarify the authentic notion of “legitimate expectations” under the ACIA. It may guide ACIA tribunals to interpret FET according to ASEAN Member States’ intention and to apply these interconnected core standards consistently throughout the treaty. Section 4.2.1 traces the origins and general content of the FET standard of the ACIA, its broad interpretation and extensive use in investment arbitrations. Section 4.2.2 provides ACIA-specific solutions for these concerns and discusses its implication and effectiveness.

#### 4.2.1 General Practice

To the question of the source of FET, the ASEAN investment treaties have never referred to international minimum standards of treatment of aliens. Their FET is an autonomous self-standing standard. FET appeared for the first time in IGA article IV, which did not refer to any particular measures but generally provided that “investments made by investors of any Contracting Party shall enjoy fair and equitable treatment in the territory of any other Contracting Party”.

In the absence of reference to customary international law of minimum treatment of aliens, together with the imprecise meaning of the FET standard, some tribunals favour a case-by-case interpretation largely depending on circumstances. This has led to substantial interpretative uncertainty. To a large extent, FET has been even praised as an “overriding obligation”, as it encompasses a wider treatment than other standards of protection.<sup>363</sup> As general as FET can be, it “may well be that other provisions [...] offering substantive protections are no more than examples or specific instances of this overriding duty”.<sup>364</sup> The less guidance arbitrators have, the more discretion involves.

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<sup>361</sup> Schill, S. W. (2006), *Fair and Equitable Treatment under Investment Treaties as an Embodiment of the Rule of Law*, IILJ WP 2006/6, Global Administrative Law Series.

<sup>362</sup> See discussion on “investors’ legitimate expectations” in section 4.2.2.3(1). This reading of the ACIA’s approach of FET makes FET an independent standard rather than a duplication of the investor’s backed expectations under expropriation and compensation provisions.

<sup>363</sup> Mann, F.A. (1981), “British Treaties for the Promotion and Protection of Investments”, *BYIL*, Vol.52, p.244.

<sup>364</sup> This approach is also supported by the 1992 World Bank Guideline III.2 that FET is the general standard.

Until recently, authoritative attempts to clarify the normative content of the standard – that went beyond the case-specific application by tribunals – were relatively few. In case of NAFTA, the notion of FET had not been clarified until NAFTA article 1105(1) became the subject of an official interpretation by the NAFTA Free Trade Commission of 31 July 2001. The interpretation states that article 1105(1) reflects the customary international law minimum standard and does not require treatment beyond what is required by customary international law.<sup>365</sup>

FET standard may be an autonomous self-contained concept in the case that a particular treaty does not explicitly link FET to international law, for instance, the Energy Charter Treaty.<sup>366</sup> Instead of inducing FET content from original sources of international law, tribunals have chosen to focus on the literal meaning of the provision, lending themselves to a more general fairness and equity appraisal. Given the expansive interpretation and imbalanced approach, the ACIA tries to clarify what its standard covers, without mentioning other source of FET obligation.

#### **4.2.1.1 FET as an Autonomous Standard of Treatment**

The obligations under FET are mainly determined by reference to an established source of law. The question is which sources of law should be used when determining the proper limits of the discretion to interpret the standard: a broader international law standard and general principles customary international law; or the minimum standard of treatment of aliens under customary international law.<sup>367</sup>

The ACIA FET is autonomous from two perspectives, externally and internally. Regarding the external aspect, firstly, unlike the NAFTA-inspired treaties,<sup>368</sup> the ACIA FET has a content of its own, and is not benchmarked with the minimum standard of treatment of aliens under customary international law. Secondly, ACIA article 11(3) has

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<sup>365</sup> The language of the NAFTA Free Trade Commission's Note has found its way into the subsequent model BITs of the NAFTA countries. US Model BIT 2012 puts FET under article 5 on Minimum Standard of Treatment, which refers to customary international law and emphasizes that the MST do not require additional treatment, nor create additional substantive rights. Its footnote 9 states that the interpretation of the MST shall be in accordance with Annex A. It has also been echoed in a significant and growing number of recent IIAs involving non-NAFTA countries, including the Japan-Philippines FTA (2006), AANZFTA (2009), China-Peru FTA (2009), Malaysia-New Zealand FTA (2009), India-Korea (2009), etc.

<sup>366</sup> ECT article 10(1). See Final Act of the European Energy Charter Conference, Understandings (No.17) with respect to articles 26 and 27, p.28 and Chairman's Statement at Adoption Session on 17 December 1994, p.57.

<sup>367</sup> In the notes and comments to article 1 of the OECD Draft Convention on the Protection of Foreign Property, "the standard required conforms to the 'minimum standard' which forms part of customary international law". See OECD, 1967, p.120.

<sup>368</sup> AANZFTA article 6(1)(c), AKIA article 5(2)(c), Malaysia-New Zealand FTA article 10.10 (Minimum Standard of Treatment) provide that the concepts do not require treatment in addition to or beyond that which is required under customary international law, and do not create additional substantive rights.

provided that the breach of another provision in the ACIA or separate international agreements does not by itself constitute a breach of FET standard. This provision prevents tribunals from automatically finding a breach of FET standard. It dismantles the relationship of different treaty regimes, in particular, where the non-IIA treaty obligations,<sup>369</sup> such as WTO law and IMF Articles, lack an enforcement mechanism like the one existing in the ACIA. If investors could automatically establish violations of FET standard on the basis of a host State's breaches of extra-ACIA laws, this would expose ASEAN host governments to the risk of numerous suits accompanied by compensation claims under the ACIA.

Regarding the internal aspect, FET is independent from the other core standards in the ACIA. Although FET seems to be a more general obligation, this does not mean that a breach of other standards is equivalent to a breach of FET. This independence can be justified regarding different standards. While FET is found in the same article as full protection and security treatment, they structurally figure in separate sub-clauses and implicate two distinct substantive protections.<sup>370</sup>

Moreover, although FET implies non-discrimination, it does not duplicate relative non-discrimination rights such as MFN or national treatment.<sup>371</sup> Relative non-discrimination rights have become insufficient because they are contingent in nature and may not reach the basic expectation of the investors, or may not cover all aspects of non-discrimination principle, which all the more includes religion, sex, age, etc. In this connection, IGA article IV(2) links FET to the MFN standard, while the ACIA applies both MFN and national treatment to FET; *i.e.* FET should be no less favourable than treatment granted to investors of most-favoured nations as well as the nationals of such States.

FET is also distinguishable from unlawful expropriation right, because not all kinds of unfair administrative or governmental conduct concern property rights.<sup>372</sup> The conditions to be fulfilled for a breach of non-expropriation standard are more exigent and more specific, requiring approval in writing and total loss of property right, than those for FET standard violation, which are more flexible and also cover all ranges of potential acts

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<sup>369</sup> Mitchell, A. D. (2008), *Legal principles in WTO disputes*, Cambridge, CUP, p.150.

<sup>370</sup> Under the ACIA, "full protection and security" requires each Member State to take such measures as may be reasonably necessary to ensure the protection and security of the covered investments.

<sup>371</sup> As happened in the *SD Myers v. Canada* case under NAFTA, the majority of the tribunal held that having breached NAFTA's provision on national treatment, Canada had also breached the minimum standard of treatment. *SD Myers v. Canada*, UNCITRAL, Second Partial Award, 21 October 2002.

<sup>372</sup> UNCTAD (2012), *FET*, p.7.

or measures. Nevertheless, it is very likely that, in the same case, a host State may in a breach of several standards cumulatively.<sup>373</sup>

FET's purpose is "to fill the gaps which may be left by the more specific standards, in order to obtain the level of investor protection intended by the treaties".<sup>374</sup> In the context of the ACIA, even though FET is not the overriding obligation, it may be considered as a "gap-filling" device of the ACIA standards, *i.e.* expropriation and non-discrimination standards. In this respect, the ACIA mentions specifically denial of justice and due process as the core of FET standard.

#### 4.2.2.2 Background Discussion: Extensive Interpretation of FET

The variations in language affect the scope of discretion offered to an interpreting body, whether a government official, agency or an arbitral tribunal, and in particular, impact the outcome of the interpretative process. The interpretation may be influenced by the degree of generality or specificity of the wording of a particular treaty, its context, negotiating history or other indications of the parties' intent. There is a view that the vagueness of the phrasing is intentional to give arbitrators the possibility to articulate the range of principles necessary to achieve the treaty's purpose in particular disputes.<sup>375</sup> Similar to traditional BITs, ACIA article 11(1) has provided only a vague provision on the FET standard. Without the following paragraph (ACIA article 11(2)) explaining the content of FET, the ACIA could have rendered an extensive interpretation.

A critical issue of FET interpretation arises out of an increasing reference by arbitral tribunals to the notion of investors' "legitimate expectations", which originally did not exist in FET provisions.<sup>376</sup> The terminology refers to a situation when economic, regulatory or other conditions general or specific to the investment undergo changes negatively and substantially affecting the investment's value against the legitimate expectations of an investor prevailing at the time when the investment is made.<sup>377</sup> Tribunals should determine whether a State is attempting to avoid investment-backed expectations that State created or reinforced through its own acts.<sup>378</sup> A tribunal may read a

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<sup>373</sup> *Sempra v. Argentina*, 2007, para.301.

<sup>374</sup> Dolzer R. (2005), FET: A Key Standard in Investment Treaties, *Int'l Law.*, Vol.39, p.90.

<sup>375</sup> OECD. (2004), *FET Standard in International Investment Law*, WP on International Investment, No.3, p.3.

<sup>376</sup> *Tecmed v. Mexico*, Case No.ARB (AF)/00/2, Award 29 May 2003, para.154. The tribunal held that fair and equitable treatment requires "provid[ing] to international investment treatment that does not affect the basic expectations that were taken into account by the foreign investors to make the investments."

<sup>377</sup> *Bayindir v. Pakistan*, ICSID Case No. ARB/03/29, Date of Dispatch to the Parties: August 27, 2009

<sup>378</sup> Paulsson, J. (2000), "Investment Protection Provisions in Treaties" in International Chamber of Commerce, *Investment Protection*, No.8, Vol.19, p.22.



FET clause against the background found in the preambles of many BITs, that the main objective is emphasising investor protection. Pro-investor interpretation runs the risk of the true purpose of fair and equitable concept in BITs being lost under the weight of investor concerns alone.

Due to this lack of definition, FET obligation can be seen as lacking legitimacy as a legal norm.<sup>379</sup> This raises the issues of legitimate expectation, which involves reasonableness and proportionality.<sup>380</sup> The tribunal in *Saluka v. Czech Republic* considered the case along with the principle of proportionality arguing that “the determination of a breach [of FET] requires a weighing of the claimant’s legitimate and reasonable expectation on the one hand, and the respondent’s legitimate regulatory interests on the other”.<sup>381</sup>

In recent years, tribunals have emphasised the need for States to maintain regulatory space. A balance between the investor’s rights and the host State’s public interests has to be established.<sup>382</sup> “The protection of the legitimate expectations must be balanced with the need to maintain a reasonable degree of regulatory flexibility on the part of the host State in order to respond to changing circumstances in the public interest”.<sup>383</sup>

Hence, it is crucial to determine what kind of investor expectations can be seen as legitimate and in what circumstances they may reasonably arise. Furthermore, it is necessary to strike a balance between the expectations of the investor and those of the host country and its community at large in order to establish proper and more predictable approaches which reflect the actual social, economic and policy context in which foreign investors find themselves.

UNCTAD has illustrated the main concepts relevant in the context of fair and equitable treatment which cover prohibition of manifest arbitrariness, denial of justice and due process, discrimination and legitimate expectations.<sup>384</sup>

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<sup>379</sup> Porterfield referred to Thomas Franck’s definition of a legitimate norm as the one providing reasonably clear guidance concerning the obligation that it imposes. “To be legitimate, a rule must communicate what conduct is permitted and what conduct is out of bounds”. See Porterfield, M.C. (2006), *An International Common Law of Investors Rights?*, U.Pa.J.Int’l Econ. L., Vol.27, Issue 1, p.99.

<sup>380</sup> Salacuse is of opinion that regardless of the different arguments on the issue, it shall be accepted that the MST and FET standard overlap significantly in regards to arbitrary treatment, discrimination and unreasonableness. See Salacuse, J.W. (2010), *The Law of Investment Treaties*, p.227.

<sup>381</sup> *Saluka v. Czech*, UNCITRAL, partial award, 17 March 2006, para.306

<sup>382</sup> *Total v. Argentina*, Decision on Liability, 27 Dec 2010, ICSID Case No.ARB/04/01, paras.123-124, 162, 309,333, 429. See also *Plama v. Bulgaria*, Award, 27 Aug 2008, para.177; *EDF v. Romania*, Award 8 Oct 2009, para.299, *El Paso v. Argentina*, Award, 31 Oct 2011, para.358.

<sup>383</sup> *Lemire v. Ukraine*, Decision on Jurisdiction and Liability, 14 Jan 2010, para.500.

<sup>384</sup> UNCTAD (2012), *FET*, p.xvi.

- (a) Prohibition of manifest arbitrariness in decision-making, that is, measures taken purely on the basis of prejudice or bias without a legitimate purpose or rational explanation;
- (b) Prohibition of the denial of justice and disregard of the fundamental principles of due process;
- (c) Prohibition of targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief;
- (d) Prohibition of abusive treatment of investors, including coercion, duress and harassment;
- (e) Protection of the legitimate expectations of investors arising from a government's specific representations or investment inducing measures, although balanced with the host State's right to regulate in the public interest.

The concern about application and interpretation of FET provisions has also brought to light the need to balance investment protection of ASEAN investors, with competing policy objectives of the host State, in particular, its right to regulate in the public interest. The ACIA follows an emerging trend in IIAs rule-making. It has added substantive content to FET clauses, for more precision in their content and more predictability in their implementation and subsequent interpretation.

Lastly, like other IIAs, ACIA article 11 does not address the issue of criteria of compensation.<sup>385</sup> The question of measuring compensation for breaches of FET has not yet received much attention from arbitral tribunals. However, the compensation stage potentially allows additional room for balancing of relevant interests. It may be useful to allow ACIA tribunals some flexibility to adjust the amount of compensation in light of the circumstances of the case and equitable considerations. Faced with a FET breach, tribunals may award less than full compensation where the measure is at least partially explained by other mitigating circumstances, such as the investor-claimant's own conduct. These facts may affect the chances of a successful FET claim.

#### **4.2.2 Specificity: Specifically Narrow Reading to FET**

Newly-negotiated treaties have the UNCTAD-proposed elements, mentioned previously, into their negotiated texts.<sup>386</sup> However, given many ambiguous subjective elements in the text, one might wonder if these elements really help to clarify the notion of

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<sup>385</sup> See discussion on compensation for a breach of FET standard in Weiniger, M. *The Standard of Compensation for Violation of the Fair and Equitable Treatment Standard*, in Ortino, F., BIICL (2007). *Investment Treaty law: Current Issues Volume II: Nationality and Investment Treaty Claims, Fair and Equitable Treatment in Investment Treaty Law*, London, BIICL; Kaj Hober, "Fair and Equitable Treatment": Determining Compensation, in Hofmann, R., Tams, C.J. (2007). *The International Convention on the Settlement of Investment Disputes (ICSID): Taking Stock after 40 Years*, Baden, Nomos, pp.79-102.

<sup>386</sup> See e.g. the proposed FET clause in CETA, Section 4: Investment Protection, Article X.9: Treatment of Investors and of Covered Investments.

FET. The result remains an open-ended and imbalanced approach, which may unduly favour investor interests and overrides legitimate regulation in the public interest.

ACIA article 11(2) has chosen one element among possible FET elements: denial of justice and due process. While a prohibition of the denial of justice and disregard of due process of law are commonly considered as one of the FET element, the ACIA is specific in that these elements are the only elements of the ACIA FET. In this sense, the ACIA proposes an alternative formulation, a novel approach to addressing key issues in a more restricted and careful manner than traditional FET text. It provides interpretative guidance in the event of future disputes. The language on FET presented in the ACIA is the least likely to lead to misleadingly expansive interpretations by arbitrators.

Two important reasons may support the ACIA's choice of a specifically narrow construction of FET. First, this specificity responds generally to a lack of predictability of the concept of FET. Second, as the ACIA takes into account the level of ASEAN Member State's development, it responds to the need for effective balancing between States' and investors' interests. The ACIA has chosen essential objective elements for the normative content of FET provision, namely, denial of justice and due process.

The concrete content, in turn, grants more legitimacy to FET clauses. This signifies that if FET is put in terms of legitimate expectation, what ASEAN investor can legitimately expect is emphatically the procedural regularity. The fact that the ACIA omits to mention other traditional FET elements make "denial of justice" the only element of FET pursuant to the ACIA. The identified elements may give sufficient grounds which allow cases to be judged on the basis of law in accordance with the Vienna Convention on the Law of Treaties.<sup>387</sup>

#### **4.2.2.1 FET as Non-Denial of Justice and Due Process Standard**

The ACIA has favoured a closed list of situations that amount to a breach of FET obligation, which introduces legal certainty to the content of FET. It is also important to note that no reservations, protecting regulatory measures or regulatory authority from FET provision, are permitted. The ACIA "requires each Member State not to deny justice in any legal or administrative proceedings in accordance with the principle of due process."<sup>388</sup> The concept of "denial of justice" and "due process" presupposes the existence of justice and rules at domestic level, in order to promote the rule of law at regional level, which is also in accordance with the rules-based objective of the ASEAN Community.

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<sup>387</sup> VCLT articles 31, 32. See OECD (2004), *FET Standard in International Investment Law*, p.40.

<sup>388</sup> ACIA article 11(2)(a).

There are two approaches regarding the term “denial of justice”.<sup>389</sup> It may be employed extensively with the general notion of State responsibility for harm to aliens under customary international law, or as in the US Model BIT, which refers to “the principle of due process embodied in the principal legal systems of the world”<sup>390</sup> or to a higher level of an emerging body of global administrative law.<sup>391</sup> In contrast, the narrow sense refers merely to direct intervention by governmental authority and by judicial power. The ACIA’s FET has chosen a narrow reading, its FET takes on only the notion of denial of justice, without referring to external source. This approach is reflected in the *ADC v. Hungary* case where the tribunal held that the State is expected to avail the investors:

Some basic legal mechanisms, such as reasonable advance notice, a fair hearing and an unbiased and impartial adjudicator to assess the actions in dispute... to make such legal procedure meaningful. In general, the legal procedure must be of a nature to grant an affected investor a reasonable chance within a reasonable time to claim its legitimate rights and have its claims heard. If no legal procedure of such nature exists at all, the argument that ‘the actions are taken under due process of law’ rings hollow.<sup>392</sup>

The “denial of justice”, which has been linked to “due process” in legal and administrative proceedings, is fundamental for the interpretation of the scope of FET provisions under the ACIA. Pursuant to the ACIA, the scope of FET relates to all types of governmental conduct – legislative, administrative and judicial alike.<sup>393</sup> The lack of “denial of justice” refers to any action of an ASEAN host State’s organ which leads to the outcome offending “judicial propriety”.<sup>394</sup> In this account, “procedural irregularity” plays a significant role.

Regarding the legal proceedings, the principle of “denial of justice” relates to three stages of the judicial process: (1) the right to bring the claim or access to courts, (2) the right of both parties to fair treatment during the proceedings and (3) the right to an appropriate decision at the end of the process and its enforcement. An affirmative action to deny foreign investors’ access to court, or any unlawful conduct, results in a breach of FET obligation under the ACIA; for example, any undue interference with the ordinary proceedings of

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<sup>389</sup> See generally Brownlie, I. (2008), *Principles of Public International Law*, 7<sup>th</sup> ed. Oxford New York: Oxford University Press; Paulsson, J. (2005), *Denial of Justice in International Law*, Cambridge, CUP.

<sup>390</sup> 2004/2012 US Model BIT Article 5 (2)(a).

<sup>391</sup> Slaughter, A.M. (2004), *A New World Order*, Princeton University Press.

<sup>392</sup> *ADC v. Hungary*, Award, 2 October 2006, para.435.

<sup>393</sup> ACIA article 11(2)(a).

<sup>394</sup> The term “judicial propriety” has been found in several decisions, for example, *Waste Management v. Mexico* (No. 2), Final Award, ICSID Case No.ARB(AF)/00/3, 30 April 2004, para.98; *Loewen v. USA*, Award, 26 June 2003, para.132.

a court, failure to give investors proper notification of court hearing, unjustified decisions, or undue delay in judicial proceedings,<sup>395</sup> corruption of a judge,<sup>396</sup> discrimination against the foreign litigant.<sup>397</sup>

Regarding the denial of justice in administrative proceedings, a wide range of ASEAN Member State's governmental conduct against an ASEAN investor may be challenged as inconsistent with the FET standard; for instance, refusal to issue a permit or revocation to renew an operating licence without giving reasons, or unreasonable procrastinating administrative procedures. A denial of justice may also include a case of "pretence of form"<sup>398</sup> in order to mask a violation of the ACIA.

The next question is the degree of seriousness of breach that is required to activate a compensable claim. Since the ACIA does not tie FET obligation to the customary international law minimum standard of treatment of aliens, tribunals should not limit themselves to the high threshold of liability, as in the *Neer* case.<sup>399</sup> This famous case conveyed a clear message that only the very serious, extreme, egregious or outrageous conduct or maladministration of the host State can be seen as violating the treaty. A line should be drawn between an ordinary error and a gross miscarriage of justice or the gravest instances of injustice by domestic courts.<sup>400</sup> In contrast to the *Neer* case, the violations of FET standard under the ACIA arise out of procedural irregularity of administration or when courts refuse to entertain a suit, and arbitral tribunals consider the State's conduct in question to be simply unfair towards the investor. FET obligations may be breached regardless of whether an ASEAN host State has acted intentionally in bad faith or not.<sup>401</sup>

In order to activate a compensable claim, an ASEAN investor does not need to invoke a duty of State to make full reparation under customary international law, such as that provided by article 31 of the International Law Commission's (ILC) Articles on

<sup>395</sup> Paulsson, J. (2005), *Denial of Justice in International Law*, Cambridge, CUP.

<sup>396</sup> UNCTAD (2012), *FET*, p.80.

<sup>397</sup> *Loewen v. United States*, ICSID Case No.ARB(AF)98/3, Award, 26 June 2003, para.135.

<sup>398</sup> *Azinian v. Mexico*, ICSID Case No.ARB (AF)/97/2, Award, 1 November 1999, para.99. Tribunal further noted, at para.103, that this type of wrong doubtlessly overlaps with a case of "the clear and malicious misapplication of the law".

<sup>399</sup> *Neer*, Mexico-US General Claims Commission, Decision 15 October 1926, 4 Report of International Arbitral Awards.

<sup>400</sup> See e.g. *Loewen v. United States*, ICSID Case No. ARB(AF)/98/3, Award, 26 June 2003, para.242; *Azinian v. Mexico*, para.102.

<sup>401</sup> According to Salacuse, "good faith" or "bad faith" is the notion concerning the motivations of a public authority when dealing with foreign investors. However, no tribunal has found that a State acts in bad faith even if it is found to be in breach of FET, because faith is very difficult to prove, and the tribunal can establish the violation of standards without referring to "faith". See Salacuse, J.W. (2010), *The law of investment treaties*, pp.230, 233-234; The tribunal in *CMS v. Argentina* considered that "such intention or bad faith can aggravate the situation but are not an essential element of the standard". *CMS v. Argentina*, 2005, para.280.

State's responsibility<sup>402</sup> or the principle formulated by the Permanent Court of International Justice in the *Chorzów Factory Case*.<sup>403</sup> Pursuant to the ACIA FET, the wronged investor may invoke the ISDS mechanism wherever such violation has incurred loss or damage on covered investments.<sup>404</sup> Tribunals should ignore minor administrative faults with no consequences. Not all imperfection in a government's conduct or violation by the host State of its own domestic law necessarily amounts to a breach of FET standard. On the contrary, a State may be in a breach of FET obligation even though it has not breached its own laws.

#### 4.2.2.3 Exclusion of Substantive Irregularity

The language used in the ACIA is written in a way to suggest that the FET standard is limited to the denial of justice: "for greater certainty, ... treatment requires" rather than "includes". It is also obvious that denial of justice is the only "specified" element, and not "additional" content on top of customary international law; nor does it comprise other protections that may exist in the minimum standard of treatment of aliens, generally considered as an intrinsic element to the FET standard.

As highlighted above, the ACIA FET only deals with procedural irregularity, and declines to deal with substantive exercise of justice. The consequence is three-fold. Firstly, ASEAN investors seem to have less protection, and in the case that they desire to invoke their right to FET standard, they are obliged to specifically form its claim on procedural grounds. Secondly, *carte blanche* in interpretation of FET was revoked from tribunals. They are no longer capable of extending its consideration over the substance of the host State's acts. Thirdly, and in proportion to the two consequences mentioned above, ASEAN host States have reclaimed a generous part of their sovereignty which was previously unsecured under the vagueness of FET obligations.

The ACIA's positive approach to FET straightforwardly repudiates three categories of tentative FET grounds. Firstly, it refuses to recognise misapplication of the substantive law, where an investment has been affected by gross defects in the substance of the

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<sup>402</sup> Article 31 Reparation, ILC's Draft on Responsibility of States for Internationally Wrongful Acts 2001  
1. The responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act.

2. Injury includes any damage, whether material or moral, caused by the internationally wrongful act of a State.

<sup>403</sup> *Chorzów Factory*, 1927, PCIJ, Series A, No.9, p.2.

<sup>404</sup> ACIA article 29.

judgement itself or “manifestly unjust judgement”.<sup>405</sup> Tribunals are not required to examine if the measures concern abusive treatment of an investor, such as arrest of the investor’s employees and family members, imposition of an unfavourable agreement under physical and financial duress,<sup>406</sup> or continuous interference with activities and management of investment by a State tax authority.<sup>407</sup> These substantive issues are deemed ambiguous and susceptible to unpredictable interpretations.

Secondly, the ACIA FET does not mention the principle of consistency, contrary to the *Tecmed v. Mexico* case, where the tribunal emphasised the need for consistency in the decision-making of a national agency in order to conform to the FET standard.<sup>408</sup> ASEAN Member States have not committed to guarantee consistent application of corresponding laws, regulations, procedures and administrative guidelines. Besides, ASEAN investors cannot invoke FET against measures of targeted discrimination.

Thirdly, the ACIA has altogether discharged the “legitimate expectation” of its FET composition, because this element most conspicuously touches on sovereignty of State. “There can be no doubt... that a stable legal and business environment is an essential element of [FET]”,<sup>409</sup> and investors should be able to predict the applicable investment rules during the whole life of investment in order to make a decision to invest. Therefore, a number of tribunals have considered that the stability of the domestic legal framework is in investors’ “legitimate expectation”.<sup>410</sup> Nevertheless, the incorporation of the vague concept of “legitimate expectation” into FET is particularly troubling, and poses a clear threat to the rights of governments to regulate.

Under the ACIA, a desire to provide a stable legal framework is not identical to a “stability clause”, where the legislation of ASEAN host States cannot change in a way that may negatively affect investors. FET is not a “virtual freezing” of legal regulation of economic activities against the usual State’s regulatory power and the evolution of economic life.<sup>411</sup> The ASEAN Member States preserve their power to change and

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<sup>405</sup> See Article on Responsibility of States for International Wrongful Acts, in Report of the International Law Commission on the Work of its 53<sup>rd</sup> Session, UNGAOR, 56<sup>th</sup> sess. Supp. NO.10 UN Doc A/56/10(2001) art.4.

<sup>406</sup> See e.g. *Desert Line Projects v. Yemen*, ICSID Case No.ARB/05/17, para.194.

<sup>407</sup> See e.g. *Tokios Tokelés v. Ukraine*, ICSID Case No.ARB/02/18, paras.4, 39.

<sup>408</sup> *Tecmed v. Mexico*, Case No.ARB (AF)/00/2, Award 29 May 2003, paras.154, 162 et seq.

<sup>409</sup> *CMS Gas v. Argentina*, ICSID Case No.ARB/01/8, Award 12 May 2005, para.274.

<sup>410</sup> *Metalclad v. Mexico*, ICSID Case No.ARB(AF)/97/1, Award 30 August 2000, para.99; *Tecmed v. Mexico* (2003), para.154.

<sup>411</sup> *AES v. Hungary*, ICSID Case No.ARB/07/22, Award 23 Sept 2010, para.9.3.29: The tribunal in *AES v. Hungary* pointed out that a “legal framework is by definition subject to change as it adapts to new circumstances day by day and a State has the sovereign right to exercise its powers which includes legislative acts.”

strengthen regulatory measures in response to changing circumstances, new knowledge, investors' behaviour, public perceptions of risk, and democratic decision-making.

*A fortiori*, legal certainty and legal security are sometimes contingent on economic and political situations; in the case of a serious crisis or an emergency situation, ASEAN Member States may even invoke exception clauses and react in various ways.<sup>412</sup> In brief, the ACIA FET will not, in an investor-State arbitration, restrict ASEAN host State administrative and governmental action to a degree that threatens the policymaking autonomy of that State, because arbitrators have no ample latitude to second-guess regulators and no ability to impugn government legislative, regulatory, or administrative measures. ASEAN Member States retain the right to regulate in the public interest but they must do so without violating the due process of law.

Contrary to the conventional approach, the close-ended nature of the ACIA FET may turn FET claims into a less popular form of litigation. Nonetheless, even though the ACIA specifies that the FET refers only to “denial of justice”, traditional FET elements may survive ‘*sous le chapeau*’ of “denial of justice”. In other words, tribunals retain latitude of interpretation and application of the FET standard, supposing that they reason within the sphere of denial of justice regarding procedural issues.

## Conclusion to Section 4.2

Without guideline, a tribunal may use “common sense” approach to what is fair and equitable in investigating the components of FET. ACIA article 11 tries to reduce vagueness of its FET standard by adding substantive content to the text. This reading of FET may cool down a heated controversy on the content of FET. The precision proposed by the ACIA leads, to some extent, to more consistency, being predictable in its implementation and subsequent interpretation. This practice shows the willingness of ASEAN Member States to limit tribunals' discretion.

The ACIA FET is not an “overriding” but more balanced standard. It mentions specifically denial of justice and due process of law, which concerns only procedural and not substantive matters. Along this line of discussion, it has been seen that the ACIA was designed by very much taking into account the State's concerns. This is realistic in the sense that ASEAN States commit themselves only to the level that they can achieve. While

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<sup>412</sup> For instance, in *LG&E Energy*, the ICSID tribunal considered whether the measures taken by Argentina during a severe economic and financial crisis which affected adversely the investors' gas distribution licences were arbitrary and therefore violate US-Argentina BIT article II(2)(b). It concluded that the measures taken were not arbitrary because they resulted from reasoned judgment of Argentina seeking to avert a complete economic collapse, rather than a disregard for the rule of law. *LG&E v. Argentina*, ICSID, Case no.ARB/02/1, Decision on liability, 3 October 2006, para.162.



being more precise, the ACIA's approach to FET seems to give less protection to investors than other IIAs, which may render the ASEAN Investment Area less attractive. Despite this drawback, the certainty in the content is better than a vague and extensive content which surely no one comprehends.

Procedural fairness of governmental and judicial authorities is a fundamental requirement when dealing with foreign investment issues within the States, and even more so within the region. For the realisation of intra-ASEAN integration, the quality of a country's administration is a key element in the choices made by foreign investors. These choices mainly rely on a comparative public law approach that takes a cross-view of the restrictions of governmental activity in domestic legal systems that embrace the concept of the rule of law.<sup>413</sup>

It should be borne in mind that the national legal systems of ASEAN Member States are utterly different, from a constitutional system to tiny specific administrative requirements on foreign investment regulations, and that the ACIA FET refers to national treatment standard, and does not allude to the minimum standard of treatment. It is then possible that an ASEAN Member State may be in a breach of FET, if it does not provide reviews by an independent body in any kind of adjudicatory proceedings. In this situation, a denial of justice may arise out of substantive deficits of ASEAN States' laws themselves, *i.e.* where the domestic laws do not allow ASEAN investors to have access to courts or do not empower the authorities to the laws.

It is essential that the FET standard enshrined in the ACIA operates as the expression of an international standard that requires the establishment of a decent and civilised system of justice as reflected in accepted international and national practice. If the application of the relevant principles is a rather fact-specific one, in broader terms, it generally obliges ASEAN host States to establish a judicial system that allows the effective exercise of the substantive rights granted to foreign investors. Hence, although there are effective and efficient laws administrative procedures in some ASEAN countries, the others need to make changes in order to meet a higher standard within a time-bound schedule. This further concerns the questions of legal facilitation and harmonisation in the ASEAN Investment Area.

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<sup>413</sup> Schill, S. W. (2006), *Fair and Equitable Treatment under Investment Treaties as an Embodiment of the Rule of Law*, IILJ WP 2006/6, Global Administrative Law Series, p.4.

## Section 4.3 Transfers

The right to transfers is one of typical standards of protection of foreign investments found in BITs. BITs normally require host States to allow the full range of investments made by the investors of the Parties. Under customary international law, States may impose exchange control restrictions without incurring international responsibility. Investors' exposure to loss comes from the fact that States have sovereign power over their own currency, which relates to both internal and external aspects of their monetary and financial systems.<sup>414</sup> Most ASEAN governments are usually reluctant to accept international legal obligations that would constrain their monetary sovereignty, especially where the "ASEAN Way" esteems so much sovereignty and non-external interference in domestic affairs.

In order to attract investment flows, the ACIA guarantees an investor's right to cross-border transfers in its article 13, which allows both inward and outward transfers of all types of "covered investments". It offers a range of specific guarantees to ASEAN investors to mitigate the risk of arbitrariness of ASEAN host States. In addition, the ACIA typically establishes a number of obligations regarding the manner in which ASEAN host States should treat investments prior to the transfer of the proceeds. These obligations are necessary to render the right to transfers effective.

Under the AEC, freedom to manage funds to and from ASEAN host States is essential for any business operation. The ACIA transfer provision allows freer flow of capital in the ASEAN single market.<sup>415</sup> The transfer provision ensures that a foreign investor is able to enjoy financial benefits from successful investments. In general, States that commit to permit foreign investors to transfer and repatriate proceeds of investments in their territory are more attractive than States with transfer restrictions.<sup>416</sup>

Nevertheless, a notable feature of the ACIA is that it contains a provision that specifically allows for temporary imposition of restrictions on transfers in exceptional circumstances. Although "general exceptions" and "security exceptions" are commonly found in other BITs, this specific economic exception is unusual. The temporary use of

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<sup>414</sup> Zimmermann, C.D. (2013), "A Contemporary Concept of Monetary Sovereignty", *EJIL*, Vol.24, No.3, p.799.

<sup>415</sup> The AEC Blueprint sets the ACIA as a realising tool of a single investment area as ASEAN policy is to allow greater capital mobility.

<sup>416</sup> Dolzer, R., Schreuer, C. (2012), p.212; Newcombe, A.P., Paradell, L.S. (2009), *Law and Practice of Investment Treaties: Standards of Treatment*, p.399.

capital controls as a safeguard measure is similar to rules under the IMF,<sup>417</sup> OECD,<sup>418</sup> and the WTO.<sup>419</sup> Most bilateral and regional investment agreements do not contain such derogations. The general absence of these provisions may be attributable to the general perception that the priority of BITs is to protect FDI, rather than the State.<sup>420</sup>

Among regional agreements in force in the 1990s, only the NAFTA contains such a specific provision. The ACIA has opted for the NAFTA model and become one of the few investment agreements to contain this peculiar feature. Hence, ACIA article 13 contains not only a non-exclusive list of “all transfers relating to a covered investment to be made freely and without delay into and out of” the ASEAN Member State’s territory, but also circumscribes the situations in which the imposition of restrictions on any capital transactions are allowed.

Two observations may explain the derogation provisions provided in the ACIA. First, the objectives and the scope of application of the ACIA are broader than the IGA/AIA agreements. The ACIA covers not only protection but also liberalisation of investment. This means that ASEAN Member States must not only allow the repatriation of the proceeds but also liberalise transfers that are necessary to make new investments. The treatment of transfers for liberalisation purposes reduces the economic and financial policy space of ASEAN Member States. Besides, the ACIA unusually includes portfolio investment in its definition of “investment”, and portfolios investment flows are more volatile than FDI. In the context of a balance-of-payments crisis, it is possible that an ASEAN Member State may be forced to impose restrictions to the investment-related transfers.

Second, ASEAN experienced its greatest financial crisis at the end of last century, where the whole region suffered from the threat of serious balance-of-payments and external financial difficulties. Under the previous regime, there was no exception provision in the IGA allowing States the use of capital control without the possibility of infringing investor’s right to transfers. In that situation, an ASEAN Member State could have only invoked, as defence, the “state of necessity” under customary international law, as codified by article 25 of the 2001 International Law Commission (ILC) Draft Articles on Responsibility of States for Internationally Wrongful Acts. This defence was repeatedly

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<sup>417</sup> IMF Articles of Agreement, Article V: Operations and Transactions of the Fund, Section 3(a) Conditions governing use of the Fund’s general resources.

<sup>418</sup> OECD Code of Liberalisation of Capital Movements, article 7.

<sup>419</sup> GATT, Article XII: Restrictions to Safeguard the Balance of Payments, Article XVIII:B Governmental Assistance to Economic Development.

<sup>420</sup> UNCTAD (2000), *Transfer of Funds*, New York Geneva, UN Publication, p.37.

invoked, with or without success, by the Argentinean Government during its financial crisis in 2001-2002.<sup>421</sup>

For these two major reasons, the ACIA is specifically designed to balance the value of monetary sovereignty and the attraction of the AEC. Given its significance in the ASEAN context, the transfer provision became the longest substantive article in the ACIA. ACIA article 13 provides details on transfers and several categories of exceptions, whereas ACIA article 16 further explains one specific exception regarding measures used by an ASEAN host State to safeguard the balance-of-payments, as follows:

#### Article 13 Transfers

1. Each Member State shall allow 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, including the initial contribution;
- (b) profits, capital gains, dividends, royalties, license fees, technical assistance and technical and management fees, interest and other current income accruing from any covered investment;
- (c) proceeds from the total or partial sale or liquidation of any covered investment;
- (d) payments made under a contract, including a loan agreement;
- (e) payments made pursuant to Articles 12 (Compensation in Cases of Strife) and 14 (Expropriation and Compensation);
- (f) payments arising out of the settlement of a dispute by any means including adjudication, arbitration or the agreement of the Member States to the dispute; and earnings and other remuneration of personnel employed and allowed to work in connection with that covered investment in its territory.

2. Each Member State shall allow transfers relating to a covered investment to be made in a freely usable currency at the market rate of exchange prevailing at the time of transfer.

3. Notwithstanding paragraphs 1 and 2, a Member State may prevent or delay a transfer through the equitable, non-discriminatory, and good faith application of its laws and regulations relating to:

- (a) bankruptcy, insolvency, or the protection of the rights of creditors;
- (b) issuing, trading, or dealing in securities, futures, options, or derivatives;
- (c) criminal or penal offences and the recovery of the proceeds of crime;
- (d) financial reporting or record keeping of transfers when necessary to assist law enforcement or financial regulatory authorities;
- (e) ensuring compliance with orders or judgments in judicial or administrative proceedings;
- (f) taxation;
- (g) social security, public retirement, or compulsory savings schemes;
- (h) severance entitlements of employees; and

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<sup>421</sup> See e.g. *CMS v. Argentina*, ICSID case no.ARB/01/8, Award 12 May 2005; *LG&E v. Argentina*, ICSID case no.ARB/02/1, Decision on Liability, 3 Oct 2000; *Enron v. Argentina*, ICSID case no.ARB/01/3, Award 22 May 2007, *Sempra v. Argentina*, ICSID case no. ARB/02/16, Award 28 Sept 2007; *Vivendi v. Argentina*, ICSID case no.ARB/03/09, Decision on Liability, 30 July 2010; *BG Group v. Argentina*, UNCITRAL, Final Award 24 Dec 2007; *National Grid v. Argentina*, Award 3 Nov 2008.

- (i) the requirement to register and satisfy other formalities imposed by the Central Bank and other relevant authorities of a Member State.
- 4. Nothing in this Agreement shall affect the rights and obligations of the Member States as members of the IMF, under the Articles of Agreement of the IMF, including the use of exchange actions which are in conformity with the Articles of Agreement of the IMF, provided that a Member State shall not impose restrictions on any capital transactions inconsistently with its specific commitments under this Agreement regarding such transactions, except:
  - (a) at the request of the IMF;
  - (b) under Article 16 (Measures to Safeguard the Balance-of-Payments); or
  - (c) where, in exceptional circumstances, movements of capital cause, or threaten to cause, serious economic or financial disturbance in the Member State concerned.
- 5. The measures taken in accordance with sub-paragraph 4(c):
  - (a) shall be consistent with the Articles of Agreement of the IMF;
  - (b) shall not exceed those necessary to deal with the circumstances described in sub-paragraph 4(c);
  - (c) shall be temporary and shall be eliminated as soon as conditions no longer justify their institution or maintenance;
  - (d) shall promptly be notified to the other Member States;
  - (e) shall be applied such that any one of the other Member States is treated no less favourably than any other Member State or non-Member State;
  - (f) shall be applied on a national treatment basis; and
  - (g) shall avoid unnecessary damage to investors and covered investments, and the commercial, economic and financial interests of the other Member State(s).

Footnote 8. For greater certainty, any measures taken to ensure the stability of the exchange rate including to prevent speculative capital flows shall not be adopted or maintained for the purpose of protecting a particular sector.

#### Article 16 Measures to Safeguard the Balance-of-Payments

- 1. In the event of serious balance-of-payments and external financial difficulties or threat thereof, a Member State may adopt or maintain restrictions on payments or transfers related to investments. It is recognised that particular pressures on the balance-of-payments of a Member State in the process of economic development may necessitate the use of restrictions to ensure, inter alia, the maintenance of a level of financial reserves adequate for the implementation of its programme of economic development.
- 2. The restrictions referred to in paragraph 1 shall:
  - (a) be consistent with the Articles of Agreement of the IMF;
  - (b) avoid unnecessary damage to the commercial, economic and financial interests of another Member State;
  - (c) not exceed those necessary to deal with the circumstances described in paragraph 1;
  - (d) be temporary and be phased out progressively as the situation specified in paragraph 1 improves;
  - (e) be applied such that any one of the other Member States is treated no less favourably than any other Member State or non-Member State.
- 3. Any restrictions adopted or maintained under paragraph 1, or any changes therein, shall be promptly notified to the other Member States.

4. To the extent that it does not duplicate the process under WTO, IMF, or any other similar processes, the Member State adopting any restrictions under paragraph 1 shall commence consultations with any other Member State that requests such consultations in order to review the restrictions adopted by it.

The ACIA practice of including such provisions reflects a new and decisive trend in the investment treaty rule-making process. The first part of this section examines article 13 as to the scope and condition of transfer of funds and its implications for deeper economic integration, and then its general application in normal circumstances. The second part explains the particular context in which ACIA article 16 was conceived, *i.e.* the ASEAN Economic Crisis, the necessity of transfer restriction in exceptional circumstances, and the extent to which measures to mitigate the economic crisis are permissible.

As the adoption of these exceptions may provoke capital flight and make the ASEAN Investment Area less attractive, the ACIA has well-defined and internationally accepted criteria. Specific attention should be paid to the interaction of regional investment law and international financial law under multilateral regimes. All ASEAN Member States are members of the International Monetary Fund (IMF), whose jurisdiction and mandate in the area of balance-of-payments assessment overlaps with the scope of application of the ACIA. In order to avoid conflicting rights and obligations under the two treaty regimes, arbitral tribunals should verify if restrictive measures imposed on transfers under the ACIA comply with Members' rights and obligations under the Fund's Articles.

### **4.3.1 General Practice: Article 13 Free Transfers**

The ACIA's transfer provisions protect the investors' right similarly to the treaties of other major capital exporting nations. ASEAN Member States have relinquished part of their monetary sovereignty and aimed higher for the sake of regional economic integration. The ACIA contains a number of common considerations that are of particular relevance to the treatment of transfers, including: (1) scope of investors' rights to make transfers, and nature and types of payments covered by such rights; (2) conditions that States must allow transfers regarding currency convertibility, exchange rate, and time for effecting transfers; and (3) limitations to investors' right, where their transfers may be held for particular reasons.

#### **4.3.1.1 Scope of Transfers**

In order to operate their investments effectively within the ASEAN Investment Area, ASEAN investors need to transfer a wide variety of monies. ACIA article 13

guarantees that every ASEAN investor may freely and without delay conduct transfers relating to its investments into and out of the territory of ASEAN Member State where its investment is located. Such transfers include contributions to capital, including the initial contribution; profits, capital gains, dividends, royalties, license fees, technical assistance and technical and management fees, interest and other current income accruing from any covered investment; proceeds from the total or partial sale or liquidation of any covered investment; and payments made under a contract, including a loan agreement. Investors are also granted the right to transfer payments in case that an ASEAN host State has breached articles 12 (Compensation in Cases of Strife) or 14 (Expropriation and Compensation) of the ACIA, as well as transfer payments arising out of the settlement of a dispute.

In order to be protected, ASEAN investors must demonstrate at least two elements: first, that they have complied with all established procedures for the grant of the transfer permission, for instance, formal application to the relevant government authorities; second, that the funds sought to be transferred falls within the ACIA list of permitted transfers. Unlike the IMF Article and OECD Codes, the ACIA and most of IIAs make no distinction between payments for “current international transactions” and “capital transfers”.<sup>422</sup> In the absence of explicit reference to the purpose or nature of such transfers, the ACIA obliges States Parties to permit all transfers relating to covered investments.

Under the ASEAN investment regime, the ease of transferring funds across national borders has various purposes. Apart from free movement of investment itself, free movement of skilled labour also necessitates transfers of earnings and other remuneration of personnel employed, which allows them to work in connection with covered investments in the ASEAN Investment Area.<sup>423</sup> Where appropriate and possible, States will remove or relax restrictions, facilitate flows of payments and transfers for current account transactions and for capital flows, and support FDI and initiatives to promote capital market development and integration. The AEC Blueprint does not entail a complete removal of restrictions on cross-border capital flows. The commitment is merely limited to “freer” flow of capital than the current situation. The capital mobility within the region remains a large part under the control of ASEAN Member States. They have the policy of progressive liberalisation and very selective approach for capital flow.

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<sup>422</sup> OECD (2013), *OECD Codes of Liberalisation of Capital Movements and of Current Invisible Operations*.

<sup>423</sup> ACIA article 13(1)(g).

#### 4.3.1.2 Currency Convertibility and Time Elements

The transfer obligation requires that investors are able to receive and repatriate amounts relating to investments without any restrictions. Yet, this alone is insufficient to protect their right. Key issues relate, first, to the type of foreign currency and the applicable rate of exchange that the investor is entitled to convert their capital into, especially prior to repatriation; second, to the time element for effecting transfers. The ACIA follows standard practice in this respect.

##### (1) Currency Convertibility and Exchange Rate

ACIA article 13(2) specifies that the currency to be made available to ASEAN investors is “freely usable currency”. ACIA article 4(b) refers this term to the IMF definition. Under the IMF Articles and any amendments thereto, “a freely usable currency means a member’s currency that the Fund determines (i) is in fact, widely used to make payments for international transactions, and (ii) is widely traded in the principal exchange markets”.<sup>424</sup> ASEAN host States are required to let investors convert their incomes and profits into a foreign currency prior to repatriation, so that investors can realise the expected return and repatriated profits. The obligation to allow purchases and outflows of foreign currency significantly limits the monetary sovereignty of ASEAN host States.

Concerning the applicable exchange rate, the ACIA has an approach common to other IIAs.<sup>425</sup> It does not protect ASEAN-investors against the risk of exchange rate fluctuation. The specific exchange rate to be applied in converting domestic currency is at the market rate of exchange prevailing at the time of transfer. As a consequence, the rate of the outward transfer may be lower or higher than that of the inward transfer that ASEAN investors made at the time of the original investment.

##### (2) Time for Effecting Transfers

Another important element which the ACIA guarantees for the profitability of an investment project in the ASEAN Investment Area is the time within which an ASEAN host State must allow an investor to make transfers. ASEAN Member States have agreed to allow all transfers of money to be made “without delay”.<sup>426</sup> Nevertheless, due to its vagueness, the term “without delay” may have several interpretations. Qualification of the

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<sup>424</sup> IMF Agreement article XXX Section f.

<sup>425</sup> See e.g. NAFTA article 1109(2).

<sup>426</sup> NAFTA article 1109 and ECT article 14(2) also require that transfers are to be made without delay. However, as the ECT covers a return in kind, it is possible that such return will be transferred with delayed due to its nature.



term “without delay” is found twice in the ACIA footnotes but without further explanation of the term. Footnote 11 to ACIA article 14(2)(a) on expropriation and compensation, and footnote 15 to ACIA article 41(6) on settlement of disputes expound that transfers under these provisions must be without delay, although there may be legal and administrative processes that need to be observed before payment of the expropriation amount can be made or before an award can be complied with. Some treaties fix the time limit that transfers must not exceed in any case at a six months period,<sup>427</sup> or provide that the transfer period commences on the day on which the request for transfer has been submitted and may not exceed two months.<sup>428</sup> Unfortunately, the ACIA does not fix any time limit for the transfer obligations, and investors may have to wait longer than they would have thought. Yet it is clear from the “without delay” clause that ACIA drafters intended to follow the same rationale as that of treaties setting clearer time-limits.

#### **4.3.1.3 Limitations of Transfers**

Previously, IGA article VII guaranteed the right to repatriation of capital and earning without restriction. However, ACIA article 13(3) now sets some limitations to the right of transfers. The ACIA’s obligation not to restrict payments for transactions is circumscribed by a number of exceptions for specific purposes. Commonly found in modern IIAs, the first type addresses “good governance”, requiring ASEAN host State governments to have legal authority to supervise and regulate financial transfers under specific legislations in normal circumstances. Without this limitation to the transfer obligation, an ASEAN host State may find itself in breach of the transfer obligations. The second type is temporary derogation in exceptional circumstances. This second feature, specific to the ASEAN context, is further discussed in section 4.3.2.

Under normal circumstances, ASEAN investors must respect laws, regulations and administrative procedures of host States concerning money transfers. Investors must register and satisfy other formalities imposed by the Central Bank of a Member State, in order for the relevant State authorities to oversee all inward and outward transfers and so State may be able to prevent potential crisis. Meanwhile, ASEAN host States are not required to abandon measures that ensure compliance with their laws and regulations in order to safeguard national “public order”. ACIA article 13(3) allows States to prevent or delay transfers if those transfers are effectuated under laws and regulations mostly relating to criminal and public laws.

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<sup>427</sup> See *e.g.* 2006 French Model BIT article 6.

<sup>428</sup> See *e.g.* Austria-Philippines BIT article 6.

With respect to civil, administrative or criminal proceedings within an ASEAN host country, proceedings may result in the issuance of a monetary judgement against investors which may attach the proceeds of amounts derived from the foreign investments. In these circumstances, investors will be restricted from making necessary transfers. Regarding the protection of creditor rights, it is not a breach of free transfer obligation when assets related to covered investment are frozen and transfers of payments are restricted, pursuant to bankruptcy and insolvency laws of a host State. Administrators of insolvency proceedings retain the authority to nullify earlier payments that have been made.<sup>429</sup> ASEAN host States may also hold transfers until the tax issue of that ASEAN investor is satisfied, so that such investors cannot evade taxation.<sup>430</sup> Nonetheless, even though ASEAN host States are allowed to regulate transfers under these specific laws, a national supervision power is obliged to apply laws in an equitable, non-discriminatory, and good faith manner. This practice is consistently found in IIAs where limitations to transfers obligation are included.<sup>431</sup>

#### 4.3.2 Specificity: Capital Restriction in Exceptional Circumstances

The issue of economic exceptions within economic integration treaties is highly controversial. While supporting the free transfer principle, from the perspective of both developing and developed countries, exceptions should be allowed,<sup>432</sup> obviously with certain conditions. The ACIA is one of the notable exceptions which explicitly allows for prudential regulation of the financial sector in time of economic emergency. This exception is neither found in other regional investment agreements nor in BITs in force at the end of the 20<sup>th</sup> Century. While most of modern IIAs may have provisions on limitations to transfers, as discussed in section 4.3.1.3, they do not have specific exceptions on balance-of-payments.<sup>433</sup> Indeed, balance-of-payments exceptions are originally found in a bilateral comprehensive investment agreement between Japan and Korea.<sup>434</sup>

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<sup>429</sup> UNCTAD (2000), *Transfer of Funds*, p.36.

<sup>430</sup> ACIA article 13(3)(f).

<sup>431</sup> See e.g. ECT article 14(4).

<sup>432</sup> UNCTAD (2000), *Transfer of Funds*, p.44.

<sup>433</sup> For example, ECT article 14(4). However, Kolo argues that the absence of such an explicit stipulation on balance-of-payment exceptions, a host State may still be able to restrict capital transfers, either ECT article 24 (Exceptions) or under the doctrine of necessity in general international law (as codified in article 25 ILC's Articles on State Responsibility). See Kolo, A. (2010), "Transfer of Funds: the Interaction between the IMF Articles of Agreement and Modern Investment Treaties: a Comparative Law Perspective", in Schill, S.W. (ed.) (2010), pp.357.

<sup>434</sup> 2002 Japan-Korea CIA article 17.

While the IGA (protection agreement) contained no exception to the right to repatriate capital and earnings, emergency safeguard measures provisions appeared in AIA (liberalisation agreement) article 14. These two agreements treat only outflow direct investments. Unlike the previous IGA/AIA regime, the ACIA transfer of fund provision now covers both inflows and outflows of direct and portfolio investments. As a result, the current regime may be more vulnerable to serious balance-of-payments or external financial difficulties.

Contrary to the exclusive list of permitted transfers previously set in IGA article 7, the ACIA adopts more modern approach.<sup>435</sup> ACIA article 13 states a general obligation to allow transfer, combined with a non-exclusive list of permitted transactions, which covers both direct and portfolio investments. The term “transfer” in the ACIA covers a broader category of transfers than the term “repatriation”, previously used in the IGA.<sup>436</sup> While the latter allowed only repatriations of capital and earnings in the post-establishment phase, the former includes both inward and outward transfers in the admission and establishment phase. This more liberal approach of the ACIA should be seen as an exception to general IIAs practice. Only few investment treaties, mainly those negotiated by the US, Canada, and Japan, encompass the pre-establishment phase.<sup>437</sup> Regarding inward transfers, the ACIA covers both transfers made for purposes of making initial investments, and transfers made to develop or maintain existing investments.

The ACIA and some agreements that ASEAN concluded in 2009, such as the AANZFTA and the ASEAN-Korea Investment Agreement (AKIA), are among the first agreements which follow the NAFTA in allowing States to control investment-related transfers in extraordinary circumstances. Model BITs, such as the 2012 SADC Model BIT,<sup>438</sup> include these special economic exceptions in their text. Newly negotiated IIAs, such as CETA, and TTIP,<sup>439</sup> are proposing to include them. To date, the balance-of-payment provisions have not yet been interpreted by any investment arbitral tribunals.<sup>440</sup>

ACIA article 16 provides two scenarios where ASEAN Member States may invoke balance-of-payment exceptions: “serious balance-of-payments and external financial

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<sup>435</sup> See generally UNCTAD (2000), *Transfer of Funds*, pp.24-27. See e.g. NAFTA article 1109, Transfers.

<sup>436</sup> The OECD Codes are the examples of the broad coverage. See OECD (2013).

<sup>437</sup> See Dolzer, R., Schreuer (2012); Palacio I., Muchlinski, P., “Admission and Establishment”, in Muchlinski, P. *et al* (eds.), *The Oxford Handbook of International Investment Law* (2008) p.226, pp.239-245.

<sup>438</sup> 2012 SADC Model BIT article 8, Repatriation of Assets, 8.4 Safeguard provision.

<sup>439</sup> Cf. Public consultation on TTIP (the proposed template is negotiated based on the CETA draft) Article X: Prudential Carve-out, Article X Safeguard measures, Article X BoP.

[http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc\\_152280.pdf](http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf) (Last accessed: 23 September 2015).

<sup>440</sup> Desierto, D. (2015), *Public Policy in International Economic Law: The ICESCR in Trade, Finance and Investment*, Oxford, OUP, p.332.

difficulties or threat thereof” and “economic development”. While the former scenario is commonly found in the NAFTA,<sup>441</sup> AKIA,<sup>442</sup> COMESA<sup>443</sup>, CETA<sup>444</sup> the latter scenario is absent from their texts. The “economic development” exceptions are specifically mentioned in the ACIA and the AANZFTA.<sup>445</sup> These “economic development” exceptions are originally found in GATS.<sup>446</sup>

Several questions arise from the application of exceptions under ACIA article 13 and 16. Economic exceptions may be placed in three stages of reasoning: (1) in exceptional circumstances, such as the 1997 ASEAN Economic Crisis, the 2001 Argentinian Great Depression or the 2008 US Financial Crisis, an ASEAN Member State may invoke balance-of-payment concern as a defence against breach of transfers right of investors; (2) these measures should be in accordance with the IMF Articles; and (3) tribunals should restrict themselves only to the examination of necessity and proportionality of such measures.

#### 4.3.2.1 Background of Exceptions: ASEAN Economic Crisis

In the 1980s-1990s, ASEAN Member States desired to attract foreign investments and became leading investment destination in the developing world by opening up financially as GATT/WTO, GATS, and IMF members. They accepted article VIII of the IMF Articles requiring Members to avoid restrictions on current capital,<sup>447</sup> and deregulated the currency exchange rules which allowed freer flow of capital, in the same time as they concluded IIAs guaranteeing the right to transfers of funds. This engendered the “ASEAN Miracle” where the domestic market exploded.<sup>448</sup>

Early in 1997, excessive capital flows inevitably led to the collapse of exceeded valuations of asset price, while speculative investors attacked rapidly. Large injections of money into a small economy caused distortions in the market.<sup>449</sup> Eventually there was a sudden reversion; foreign investors pulled their money out simultaneously, causing more

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<sup>441</sup> NAFTA article 2104(1) Exceptions, Balance of Payments.

<sup>442</sup> AKIA article 11 Temporary Safeguard Measures.

<sup>443</sup> COMESA CCI article 25 Measures to Safeguard Balance of Payments.

<sup>444</sup> CETA article X.04: Restrictions in Case of BoP and External Financial Difficulties

<sup>445</sup> AANZFTA Chapter 15 article 4, Measures to Safeguard the BoP.

<sup>446</sup> GATS article XII: Restrictions to Safeguard the Balance of Payments.

<sup>447</sup> IMF Articles Agreement, article VIII, General Obligations of Members, Section 2, Avoidance of restrictions on current payments

<sup>448</sup> Krugman, P. (1994), *The Myth of Asia's Miracle*, Foreign Affairs, Essay November/December 1994 Issue 73, Vol.6, p.62.

<sup>449</sup> See Magud, N., Reinhart, C.M. (2006), *Capital Controls: An Evaluation*, NBER WP 11973, Cambridge, MA, National Bureau of Economic Research; Ocampo, J.A., Palma, J.G. (2008), “The Role of Preventive Capital Account Regulations”, in Ocampo, J.A., Stiglitz, J.E. (eds.), *Capital Market Liberalization and Development*, New York, OUP, p.170-204.

panic outward flow which further aggravated the crisis.<sup>450</sup> The balance-of-payments of these countries came under severe pressure. The Asian currencies depreciated, which resulted in economic downturn.<sup>451</sup>

The Asian crisis was primarily caused by the self-inflicted process of external financial liberalisation. ASEAN countries had liberalised capital accounts with the wrong speed and sequencing. Furthermore, the financial systems were not sophisticated enough to deal with a surge of short-term foreign investment inflows, and the ASEAN governments did not have a proper monitoring mechanism.<sup>452</sup> This was the most dramatic economic crisis in Asia since World War II, where the whole region suffered concurrently.

At the time of the 1997 Economic Crisis, the IMF was severely criticised for inappropriate policy advice, which made the situation worse. Eventually, the IMF changed its policy and allowed the use of restrictive measures. ASEAN Governments issued restrictive measures in order to slow down inflows and outflows of short-term capital. They also adopted a tighter monetary policy.<sup>453</sup> This partly solved and prevented further financial instability generated by short-term capital flows.<sup>454</sup>

After the Asian Financial Crisis, ASEAN Member States realised their errant steps in financial liberalisation. Each country shifted its policy priorities considerably to strengthen domestic demand and reform financial systems for more diverse categories of financial instruments. As structural weaknesses were addressed, the ASEAN market became more resilient; this was proved when the 2008 Global Financial Crisis struck the developed countries' markets, but largely spared ASEAN countries.

The absence of balance-of-payment or Fund-related provisions from the IGA agreement indicates that the contracting parties intended to adopt a more liberal regime on outflows. Balance-of-payments derogation provisions are often absent from most bilateral and regional agreements which, when States issues restrictive measures on transfers, raises the question of consistency with the overarching objective of IIAs. Argentina has the highest number of claims which partly relate to the financial crisis, because Argentina invoked the use of economic necessity, where it had no balance-of-payments exception

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<sup>450</sup> Gallagher, K. P. (2010), *Policy Space to Prevent and Mitigate Financial Crises in Trade and Investment Agreements*, G-24 Discussion Paper Series, No.58, May 2010, UNCTAD, p.3.

<sup>451</sup> See types of financial crisis in IMF (2009), *BoP and International Investment Position Manual*, 6<sup>th</sup> Ed.

<sup>452</sup> Duncan, E.W. (2001-2002), "Policy Perspectives on the Use of Capital Controls in Emerging Market Nations: Lessons from the Asian Financial Crisis and a Look at the International Legal Regime", *Fordham Law Review*, vol.70, p.561.

<sup>453</sup> ADB (1999), *Policy Response to the Asian Financial Crisis: An Overview of the Debate and the Next Steps*, Issue May 1999, ADB Publication, p.2.

<sup>454</sup> IMF Staff (2000), *Recovery from the Asian Crisis and the Role of the IMF*, Issue 00/05 <https://www.imf.org/external/np/exr/ib/2000/062300.htm> (Last accessed: 27 Aug 2015).

clause in its treaties. Most arbitral cases have ruled against Argentina and have awarded monetary compensation to the claimant-investors.<sup>455</sup>

To forestall risks, ASEAN Member States have developed more detailed and clearer provisions on balance-of-payment exceptions in the ACIA because of their experiences with exceptional economic and financial circumstances in recent years. Similar discussions have taken place in the European Union context. A free transfer of funds provision is found in most of the extra-EU BITs without any economic exception, in contrast to the TFEU, which contains exceptions to the free movement of capital. Articles 64,<sup>456</sup> 66,<sup>457</sup> and 75<sup>458</sup> of the TFEU permit restrictions on the free movement of capital to and from third countries.

The European Court of Justice (the “ECJ”) ruled in 2009 that the BITs of Sweden<sup>459</sup> and of Austria<sup>460</sup> with non-European countries were in violation of their obligations under the EU treaty. A similar case was, later, filed against Finland.<sup>461</sup> The ECJ recognised investors’ right to move investment-related capital without undue delay. This investors’ right, however, cannot be reconciled with the European Community’s right to regulate the movement of capital between EU Member States and third countries, including restricting capital flows in exceptional circumstances. The ruling found that Austria and Sweden had not fulfilled their obligations under TEC article 307 (now TEFU article 351), which obliges Member States to take appropriate steps to eliminate incompatibilities between their pre-accession agreements and the EC Treaty. The EU trend allows more room for States to regulate in case of emergency.

Given several crises prompted by the failure of global governance to detect the faults in global financial systems, it was time for ASEAN to establish its own credible

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<sup>455</sup> See UNCTAD (2009), *Latest Developments in Investor-State Dispute Settlement*, UNCTAD Doc, IIA Monitor No.1, p.2-3.

<sup>456</sup> TEC Ex-Article 57: TFEU article 64(1) allows Member States to maintain certain restrictions on capital movements in existence on 31 December 1993. TFEU article 64(2) authorises the European Council to regulate the movement of capital “involving direct investment,...the provision of financial services or the admission of security and capital markets”, to and from third countries.

<sup>457</sup> TEC ex-article 59: In the same vein, TFEU article 66 permits the Council to “take safeguard measures with regard to third countries for a period not exceeding six months if such measures are strictly necessary”, such as where the movement of capital causes or threatens to cause serious difficulties for the operation of economic and monetary union.

<sup>458</sup> TEC Ex-Article 60: Under TFEU article 75, the Council may restrict economic relations with third countries, for instance through economic sanctions, including restricting the movement of capital and payments, on the basis of a joint action relating to the common foreign security policy.

<sup>459</sup> C-249/06, Commission v. Sweden.

<sup>460</sup> C-205/06, Commission v. Austria.

<sup>461</sup> C-118/07, Commission v. Finland.

regional financial architecture.<sup>462</sup> The ACIA requires a more precautionary approach. Arguably, the most effective solution to avoid financial disasters is to clarify and establish the ability of the host States to impose restrictions on transfers in response to balance-of-payments crises.<sup>463</sup> Consequently, the ACIA provides specific economic and financial exceptions on top of general exceptions and security exceptions. In this respect, it is important to determine the extent to which measures to mitigate the present crisis or to prevent future crises are permissible under the ACIA. The subsequent sections discuss this in detail; they distinguish between three “stages” of State interference with the free transfer principle.

#### 4.3.2.2 Stage 1: State’s Legitimacy to Economic Exceptions

At a first stage, the free transfer obligation may be temporarily derogated in exceptional circumstances. ACIA article 13(4) provides that ASEAN Member States may impose restrictions on any capital transactions as a temporary measure on a non-discriminatory basis, in three specific circumstances: (a) at the request of the IMF; (b) where the measure is taken to safeguard the balance of payments, under Article 16; or (c) in exceptional circumstances where capital movement causes or threatens to cause serious economic or financial disturbance in the ASEAN Member State concerned.

Capital controls often heighten a country’s financial regulations and seek to limit risk-taking of financial intermediaries and borrowers. There are two broad categories of control.<sup>464</sup> First, administrative or direct controls involve prohibitions on specific types of transactions, for example on quotas, rule-based or discretionary approval, or minimum-stay requirements. Second, market-based or indirect controls rely primarily on explicit or implicit taxation in order to discourage capital flows.<sup>465</sup> Under a serious economic crisis, the importance of economic derogation clauses, as measures of last resort to confront financial chaos, cannot be underestimated.

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<sup>462</sup> Rillo, A.D. (2009), “ASEAN Economies: Challenges and Responses amid the Crisis”, *Southeast Asian Affairs*, Vol.2009, pp.17-27; Sussangkarn, C. (2010), *The Chiang Mai Initiative Multilateralization: Origin, Development and Outlook*, ADBI WP Series No.230.

<sup>463</sup> Even “where the proposed Fund institutional view recognizes the use of inflow or outflow CFMs as an appropriate policy response, these measures could still violate a member’s obligations under other international agreements if those agreements do not have temporary safeguard provisions compatible with the Fund’s approach”. See International Monetary Fund (2012), *The Liberalization and Management of Capital Flows: An Institutional View*, Washington, IMF, p.42.

<sup>464</sup> Ariyoshi, A. et al. (2000), *Capital Controls: Country Experiences with Their Use and Liberalization* 6, IMF Occasional Paper No.190, Part 1: Main Paper, p.6.

<sup>465</sup> *Idem*. In general, indirect, or market-based, controls discourage particular capital movements by making them more costly. Market-based controls often involve explicit or implicit taxation “on external financial transactions, thus limiting their attractiveness.”

Under exception (a), ASEAN Member States are allowed to breach their transfer obligations for the sake of the global financial regime, as the IMF provisions recognise the exchange controls as instrument of economic policy. In this connection, it is useful to remember that all ASEAN member States are also IMF members.<sup>466</sup> In critical situations, the Fund may request Member States to impose capital control in order to prevent large outflows that could make it necessary for them to resort to the Fund for financial assistance. In consultation with the IMF, States may impose restrictive measures, ranging from voluntary standstill arrangements with creditors to limit net outflows of capital or, if necessary and as a last resort, to impose such measures unilaterally. Foreign private investors may not be allowed to repatriate their money freely; they may then be asked to stay the capital, rollover the debt, or even take some losses.<sup>467</sup> Otherwise, the Fund may declare that Member ineligible to use the general resources of the Fund.<sup>468</sup>

For exception (b), ACIA article 16 allows States to adopt or maintain restrictions on payments or transfers related to investments, in the event of external financial difficulties or threat thereof, or for the purpose of economic development. Although these measures may result in unduly delay transfers of funds, an ASEAN host State will not be held in breach of transfer obligations.

In the event of external financial difficulties, the balance-of-payment clause in the ACIA allows an ASEAN host State to impose *new* restrictions on a temporary basis for reasons of balance of payments stability and macroeconomic management; that is, to protect monetary reserves and national currency from abrupt exchange rate fluctuations or devaluation,<sup>469</sup> by means of capital controls, and restrictions on payments or transfers related to investments. This exception is also found in the OECD Codes,<sup>470</sup> the GATS<sup>471</sup> and the IMF Articles.<sup>472</sup>

The ACIA allows also unusual exceptions for “internal” financial difficulties. Article 16(1) contains “transitional derogation” which permits an ASEAN host State to

<sup>466</sup> See list of members and the effective date of membership at <https://www.imf.org/external/np/sec/memdir/memdate.htm>

<sup>467</sup> IMF (2000), *Involving the Private Sector in the Resolution of Financial Crises - Standstills - Preliminary Considerations*, Prepared by the Policy Development and Review and Legal Departments, 5 September 2000. <http://www.imf.org/external/np/pdr/sstill/2000/eng/> (Last accessed: 26 August 2015)

<sup>468</sup> Article VI: Capital Transfers, Section 1. Use of the Fund’s general resources for capital transfers.

<sup>469</sup> Viterbo, A. (2012), *International Economic Law and Monetary Measures: Limitations to States’ Sovereignty and Dispute settlement*, Northampton, MA, Edward Elgar Pub, p.153.

<sup>470</sup> OECD Codes article 7(c) provides that members may temporarily suspend their measures of liberalisation “if the overall balance of payments of a member develops adversely at a rate and in circumstances, including the state of its monetary reserves, which it considers serious”.

<sup>471</sup> GATS article XII.

<sup>472</sup> Article VI: Capital Transfers, Section 3 Controls of capital transfers, referring to article VII, Section 3(b) Scarcity of the Fund’s holdings, after approval and consultation with the Fund.



maintain and adapt *existing* restrictions to changing circumstances on the grounds that its economic position is not sufficiently firm to discard these restrictions.<sup>473</sup> As mentioned earlier, the balance-of-payment exceptions for economic development are ASEAN-specific elements. The balance-of-payment exceptions can be found in multilateral agreements on trades, trades in services or financial services. They are not usually found in IIAs, even in IIAs among developing countries containing balance-of-payment exceptions.<sup>474</sup> Therefore, ASEAN Member States are given more leeway in recognition of their foreign exchange reserve needs.

While the GATT has endorsed reduction in trade barriers as one of the means to promote economic development, its article XII addresses the balance-of-payment exceptions in order to impose quantitative restrictions on imports to safeguard States' balance of payments, by setting conditions relating to the use and subsequent removal of emergency trade measures. ASEAN Member States still need to enact financial restrictions to maintain an adequate level of financial reserves and to implement national economic development or transitional programmes.<sup>475</sup> This reflects the economic landscape of ASEAN Member States still not yet ready for full liberalisation.

The ACIA gives particular attention to the exception (c), where movements of capital cause, or threaten to cause, serious economic or financial disturbance in the Member State concerned. Through this channel, ASEAN host States may defend themselves in exceptional circumstances, without calling upon the principle of necessity under customary international law. However, one might wonder what the term "exceptional circumstances" means. While this term seems to refer to a very narrow set of circumstances, in fact, States can put everything under the name of specific circumstances, which may be markedly even more extensive than situations targeted in sub-paragraph (a) and (b). Hence, despite the fact that States retain discretion to determine whether they are in "exceptional circumstances", ACIA article 13(5) provides a list of criteria that ASEAN host States must observe, namely, consistency with the IMF Articles, necessity to deal with

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<sup>473</sup> IMF article XIV, Transitional Arrangements, provides that a member may maintain and adapt the restrictions that were in effect on the date on which it became a member, by notifying its intention to avail itself of transitional arrangements under this provision to the Fund.

<sup>474</sup> See *e.g.* COMESA CIA article 25.

<sup>475</sup> AIA article 15(1) (Measures to Safeguard the Balance-of-Payments) is added to general exceptions (article 13) and to emergency safeguard measures (article 14). The same provision is found in AANZFTA article 4(3)(a) Chapter 15.

the circumstances, temporariness, prompt notification to the other Member States, MFN, national treatment. These criteria are further discussed in section 4.3.2.4.<sup>476</sup>

### 4.3.2.3 Stage 2: ASEAN under Multilateral Control of IMF

Under stage 1, ASEAN Member States are self-judging in determining whether they are in exceptional circumstance and need to invoke the safeguard of balance-of-payment measures. This ensures the necessary flexibility for ASEAN Member States to adopt crisis management measures. However, concerning investment-related transfers, IMF regulations partially overlap with the scope of the ACIA.<sup>477</sup> At stage 2, ASEAN host States are not self-judging anymore. The ACIA specifically contains substantial and procedural linkages between exchange restrictions and capital controls, and IMF legal framework in order to ensure consistency and avoid norm conflicts between multilateral and regional rules. Questions arise as to the role of the IMF in the process of determination of the legal nature of opinions. Compared to other IIAs with no link to the IMF Articles, the situation under the ACIA is clearer in a sense that articles 13 and 16 expressly refer to the IMF Articles. The following analysis is based on both technical and legal grounds.

First of all, transfer restrictions imposed by ASEAN host States must be in concurrence with IMF Articles. IMF Article VIII(2)(a) establishes a general prohibition on the imposition of restrictions on payments and transfers for current international transactions without the approval of the Fund.<sup>478</sup> Consequently, ASEAN Member States' discretion is limited in the sense that their measures must be approved by the Fund. Muchlinski advocates that the reference to the right and obligations of the host country as a member of the IMF introduces, by implication, the standards of the IMF Articles of Agreement into the investment treaty regime.<sup>479</sup>

The question arises whether the views of the IMF on factual assessment of the host State's exchange restriction measures are binding. While there has never been a case under

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<sup>476</sup> The ACIA mechanism differs from the interpretation mechanism of financial services under the Canadian FIPA and the US Model BIT, which delegate interpretation to joint commissions of host and home State agencies. For financial services, when a State invoking a "prudential measures" exception in an investor-State arbitration, a tribunal cannot decide whether that exception is a valid defence. Instead, the tribunal must seek a report on the disputing issue from the treaty Parties, who may then issue a joint decision that is binding on the tribunal. See Canada FIPA (2004) Prudential Measures article 17(2). US Model BIT (2004) (2012) article 20(3) Financial Services.

<sup>477</sup> IMF Article XXX(d) provides that the notion of current payments encompasses investment income, interest on loans, and amortisation of principal.

<sup>478</sup> Myanmar is the third ASEAN country to join the IMF, and remains the only country still working towards acceptance of the obligations under IMF Articles VIII, Sections 2, 3, and 4. See article VIII: General Obligations of Members, Section 2 of the IMF Articles.

<sup>479</sup> Muchlinski, P. (2009), "The Framework of Investment Protection: The Content of BITs" in Sauvant, K., Sachs, L. (eds) (2009), *The Effect of Treaties on Foreign Direct Investment*, Oxford, OUP, p.60.

the ACIA, tribunals may look at how analogous provisions relating to the relationship between the IMF Agreement, GATT<sup>480</sup> and GATS<sup>481</sup> have been dealt with by the WTO Dispute Settlement Body or by other tribunals as a useful guide in the interpretation of the ACIA.

Two different views are worth consideration. The first view supports the binding nature of IMF's opinions.<sup>482</sup> It argues that if the IMF has not approved restrictions where necessary, they will not be considered to be maintained or imposed consistently with the Articles.<sup>483</sup> IMF Article XXIX vests the Executive Board with the power to give interpretation of the Agreement in the event of any question of interpretation of the IMF provisions arising between any member and the Fund or between any members of the Fund, and to refer that question to the Board of Governors, whose decision is final.<sup>484</sup> The question of the consistency of exchange control regulations with this Agreement thus falls within the interpretation matters of the Fund's bodies. In contrast, the second view suggests that tribunals are not bound by the Fund's determinations.<sup>485</sup> IMF's interpretative views are regarded as dispositive of the issue in dispute. They were instead viewed as having only a persuasive effect. Hence, the consistency of exchange regulations with the Fund Agreement will ultimately be decided by the court or tribunal.<sup>486</sup>

For the interpretation of the relationship between the ACIA and the IMF, the second approach is more persuasive. On policy grounds, the IMF's political and administrative roles could be in conflict; that is, between policy-maker, regulator of monetary matters, and lender of last resort to Member States. In other words, the IMF is concurrently adviser and judge. This situation potentially undermines the independence and neutrality of the IMF and, by implication, the significance or credibility of its opinion on the issue of consistency of currency exchange regulations.<sup>487</sup> On legal grounds, it seems that nothing in the IMF texts suggests the intention of the drafters to extend the

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<sup>480</sup> GATT article XV:9(a).

<sup>481</sup> GATS article XI:2.

<sup>482</sup> See e.g. *Emek v. Bossers & Mouthaan* Commercial Tribunal of Courtrai, Belgium, 9 May 1953, 22 ILR 722, 724 (1955).

<sup>483</sup> IMF Articles, Section 2 Avoidance of restrictions on current payments, Article VIII: General Obligations of Members

<sup>484</sup> Article XXIX: Interpretation, IMF Agreement

<sup>485</sup> See e.g. *India-Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products* WT/DS90/R, Report of the Panel, 6 April 1999, paras.5.86-5.87, as modified by WT/DS90/AB/R, AB-1999-3, Report of the Appellate Body, 22 September 1999, para.102. See Proctor, C., Mann, F. A. (2005), *Mann on the legal aspect of money*, 6<sup>th</sup> ed., Oxford, New York, OUP, p.403; Siegel, D.E. (2002), "Legal Aspects of the IMF/WTO Relationship: The Fund's Articles of Agreement and the WTO Agreements", 96 *AJIL* 561, p.582

<sup>486</sup> Kolo, A. (2010), "Transfer of Funds: the Interaction between the IMF Articles of Agreement and Modern Investment Treaties: a Comparative Law Perspective", in Schill, S.W. (ed.) (2010), p.369.

<sup>487</sup> *Idem*, p.370.

interpretative powers of the Executive Board on questions of the consistency of a Member State's exchange restrictions and the Fund Agreement, to cover disputes between private parties. Besides, no ACIA provision explicitly requires tribunals to seek the IMF's advices in such circumstances. However, nothing in the ACIA prohibits tribunals to refer the questions of consistency of restrictive measures to the Fund for advice. IMF advice may be seen as equivalent to expert opinion, pursuant to ACIA article 38.<sup>488</sup> Under the ACIA mechanism, reference to expert opinions is totally optional. Nothing hinders tribunals either to decide from their own perspective or to base their decisions upon the opinions received.

The situation is more nuanced, as it is possible that the IMF provides financial help to a Member State even if it does not explicitly approve the restrictive regulations. Such IMF financial assistance, with the omission of express approval of the existence of exchange regulations in force at the time of crisis, may be considered "*de facto*" approval. The majority of judicial authorities take a pragmatic approach, suggesting the appropriateness of such presumptions. Should all questions concerning the consistency of a State's exchange control regulations be referred to the IMF for advice, this would be time-consuming, with undue delay and costs to the disputing parties.

Lastly, under IMF article XXVI, sanctions which may be imposed on a Member State in breach of its obligations are limited to it being declared ineligible to use the Fund's general resources, suspension of voting rights, or suspension of membership. They do not include an order to pay damages to entities adversely affected by the breach. Hence, even if restrictive measures imposed by ASEAN host States are found not to be in conformity with the IMF Agreement, investors cannot obtain any remedy under the Fund Agreement, or under domestic law. In order to claim compensation, aggrieved investors should bring the case before an arbitral tribunal, pursuant to ACIA article 32.

#### **4.3.2.4 Stage 3: Review on Administration of Restrictive Measures before Arbitral Tribunal**

The discussion above has presented two stages of reasoning. Firstly, ASEAN host States are sovereign over their monetary matters, and may lawfully and legitimately impose outright restrictions on transfers in a situation where they deem that movements of capital cause or threaten serious economic or financial disturbance. Secondly, restrictive

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<sup>488</sup> ACIA article 38, Expert Reports.

measures must be in consistent with IMF Articles. At stage 3, tribunals may exercise the power of review only on the administration of measures, both procedural and substantive, that ACIA article 13(5) has imposed to frame States' behaviour so that they cannot harm an investor's right in an unacceptable way.

### **(1) Procedural Requirements**

ASEAN host States which adopt or maintain or change any balance-of-payments measures must fulfil two procedural requirements, internal and external. Regarding internal procedure, ACIA articles 13(5)(d) and 16(3) require that the host State taking such measures must promptly notify other Member States, so that the latter can provide information to their investors. Article 16(4) further instructs the commencement of the consultation to review such restrictions, should any other Member State request this. A Member State must commence consultation to the extent that it does not duplicate the process under WTO, IMF, or any other similar processes. It is worth noting that notification and consultation were also required in the previous AIA regime.<sup>489</sup> These procedural requirements affirm the ASEAN internal emergency assistance in the event of a crisis.

### **(2) Substantive Tests**

A tribunal should consider whether restrictive measures taken to ensure the stability of the exchange rate, and to prevent speculative capital flows, are in accordance with the principles of non-discrimination, necessity, proportionality and transparency. These conditions are found in most contemporary treaties which contain balance-of-payment exceptions, for example, NAFTA, OECD and WTO.<sup>490</sup> States issuing measures must avoid unnecessary damage to commercial, economic and financial interests of another ASEAN Member State.

Restrictions must respect the MFN and national treatment standards,<sup>491</sup> and must not exist for the purpose of protecting a particular sector.<sup>492</sup> Measures must not exceed those necessary to deal with the circumstances described. In order to prevent possible abuse by a sovereign power, these principles require an adjudicator to assess whether there were any other reasonably available alternatives to such measures which had less restrictive effects on ASEAN investors' rights. Measures must be temporary and be phased

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<sup>489</sup> AIA article 15(2), (4).

<sup>490</sup> GATT article XVIII:B(9) and IMF Understanding on the Balance-of-Payments provisions of the GATT 1994, para.4.

<sup>491</sup> ACIA article 13(5)(e) and (f). IGA article VII(3) previously required the Contracting Parties to accord only MFN treatment to transfers.

<sup>492</sup> ACIA Footnote 8.

out progressively as the situation improves and conditions no longer justify their institution or maintenance. Some agreements further provide a time limit of restrictive measures; for example, one year in the AKIA or six months in the consolidated CETA text, with a possibility of an extension.

Transfer restrictions may also amount to expropriations. It may happen that ASEAN investors are unable to buy goods and services from abroad for the establishment of their business, or to transfer profits out of the host country. In an extreme case, their funds and bank accounts may be frozen or seized. Hence, transfer restrictions may be seen as “indirect expropriation” or “creeping expropriation” or “regulatory taking”, where investors lose effective management, use or control, or encounter a significant depreciation of the value of their invested assets. The burden of proof weighs heavily on a disputing investor to display that restrictive exchange measures substantially affected the value of the investment, and as a result, amounted to expropriation.<sup>493</sup> Otherwise, investors may fail to claim that a host State has breached its regional obligations.

An issue arises regarding the sovereign debt restructuring that States can possibly use, after a crisis, in order to recover the economic situation.<sup>494</sup> Certain safeguarding measures put in place may substantially affect the values of bonds, and private bondholders may file arbitral claims on this ground under the ACIA.<sup>495</sup> Generally, it is for States parties to decide whether to explicitly include sovereign debt in their investment treaties or to explicitly exclude it.<sup>496</sup> The ACIA does not clearly address sovereign debt nor give any special treatment thereof, but has a very broad asset-based definition of “investment”, which is deemed to cover “any kind of asset”,<sup>497</sup> and sovereign debt should fall within this definition. Therefore, measures purporting to sovereign debt restructuring (SDR) could be seen as a breach of States’ obligation under the ACIA.

The SDR may also be considered indirect expropriation in the case that it reduces the face value of sovereign bonds. At the time of investing, ASEAN investors would not

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<sup>493</sup> Kolo, A., Walde T. (2008), “Capital Transfer Restrictions under Modern Investment Treaties”, in Reinisch, A., *Standards of Investment Protection*, Oxford, New York, OUP, p.227.

<sup>494</sup> Das, U. S., Papaioannou, M. G., Trebesch, C. (2012), *Sovereign Debt Restructurings 1950-2010: Literature Survey, Data, and Stylized Facts*, IMF WP/12/203, p.5.

<sup>495</sup> See UNCTAD (2011), *Sovereign Debt Restructuring and International Investment Agreements*, IIAs Issues Note No.2, July; Gallagher, K.P. (2011), *The New Vulture Culture: Sovereign Debt Restructuring and Trade and Investment Treaties*, IDEAs WP Series No.02/2011, IDEAs, New Delhi.

<sup>496</sup> *Idem*. In most cases, States do not make this clear when they draft treaties. Some of the recent IIAs negotiated by the United States precisely include sovereign bonds in the definition of covered investments; they even provide explicit guidelines for the interaction between SDR and the IIAs in form of a special annex on SDR. The US Government includes sovereign debt in the definition of “investment” in its 2012 Model BIT; on the contrary, Section C Definition of the NAFTA excludes sovereign debt from the definition of investment altogether.

<sup>497</sup> ACIA article 4 Definition.

expect that bonds would be swapped. This may break investors' legitimate expectations. In some financial circumstances, it may be imperative during a crisis for ASEAN host States to treat domestic bondholders differently from foreigners, or to treat one ASEAN investor differently from another; this is perhaps in contradiction to national treatment and MFN principles.<sup>498</sup> It is recommended that national governments and their international financial and monetary authorities should hold the power to ensure the survival of the country in case of crisis, even by way of sovereign debt restructuring.<sup>499</sup> Then, it may be of interest to expressly exclude sovereign debt from the ACIA.<sup>500</sup>

In conclusion, while the ACIA guarantees to protect investors' right to transfer of funds, it simultaneously maintains a policy space for ASEAN host States in case of exceptional circumstances. Remarkably, ASEAN Member States may invoke the balance-of-payment exceptions as grounds to restrict investors' right to transfer for many cases regarding financial difficulties. These exceptions illustrate the ASEAN Member States' concerns on economic matters. However, the ACIA requires that these measures must be reasonably adopted. It is also designed to be consistent with the multilateral rules of capital control, such as the IMF Agreement, and with the economic realities of the 21<sup>st</sup> century.

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<sup>498</sup> See Gelpern, A., Setser, B. (2004), "Domestic and External Debt: The Doomed Quest for Equal Treatment," *Georgetown Journal of International Law*, Vol.35, No.4, pp.795-814.

<sup>499</sup> Gallagher, K.P. (2011), p.27.

<sup>500</sup> On 24 February 2015, the German Federal Court of Justice ("*Bundesgerichtshof*") handed down two judgments holding that the Argentine Republic could not refuse payment to private creditors under its government bonds ("*Inhaberschuldverschreibung*") by invoking a state of necessity due to inability to pay. In the view of the German Court, no rule of general international law existed that would have obliged all creditors to participate in debt restructuring with States in economic crisis.

## Conclusion to Chapter IV

Chapter IV has discussed three standards, namely, lawful expropriation, fair and equitable treatment and transfer of funds. The ACIA proposes state-of-the-art solutions to the debate on how to balance the interests between protection of investors and protection of State sovereignty. The ACIA guarantees all commonly found rights of investors in line with international practice. However, this thesis shows that several elements of the ACIA illustrate significant ASEAN-specific needs, which departs from the general pro-investor IIAs approach.

The overall findings highlight that the ACIA is precautionary in adopting existing standards: either it selects only some elements of each standard, or it adopts the whole standard but makes it subject to particular exceptions or actions. Arguably, these exceptions are, sometimes, as important as the rules. Additionally, none of the States demonstrate an overreliance on the doctrine of investors' legitimate expectations, overly advocated in previous decades. An expansive interpretation of minimalist treaty language had given rise to a lack of predictability in the application of standards. ASEAN Member States realised that such an approach may lead to an imbalanced result. Therefore, the ACIA has solved the problem by asserting legitimate State intervention for economic, social, environmental and other developmental ends. These substantive provisions reflect the "ASEAN Way" of investment protection.

While each core standard is independent, they are interconnected. FET is the most ingenious approach among the ACIA standards. This solution is innovatively proposed to solve the intensive debate on extensive interpretation of investors' legitimate expectations. FET provisions are short and less detailed, compared to the other two standards here studied. While the latter provide broad principles with several exceptions, the content of FET is written in a positive way, under which no exception is allowed. This truly shows the character of FET as an absolute right. The ACIA has positively chosen some conventional elements of the FET, which concretise the content of the standard. FET comes to fill the substantive gap in the ACIA protection standards relating to denial of justice and due process.

In contrast, the ACIA provisions on expropriation and transfer of funds standards are very meticulous. The expropriation provision explicitly recognises both direct and indirect expropriation so that aggrieved investors can claim compensation. However, this right grants great room for manoeuvre to ASEAN Member States, under normal circumstances, to issue regulations for public purpose, where investors are barred from claiming any compensation. As a result, investors need more effort to successfully invoke the



expropriation claim under the ACIA. Similarly, the transfer standard and its exceptions of balance-of-payments provisions, under exceptional circumstances, are utterly detailed and complicatedly intertwined with external financial rules. While the expropriation and transfers provisions do not break new ground for the IIAs practice, they are pioneers which advocate for more concerns on States' legitimate interests.

Given their economic and financial significance, the features of these provisions were the subject of considerable scrutiny when the ACIA was negotiated, so as to be as clear as possible when interpreted and applied. The coordination of these three standards demonstrates the deliberate efforts of governmental authorities across ASEAN to design the timing and magnitude of the ACIA. Therefore, tribunals should take into account ASEAN Member States' concerns, and give them greater and more tailored flexibility.

In examining States' acts, a tribunal is granted powers of consideration which possibly intrude on States' sovereignty and raise the issue of legitimacy of the tribunal. For a tribunal, the most important test is the principle of proportionality: measures must not exceed those necessary to deal with the circumstances described. Tribunals should appropriately distinguish between acts of protectionism and *bona fide* interventions for a public purpose. Exceptional mechanisms should be literally interpreted in a restrictive manner. Otherwise, in guise of protectionism, some countries may use restrictive measures at risk of breaching commitments under the ACIA.

## Chapter V. Relative Standards

This chapter addresses non-discrimination obligations of the ACIA, embodied in national treatment and most-favoured-nation (MFN) principles. Unlike the usual practice of BITs, the ACIA opts for a combined approach, guaranteeing both national treatment and MFN treatment for its covered investments and investors. Especially with the AEC liberalisation objective, issues related to MFN and national treatments lie at the heart of the ACIA.

As opposed to the “absolute” standards discussed in chapter 4, these non-discrimination standards are “relative” to a designated comparator. In other words, they are defined by reference to treatments accorded to other investments or investors.<sup>501</sup> The MFN and national treatment obligations exist only when a treaty clause creates them.<sup>502</sup> Unless otherwise specified in a treaty, ASEAN Member States retain the possibility of discriminating between foreign investors and their own economic activities. By prohibiting differentiated treatment in the ASEAN Investment Area, these treatment clauses establish a level playing field amongst the relevant players. All investors are subject to the same rules and the same level of market access.<sup>503</sup>

The non-discriminatory or “no less favourable” standards apply to both ASEAN investors and their investments, if they are “in like circumstances” to nationals of a host State (article 5 National Treatment), or “to investors of any other Member State or a non-Member State” (article 6 MFN), as the case may be, with respect to the admission, establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.

### Article 5 National Treatment

1. Each Member State shall accord to investors of any other Member State treatment no less favourable than that it accords, *in like circumstances*, to its own investors with respect to the admission, establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.
2. Each Member State shall accord to investments of investors of any other Member State treatment no less favourable than that it accords, *in like circumstances*, to investments in its territory of its own investors with respect to the admission, establishment, acquisition, expansion,

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<sup>501</sup> See UNCTAD (1998), *BITs in the Mid 1990s*.

<sup>502</sup> According to article 7 of the ILC Draft Articles on the MFN Clause, 1978. See also Oppenheim’s International Law (1992), Jennings, R., Watts, A.(eds.) Vol. I, Harlow, p.1326.

<sup>503</sup> UNCTAD (2010), *MFN Treatment: A Sequel*, UNCTAD Series on IIAs II. Switzerland, United Nations. UNCTAD (1996), *International Investment Instruments: A Compendium, vol.I, II and III*; UNCTAD (1999), National Treatment, United Nations publications.

management, conduct, operation and sale or other disposition of investments. [Emphasis added.]

#### Article 6 Most-Favoured-Nation Treatment

1. Each Member State shall accord to investors of another Member State treatment no less favourable than that it accords, *in like circumstances*, to investors of any other Member State or a non-Member State with respect to the admission, establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments.
2. Each Member State shall accord to investments of investors of another Member State treatment no less favourable than that it accords, *in like circumstances*, to investments in its territory of investors of any other Member State or a non-Member State with respect to the admission, establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments. [Emphasis added.]
3. ...

MFN and national treatment standards have parallel structures, regarding beneficiaries, models of protection and liberalisation, and conditions for breach of obligations. This introductory part limits itself to discussion on these parallel structures, whereas the specificities of each treatment are discussed in sections 5.1 and section 5.2.

As the ASEAN Investment Area is stepping towards a “full integration” investment model, the ACIA combines the rules of both internal and external investment liberalisation. Under this approach, ASEAN Member States have made commitments to reduce barriers and remove restrictions to the entry of foreign investments. Therefore, the application of non-discrimination standards is essential to foster deeper economic integration. The MFN and national treatment standards in the ACIA seek to ensure a degree of competitive equality between national investors and ASEAN investors. MFN and national treatments were introduced, firstly, in the IGA regarding the post-establishment phase, then in the AIA Agreement regarding the pre-establishment phase.

Similar to some modern investment agreements,<sup>504</sup> the ACIA has adopted the pre-establishment model. The ACIA guarantees non-discrimination in the post-establishment phase, and in the admission phase of investors and their investments, which typically includes establishment, acquisition and expansion of investments. The treatments seek to avoid preferential access or a selective liberalisation that would benefit some foreign investors and not others.

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<sup>504</sup> See e.g. NAFTA, AANZFTA, Japan-Singapore EPA (2002); Japan-Thailand EPA (2007).

Most old-fashioned BITs follow the post-establishment model, under which the entry of investments is fully governed by laws and regulations of host States. States are not at all committed to any level of investment liberalisation or to the removal of any restriction affecting the establishment of foreign investments.<sup>505</sup> Some developing countries, such as the SADC countries, consider the non-discriminatory obligations to be detrimental to their national development and prefer not to include them in treaties. However, if needed, it is recommended that the treatments should be limited to the post-establishment phase, and subject to exceptions.<sup>506</sup>

Some regional economic integration organisation (REIO) agreements rule merely on internal investment liberalisation. For instance, the EFTA<sup>507</sup> does not have provisions on investment coming from non-Member States (external investment relations). Hence, each Member State may have different strategies vis-à-vis investors of third countries.<sup>508</sup> Some agreements have internal investment regime and rules on external relations. For example, MERCOSUR has two agreements dealing with investments in MERCOSUR: the 1994 Colonia Protocol regulates investments of MERCOSUR investors,<sup>509</sup> and the 1994 Buenos Aires Protocol regulates investments from non-Member Countries.<sup>510</sup> Under the 1994 Colonia Protocol (on MERCOSUR investors), national treatment and MFN treatment apply both in the pre- and post-establishment phases. Up to this stage, the ACIA resembles the approach taken in MERCOSUR.

ASEAN and MERCOSUR differ regarding the application of MFN to investors from non-Member States. MERCOSUR State Parties are committed to grant the investments made by investors from Third States a treatment no more favorable than that stipulated in the Buenos Aires Protocol.<sup>511</sup> The application of MFN and national treatment is limited to post-establishment phase, whereas its application to pre-establishment phase is left to the discretion of each MERCOSUR State.<sup>512</sup> While MERCOSUR has two sets of rules applicable to internal and external investment relations, the ACIA has one set of rules applicable to both ASEAN and non-ASEAN investments in the ASEAN Investment Area. As mentioned *supra*, the ACIA opts for a “full integration” investment model, its

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<sup>505</sup> Joubin-Bret, A. (2008), “Admission and establishment in the context of investment protection”, in Reinisch, A. (ed.), *Standards of Investment Protection*, OUP, pp.9-28.

<sup>506</sup> SADC Model BIT (2012).

<sup>507</sup> EFTA articles 23.

<sup>508</sup> UNCTAD (2004), *The REIO Exception in MFN Treatment Clauses*, p.23

<sup>509</sup> The Colonia Protocol for the Promotion and Protection of Investments in MERCOSUR was approved by the Decision No.11/93 of the Common Market Council of 17 January 1994.

<sup>510</sup> The Buenos Aires Protocol for the Promotion and Protection of Investments in MERCOSUR from Non-Member Countries was approved by Decision No.11/94, 5 August 1994.

<sup>511</sup> Buenos Aires Protocol, article 1.

<sup>512</sup> *Idem*, article 2.

protective standard apply to both intra- and extra-ASEAN investments. ASEAN Member States intend to increase investment flow into the Area from both ASEAN and non-ASEAN sources. This liberal approach helps avoiding investment distortions within the Area.

The key element to establishing ASEAN as a single market and production base is an open investment regime, where non-discriminatory treatments are granted to ASEAN investors and foreign-owned ASEAN-based investments. However, the general scope of the ACIA is specifically limited by the additional scope of the non-discriminatory standards. Pursuant to ACIA articles 3(4)(e) and 3(5), pre-establishment phase of the commercial presence (Mode 3) of service supply of the five liberalised sectors under the ACIA (manufacturing, agriculture, fisheries, forestry and mining) are excluded from the scope of national treatment and MFN treatment. The pre-establishment phase (liberalisation) of these services incidental to the listed investment sectors is scheduled in the Member States' schedule of commitments made under the ASEAN Framework Agreement on Services (AFAS).<sup>513</sup> In other words, for these commercial presences, MFN and national treatment are only granted to their post-establishment phase.

The non-discrimination commitments indicate the readiness of ASEAN Member States and their transitional period in investment liberalisation. Non-discriminatory rights are generally subject to limited exceptions, due for progressive elimination.<sup>514</sup> ASEAN Member States may express their reservations regarding some treaty provisions, by providing annexes or framing up protocols to limit the application of the treatments, especially in the areas where they are not ready to make concessions and need to reserve their rights to regulate.<sup>515</sup>

The exceptions of MFN and national treatment may differ; nonetheless, one common exception to both exists. ACIA article 20 allows ASEAN Member States to adopt or maintain a measure that prescribes special formalities in connection with investments; for example, a requirement that the investments are legally constituted under laws or regulations of host States, provided that such formalities do not materially impair protections afforded to ASEAN investors. Subject to the protection of confidential information, ASEAN Member States may also require investors to provide information

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<sup>513</sup> See pp.59-60.

<sup>514</sup> See "Progressive Liberalisation" principle in Chapter 2 Section 4.

<sup>515</sup> ACIA article 9.

concerning investments solely for statistical or informational purposes.<sup>516</sup> This exception aims at transparency and the good faith application of national laws.

Several exceptions are allowed regarding non-discriminatory rights in the pre-establishment phase because they involve sensitive issues which States need to supervise closely. Therefore, only MFN and national treatment disputes arising from the post-establishment phase are covered by the ISDS mechanisms, whereas disputes arising from the pre-establishment phase are subject to the State-to-State mechanism.<sup>517</sup> For the post-establishment disputes, tribunals need to determine appropriate grounds for finding whether an investment or investor is “in like circumstances” under domestic measures.

A violation of the MFN and national treatments may be assessed in the same way, as both treatments share the same comparison requirement. The ACIA does not explain the meaning of “similarity” or “likeness”.<sup>518</sup> In practice, “likeness” is a flexible term, which refers to the *ejusdem generis* rule. The ILC Draft Articles on MFN article 10 provides that “the rights acquired should be those that the granting State extends to a third State within the limits of the subject matter of the MFN clause and only if the beneficiary persons or things belong to same category of persons or things which benefit from the treatment extended to the third party and have the same relationship with that State”.<sup>519</sup> The majority of NAFTA cases consider that the investments in question shall be in the same business or economic sector.<sup>520</sup> Differing sectors are not legitimate comparisons, and they deserve different solutions.<sup>521</sup> The MFN and national treatment of the ACIA should also be narrowly interpreted, because extensive interpretation would render the term “likeness” uncertain.

In the likeness test, ASEAN investors may bear a burden of proof. They should provide two pieces of evidence: (1) the comparability of investors (like investor, like investment), and (2) the less favourable treatment. The intent of discrimination is not always required, though having proven the intent of discrimination will render the claim more efficient. It is then possible that the ASEAN Member States treat ASEAN investors or their investment differently, because different treatment does not necessarily mean less favourable treatment.

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<sup>516</sup> ACIA article 20, Special Formalities and Disclosure of Information.

<sup>517</sup> See Chapter 7.

<sup>518</sup> In fact, the “likeness” issue is largely addressed in the international trade law literature, especially under the GATT/WTO.

<sup>519</sup> Draft Articles (1978), article 10, Acquisition of rights under a MFN clause.

<sup>520</sup> *Methanex vs. USA*, 3 August 2005, Final Award.

<sup>521</sup> *Sempra v. Argentina*, Award, 28 September 2007, para.319; corresponding to *Enron v. Argentina*, ICSID Case No.ARB/01/3, Award 2007, para.282.

Differences are justified only if the sectors are reasonably or objectively different, and not considered legitimate comparators. In the case that investors in the same sector are treated differently, these different treatments may most likely be justified by legitimate host State policies.<sup>522</sup> Public policy justifications may plausibly appear as rebuttal to presumption of “like circumstances”, provided that the domestic policy is reasonable and are not based upon nationality discrimination. In response, ASEAN host States may give justification of different treatment. While some IIAs put emphasis on the conditions of the application of the treatment clauses by defining the method of comparing the treatment afforded to foreign investors of different nationalities,<sup>523</sup> ASEAN Member States intentionally leave this application vague for more room of interpretation.

## Section 5.1 Most-Favoured-Nations Treatment

MFN treatment is one of the most fundamental standards in the ACIA. In order to ensure that ASEAN Member States do not discriminate between their trading partners, every time a Member State grants investors and investments of a third State more favourable benefits, the former must grant the same privileges to investors and investments of the other Member States. As discussed *supra*, ACIA article 6(1) and (2) provides a general scope of more favourable rights to all ASEAN investors. Footnote 4 to article 6 contains, however, the limitation of the MFN application:

For greater certainty:

- (a) this Article shall not apply to investor-State dispute settlement procedures that are available in other agreements to which Member States are party; and
- (b) in relation to investments falling within the scope of this Agreement, any preferential treatment granted by a Member State to investors of any other Member State or a non-Member State and to their investments, under any existing or future agreements or arrangements to which a Member State is a party shall be extended on a most-favoured-nation basis to all Member States.

Article 6(3) continues the limitation that: the MFN treatment

... shall not be construed so as to oblige a Member State to extend to investors or investments of other Member States the benefit of any treatment, preference or privilege resulting from:

- (a) any sub-regional arrangements between and among Member States; or
- (b) any existing agreement notified by Member States to the AIA Council pursuant to Article 8(3) of the AIA Agreement.

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<sup>522</sup> See *e.g.* in *SD Myers v. Canada*, 2000, para.250; *Enron v. Argentina*, Award, para.282; *Sempra v. Argentina*, Award, para. 319; *CMS Gas v. Argentina*, *Pope & Talbot*, Award on Merits Phases 2, 2001; *National Grid v. Argentina*, 3 Nov 2008.

<sup>523</sup> See COMESA article 17(2), 2012 SADC Model BIT article 4.2

From the reading of the text, two specificities are found. First, while the issue of the inclusion of MFN's procedural scope is still globally debated, the ACIA explicitly excludes procedural rights from the scope of MFN. Second, article 6(3), read in conjunction with footnote 4, emphasises that ASEAN Member States cannot be exempted from the MFN obligations regarding any existing or future agreements or arrangements. They may, however, be exempted if they conclude sub-regional arrangements among themselves.

By adopting this particular approach, the ACIA has created a true system of non-discriminatory investment based on regional integration.

### 5.1.1 General Practice

Under the ACIA, each Member State immediately and unconditionally accords MFN treatment to investors and investments of another Member in the pre- and post-establishment phases. ACIA footnote 4(b) indicates that, except in the case of notification, the MFN clause applies retrospectively to any existing ASEAN investment agreement, as well as to future agreements.<sup>524</sup> Contrary to the IGA which limited the MFN application to some standards,<sup>525</sup> the ACIA MFN applies to every standard in the ACIA. Moreover, unlike other BITs, the ACIA does not allow States to set up a list of MFN exemptions in the schedule of commitment. This demonstrates that the ACIA truly encourages non-discrimination among ASEAN Member States.

The MFN of the ACIA unconditionally extends more favourable treatment provided in third-party treaties to all Member States. However, the MFN standard is not a substitute for external liberalisation policies *per se*.<sup>526</sup> It does not multilateralise the relationship between ASEAN Member States and third parties. Any extension of more favourable elements to non-ASEAN members remains on a reciprocal basis. In this context, the third-party treaty does not govern the relationship among ASEAN Member States as the applicable international treaty, but its content becomes operative by means of the MFN clause. The third-party treaty is incorporated by reference and *ipso iure* into the relationship among ASEAN Member States, without any additional negotiation. For this reason, MFN clauses have been characterised as the mechanism of “drafting (and deletion)

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<sup>524</sup> See also AIA article 8(2).

<sup>525</sup> The MFN under the IGA applied merely to fair and equitable treatment, and outbreak of hostilities or a state of national emergency. It did not apply to the compensation for expropriation, repatriation of capital and earnings, subrogation, and arbitration. See Article 4(2) and (3) IGA.

<sup>526</sup> See Falsafi, A. (2008), “Regional Trade and Investment Agreements: Liberalizing Investment in a Preferential Climate”, *Syracuse Journal of International Law and Commerce*, Vol. 36, Issue 1, pp.43-86.



by reference”.<sup>527</sup> As a consequence, the ACIA automatically adapts to changing circumstances.

This adaptation distinguishes the ACIA from other IIAs. For example, the IGA, the 2009 ASEAN-China and the ASEAN-Korea Framework Investment Agreements do not grant the MFN treatment automatically. Their MFN mechanisms do not immediately apply more favourable treatment to investors and their investments but entitle States to renegotiate the content of the basic agreement in order to include provision for such concessions. In this respect, their MFN mechanisms seem self-contradictory and virtually render the treatment meaningless because they allow complete discretion of the MFN application regarding any future agreements or arrangements. East Asian countries (China, Japan, Korea), as well as Brazil and India, demonstrate clear intentions to keep their specific bargains from being applied across the board, as they have more negotiating power to resist investment rules restraining their ability to regulate foreign investment.<sup>528</sup> This restrictive MFN formula may trigger more competition in signing new treaties.

On the contrary, the automatic and extensive MFN clause in the ACIA may prevent the issue of power struggle among the Parties, as it moderates differences in negotiation power.<sup>529</sup> The MFN approach of the ACIA protects the value of ASEAN concessions made among contracting parties. It prevents market distortions in the ASEAN Investment Area which may stem from the imposition of differential standards of protection offered to investors from different ASEAN Member States and non-ASEAN States in bilateral or multilateral relations.

Equal treatment demanded by the MFN principle acts as a force for unifying treatment at the most advantageous level for ASEAN investors and investments. The MFN standard helps ASEAN Member States to reduce their monitoring and negotiation costs for new agreements and for remedies to disadvantageous treatments. It may eventually deter efforts to contain inter-State investment relations on bilateral grounds. Hence, the MFN mechanism enhances predictability and transparency of the ACIA and has broader

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<sup>527</sup> Schwarzenberger, G. (1945), *The Most-Favoured-Nation Standard in British State Practice*, 22 BRIT. Y.B. Int’l L. 96, p.100; *International Law as Applied by International Courts and Tribunals* (1957), vol. I, London, 3<sup>rd</sup> ed., p. 243; Chapter 4 MFN in IIAs, OECD (2005), *International Investment Law: A Changing Landscape: A Companion Volume to International Investment Perspectives*, OECD Publishing.

<sup>528</sup> Buckley, R.P., Hu, R.W., Arner, D.W. (2011), *East Asian Economic Integration: Law, Trade and Finance*, Northampton/ Massachusetts, Edward Elgar; Xiao, J. (2010), “The ASEAN-China Investment Agreement: A Regionalization of Chinese New BITs”, 23 June 2010), Society of International Economic Law (SIEL), Second Biennial Global Conference, University of Barcelona, 8-10 July 2010; FitzGerald, E.V.K. (2001), “Developing Countries and Multilateral Investment Negotiations”, in Nieuwenhuys, E.C., Brus, M.M.T.A. (eds), *Multilateral Regulation of Investment*, Kluwer Law International, the Hague, p.40.

<sup>529</sup> Schefer, K.N. (2013), p.304.

implications for the regional structure by implementing equal treatment among ASEAN Member States.

Cases on MFN issues have highlighted the role of MFN clauses in both harmonising and raising standards of investment protection.<sup>530</sup> Generally, unless otherwise provided by treaty text, tribunals have been more likely to allow the party to attract better or even new treatment standards through the MFN clause.<sup>531</sup> In the *Siemens v. Argentina* case,<sup>532</sup> the tribunal permitted the investor to “cherry-pick” more favourable provisions from third-country BITs without being bound to the less favourable conditions. In this sense, Schill considers that a selective multilateralisation of certain benefits without extending connected disadvantages can also be understood as a stringent application of the unconditional character of MFN clauses.<sup>533</sup> According to the logic of the MFN mechanism, the ACIA should allow investors to choose to import only better standards, without being obliged to import every standard. Nonetheless, it should be noted the absence of a provision in a third-party treaty cannot be the basis for excluding a non-beneficial provision contained in the ACIA, such as balance-of-payment exceptions, by invoking an MFN provision.<sup>534</sup>

Despite the automatic MFN mechanism, the MFN clause should not alter the scope of application of the basic treaty (*ratione temporis*, *ratione materiae*, or *ratione personae*), as these matters “go to the core of matters that must be deemed to be specifically negotiated by the Contracting Parties”.<sup>535</sup> “Each treaty defines what it considers a protected investment and who is entitled to that protection, and definitions can change from treaty to treaty. In this situation, resort to the specific text of the MFN clause is unnecessary because it applies only to the treatment accorded to such defined investment, but not to the definition of ‘investment’ itself”.<sup>536</sup> Likewise, the meaning of “investor” or “investment” under the ACIA should not change by way of the MFN mechanism, even if a third-country BIT provides for a broader scope of application.<sup>537</sup> This recommended

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<sup>530</sup> *Asian Agricultural Products Ltd (AAPL) v. Sri Lanka*, Final Award, 27 June 1990, ICSID Case No.ARB/87/3; *Pope & Talbot v. Canada*, Award on the Merits of Phase 2, 10 April 2001; *ADF v. USA*, ICSID Case No.ARB(AF)/00/1, Award, 9 January 2003.

<sup>531</sup> See e.g. *MTD v. Chile*, ICSID Case No.ARB/01/7, Award, 25 May 2004, para.104; *Bayindir v. Pakistan*, ICSID Case No.ARB/03/29, Decision on Jurisdiction, 14 November 2005, paras.227-235.

<sup>532</sup> *Siemens v. Argentina*, Decision on Jurisdiction, 3 August 2004, paras.32-110.

<sup>533</sup> See Schill, S.W. (2009), *The Multilateralization of International Investment Law*, CUP, p.156; Schill S.W. (2009), *Multilateralizing Investment Treaties through Most-Favored-Nation Clauses*, 27 Berkeley J. Int'l Law, p.496.

<sup>534</sup> *CMS v. Argentina*, ICSID Case No. ARB701/08, Award, 25 April 2005, p.377.

<sup>535</sup> *Tecmed v. Mexico*, Award, 29 May 2003, para.69.

<sup>536</sup> *Société Générale v. Dominican Republic*, LCAI Case No.UN 7927, Award on Preliminary Objections to Jurisdiction, para.41.

<sup>537</sup> See e.g. *Yaung Chi Oo v. Myanmar* (2003).

approach may strike a fairer balance: ASEAN investors get the most favourable treatments but only to the extent that the States have intentionally promised.

### 5.2.2 Specificities

As mentioned earlier, the ACIA MFN is specific in that each member accords immediately and unconditionally to investors and investments of another member MFN treatment in both pre- and post-establishment phases. The ACIA also gives additional clarification on the possibility of importing substantive and procedural provisions from other treaties via its MFN treatment clauses. On the procedural issue, the ACIA has explicitly excluded procedural rights from the scope of the MFN. For the purpose of the ACIA, this ends the debatable issue of whether investors can seek to import more favourable ISDS provisions from a third-party treaty into the basic treaty. By refusing straightforwardly the *Maffezini* approach, the ACIA has shaped the IIAs practice on an MFN issue. On the substantive matter, the ACIA contains remarkable exemptions of MFN treatment among ASEAN Member States, by means of more advanced sub-regional agreements, while exemption *vis-à-vis* third parties' investment agreements, typically found in other BITs, is not found in the ACIA.

#### 5.1.2.1 Explicit Exclusion of MFN on Procedural Rights

The application of MFN clauses to dispute settlement provisions has generated an intensive debate in academic settings, because traditional BITs had usually not determined whether the MFN standard applied to procedural rights, and investment jurisprudence had been divergent on this issue.<sup>538</sup> In the *Maffezini v. Spain* case,<sup>539</sup> the tribunal decided that, by virtue of the MFN clause in the basic treaty, the claimant had the right to import the more favourable jurisdictional provisions from the third party treaty. In this case, the investors were not required to submit the claim to domestic courts before resorting to international arbitration.

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<sup>538</sup> On this debate, see generally Dolzer and Myers (2004), *After Tecmed: MFN Clauses in International Investment Protection Agreements*, 19 ICSID Review, Foreign Investment Law Journal 49; Radi, Y. (2007). "The Application of the MFN Clause to the Dispute Settlement provisions of the BITs: Domesticating the - Trojan Horse", *The European Journal of International Law*, Vol.18, Issue 4, pp.757-774; UNCTAD (2010), *MFN*, pp.66-92.

<sup>539</sup> *Maffezini v. Spain*, (ICSID Case No. ARB/97/7, 2000); Kurtz, J. (2005) "The Delicate Extension of MFN Treatment to Foreign Investors: *Maffezini v. Kingdom of Spain*" in Weiler, T. (Ed.). *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law*, London, Cameron, May.

However, an increasing number of decisions support the argument that MFN clauses relate merely to substantial protections afforded to investors and investments and do not extend to procedural issues, such as dispute resolution; for example, *Yaung Chi Oo v. Myanmar*,<sup>540</sup> *Salini v. Jordan*,<sup>541</sup> *Plama v. Bulgaria*,<sup>542</sup> and *Telenor v. Hungary*.<sup>543</sup> These decisions have raised doubts about whether the parties could reasonably have intended to provide for jurisdiction through incorporation by reference. The answer should be negative unless such intent had been explicitly reflected in the basic investment agreement.

The question of whether to incorporate procedural rights via an MFN clause is fundamental, because procedural issues affect the operations and enforcement of the protections of the relevant treaties. In the *Plama* case, the tribunal states that: “[i]t is one thing to add to the treatment provided in one treaty more favourable treatment provided elsewhere. It is quite another thing to replace a procedure specifically negotiated by parties with an entirely different mechanism”.<sup>544</sup> “If that were true, a host State which has not specifically agreed thereto can be confronted with a large number of permutations of dispute settlement provisions from the various BITs which it has concluded. Such a chaotic situation – actually counterproductive to harmonization – cannot be the presumed intent of Contracting Parties”.<sup>545</sup>

Prompted by these debates, the ACIA expressly excludes the ISDS provisions from the scope of the MFN. It follows the *Yaung Chi Oo* approach and directly refuses the *Maffezini* one. A criticism regarding the *Yaung Chi Oo v. Myanmar* case is that by refusing the import of ISDS provisions, this decision probably went against the essence of fair and equitable treatment and full protection of investments under the IGA. It was also said to frustrate the intent underlining the AIA to create a predictable investment regime in ASEAN and to realise a more liberal and transparent investment environment.<sup>546</sup> However, it has been the only arbitral case under the ASEAN investment regime attempting to clarify and articulate the MFN mechanism. The ACIA has ended the debate on the scope of application of the MFN treatment regarding procedural rights, and has endorsed the *Yaung Chi Oo* approach.

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<sup>540</sup> *Yaung Chi Oo v. Myanmar* (2003).

<sup>541</sup> ICSID ARB/02/13, 9 November 2004.

<sup>542</sup> ICSID ARB/03/24, 8 February 2005.

<sup>543</sup> ICSID ARB/04/15, 13 September 2006.

<sup>544</sup> *Plama and Bulgaria*, ICSID Case No.ARB/03/04, Decision on Jurisdiction, 8 February 2005, para.209.

<sup>545</sup> *Idem*, paras.212, 219.

<sup>546</sup> Tan, L.H. (2004), “Will ASEAN Economic Integration Progress beyond a Free Trade Area? *International & Comparative Law Quarterly*, Vol.53, Issue 4, pp.935-967.

### 5.1.2.2 Exemption of MFN on Substantive Rights: ASEAN Sub-Regional Agreements

As a second specificity, the MFN obligation can be waived in case of REIO.<sup>547</sup> The regional integration exception originates from trade agreement practice. Ordinarily, REIO explicit exceptions to MFN clauses are an effective means of shielding bilateral bargains between Member States and non-ASEAN countries which otherwise would go against the regionalising effect of the clauses.<sup>548</sup> A number of investment agreements stipulate that if a contracting party accords preferential treatment to investors of any third State by virtue of an agreement establishing a free trade area, a customs union or a common market, it is not be obliged to accord such advantages to investors of another contracting party, by means of MFN treatment.<sup>549</sup>

While others REIOs have exemptions *vis-à-vis* other third parties, the ACIA has a specific clause allowing exceptions *vis-à-vis* other ASEAN Member States. ACIA article 6(3), read in conjunction with footnote 4, emphasises that ASEAN Member States are not exempted from the MFN obligations, unless they have notified the AIA Council of any extra-ASEAN agreements under the previous regime. Regarding any other existing or future agreements or arrangements, only sub-regional agreements, which are more favourable among ASEAN Member States, are exempted.

For extra-ASEAN agreements, the only treaty notified under the AIA regime is the 1966 Thailand-United States Treaty of Amity and Economic Relations.<sup>550</sup> Given the economic and political importance of the United States in Thailand, this treaty gives more favourable treatment to the Americans. The level of protection and security of this BIT must be, in no case, less than that required by international law.<sup>551</sup> This BIT grants national treatment for American investors and their investments in Thailand, subject to few exceptions.<sup>552</sup> The American companies are exempted from most of the restrictions on foreign investment imposed by the 1999 Aliens Business Act, particularly requirements for board of directors and maximum shareholders. Hence, they have an equal playing field

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<sup>547</sup> See generally UNCTAD (2004), *The REIO Exception in MFN Treatment Clauses*, United Nations.

<sup>548</sup> *Idem*, p.1.

<sup>549</sup> According to GATT article XXIV, and GATS articles V and XIV, GATT/GATS members are permitted to be in a free trade area or customs union with preferential treatments, provided that (a) the purpose of the REIO is to facilitate internal trade, and (b) the REIO does not create new trade barriers for importers from outside its territory.

<sup>550</sup> ACIA article 6(3)(b) refers to any existing agreement notified by Member States to the AIA Council pursuant to AIA article 8(3).

<sup>551</sup> Thailand-US BIT article I(2).

<sup>552</sup> *Idem*, article IV.

with Thai companies. These preferential treatments are not extended to ASEAN investors via the MFN mechanism of the ACIA.

Regarding intra-ASEAN agreements, the ACIA has innovatively introduced an MFN exemption for sub-regional agreements into treaty-making practice. The MFN exemption *vis-à-vis* intra-regional agreements is not found in other multilateral investment treaties. ACIA article 6(3)(a)<sup>553</sup> grants MFN exceptions between two or more ASEAN Member States *vis-à-vis* other ASEAN members. They may conclude new agreements among themselves in order to cooperate in projects, for particular purposes, such as development projects among neighbouring countries. These agreements reciprocally grant more favoured treatment to the parties but benefits enjoyed by specific Members are not provided to the countries of non-application.

The list of ASEAN sub-regional agreements which do not apply MFN treatment is evolving. Footnote 5 to the ACIA lists five: Greater Mekong Sub-region (“GMS”), ASEAN Mekong Basin Development Cooperation (“AMBDC”), Indonesia-Malaysia-Thailand Growth Triangle (“IMT-GT”), Indonesia-Malaysia-Singapore Growth Triangle (“IMS-GT”) and Brunei-Indonesia-Malaysia-Philippines East ASEAN Growth Area (“BIMP-EAGA”). This practice leads to results that are contrary to the general MFN principle, according to which the “standstill” obligations prohibit ASEAN Member States from introducing any new discriminatory investment restrictions,<sup>554</sup> and non-conforming measures are subject to gradual elimination.

Arguably, this anti-MFN practice would defeat the very purpose of the ACIA, namely, to create legal stability and predictability, equal rights and obligations for the contracting parties. However, wide disparities and development gaps between ASEAN Member States may be an obstacle for a more advanced regional regime. In response to this potential stumbling block, ASEAN Member States have felt the need to allow some departure from their MFN obligation and call for a multi-track and multi-speed approach in order to deepen their economic integration. This innovation has enriched a new dimension of the “ASEAN Way” of investment protection by allowing for closer economic integration within ASEAN.

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<sup>553</sup> Ex-article 8(4) AIA.

<sup>554</sup> ACIA article 10 Modification of Commitments.

## Section 5.2 National Treatment

National treatment is one of the most controversial issues in the ACIA. National treatment can be defined as a principle whereby a host country extends to foreign investors treatment at least as favourable as the treatment it accords to national investors, in like circumstances.<sup>555</sup> ACIA article 5 requires that ASEAN host States must make no negative differentiation between national investors and ASEAN investors when applying their rules and regulations. This ensures that ASEAN investors enjoy the same level of treatment as nationals, and allows them to compete on an equal footing. Nevertheless, national treatment commitments may touch on politically and economically sensitive sectors. Even the most advanced economic countries do not totally grant national treatment without qualifications, especially with regard to admissions of investments.

As mentioned *supra*, national treatment under the ACIA applies to both pre- and post-establishment phases, and to both protection and liberalisation regimes. The commitment to national treatment in the post-establishment phase is common practice in many IIAs; it is rarer that application is extended to the pre-establishment phase. Hence, for emerging economic countries such as ASEAN, reservations to the national treatment are needed. ACIA article 9(1) provides that:

Articles 5 (National Treatment) and 8 (Senior Management and Board of Directors) shall not apply to:

- (a) any existing measure that is maintained by a Member State at:
  - i) the central level of government, as set out by that Member State in its reservation list in the Schedule referred to in paragraph 2;
  - ii) the regional level of government, as set out by that Member State in its reservation list in the Schedule referred to in paragraph 2; and
  - iii) a local level of government;
- (b) the continuation or prompt renewal of any reservations referred to subparagraph (a).

ACIA article 9(4) continues further that “[e]ach Member State shall reduce or eliminate the reservations specified in the Schedule in accordance with the three phases of the Strategic Schedule of the AEC Blueprint and Article 46 (Amendments)”.

ASEAN Member States consider national treatment as public policy relating to countries’ development. For the moment, the ACIA needs to balance the attraction of the ASEAN Investment Area by giving equal protection to investors and the regulatory power of ASEAN Member States by allowing them to screen and channel investment in tune with

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<sup>555</sup> See generally UNCTAD (1999), National Treatment.

their domestic interests and priorities. This dilemma is reflected in the extensive use of national treatment and its extensive reservations.

### 5.2.1 General Practice

Early BITs of ASEAN member States, either between themselves or with a third party, generally did not contain national treatment commitments. This approach clearly reflects a high level of caution towards foreign capital flows. The Asia Pacific Economic Cooperation (APEC) Non-Binding Investment Principles extend the national treatment standard to the pre-establishment of foreign investments.<sup>556</sup> However, the APEC instrument is non-binding and represents only a “best efforts” commitment.<sup>557</sup> The Energy Charter Treaty extends national treatment to operations of foreign investments and investors in the post-establishment phase, but as regards the making of investments, contracting parties are only required to “endeavour to accord” national treatment.<sup>558</sup> The Southern African Development Community (SADC) also includes national treatment clauses but leaves market access to domestic jurisdiction.<sup>559</sup>

While most IIAs in the 1990s grant generally national treatment in the post-establishment phase,<sup>560</sup> the IGA had an unusual approach of not automatically granting national treatment. Its article IV(4) provided national treatment for ASEAN investors but only subject to bilateral negotiations. By virtue of reciprocity, any two or more ASEAN Member States were able to grant national treatment to investments of any contracting party, providing that they concluded another agreement within the scope of the IGA. The national treatment in such agreements was not extendable to other ASEAN countries on an MFN basis. Consequently, national treatment under the IGA would hardly be enforceable.

Apparently, ASEAN Member States were not willing to grant national treatment to other ASEAN investors, except on a case-by-case basis and subject to host country approval. Putting the national treatment clause beyond the scope of MFN consideration preserved the ability of ASEAN Member States to maintain a dual investment regime able to discriminate between domestic and foreign investors. Nevertheless, subsequent agreements have shown more eagerness to attract foreign investments by extending national treatment to more categories of investors and investments. In line with the general

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<sup>556</sup> APEC Non-Binding Investment Principles, adopted in November 1994, Jakarta.

<sup>557</sup> UNCTAD (1996), *International Investment Instruments: A Compendium*, vol.II, p.536.

<sup>558</sup> ECT article 10(7).

<sup>559</sup> SADC Model BIT, Annex 1 Cooperation on Investment, Article 2 Promotion and Admission of Investments.

<sup>560</sup> This unusual approach is exemplified by the early BITs signed by China, Norway and Sweden. UNCTAD (1999), *National Treatment*, pp.17-18.



IAs practice, the ACIA has now granted national treatment in the post-establishment phase.

### 5.2.2 Specificities

ASEAN Member States are obliged not only to treat ASEAN investors similarly to their own nationals in the post-establishment phase, they are also required to liberalise their national entry requirements. In practice, discrimination between national investors and ASEAN investors enables ASEAN host States to raise their development concerns and to pursue national public policies in conformity with their regional investment commitments. Given the large scale effects of the pre-establishment commitments, the question is raised regarding the proper limits of national treatment in the ASEAN investment regime. As a result, while the ACIA has made a concession to accord national treatment to ASEAN investors and their investments, it subjects this treatment to a large number of reservations. Currently, it remains challenging for ASEAN Member States to find an appropriate “ASEAN Way” of dealing with the tension between regional integration objectives and national priorities.

#### 5.2.2.1 Realistic Approach to National Treatment

National treatment in IAs can be read as a limit on protectionism.<sup>561</sup> Modern investment agreements provide national treatment for market access, pre-establishment rights, and rules for investment protection.<sup>562</sup> NAFTA article 1102 provides national treatment for both investors and investments. The EU treaty prohibits restrictions on the freedom of establishment on a national basis, including both primary rights (to set up and manage new undertakings), and secondary rights (to set up agencies, branches, subsidiaries) in the territory of any Member State.<sup>563</sup> The Colonia Protocol also requires that investments of investors from other MERCOSUR Member States must be admitted on a national basis.<sup>564</sup>

Unlike the restrictive approach of the IGA, the AIA had a liberal policy on the pre-establishment phase. States were required to relinquish their sovereignty to control access

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<sup>561</sup> Kurtz, J. (2010), “The Merits and Limits of Comparativism: National Treatment in International Investment Law and the WTO” in Schill, S.W. (2010), *International Investment Law and Comparative Public Law*, p.272-274.

<sup>562</sup> Deters, E. (2012), “Preferential Trade and Investment Treaties”, in Gazzini, T., Brabandere, E.D. (eds.), *International Investment Law: The Sources of Rights and Obligations*, Leiden, Boston, Martinus Nijhoff Publishers, pp.62-63.

<sup>563</sup> TFEU article 49 (ex-Article 43 TEC).

<sup>564</sup> Colonia Protocol article 3(2) Treatments.

of foreign investment to their territory. The AIA aimed to accord national treatment to both ASEAN and non-ASEAN investors and their investments in all industries immediately.<sup>565</sup> Each ASEAN Member State was obliged to treat other ASEAN investors and investments no less favourably than its own. According to the objective of liberalisation, national treatment had to be fully granted within six months after the date of signing of the AIA, firstly, to ASEAN investors in the manufacturing sector.<sup>566</sup> The AIA modality was similar to that of the CEPT, *i.e.* Member States were able to place industries that they were not ready to open on either a Temporary Exclusion List (TEL) or a Sensitive List (SL). The TEL was to be phased out by 2010 for the six ASEAN countries and by 2020 for non-ASEAN investors; the SL was subject to periodic review by the AIA Council.<sup>567</sup> On this schedule, CLMV had a longer timeframe. It is worth noting that the AIA entered into force when ASEAN encountered the economic crisis. During the period 1999-2000, ASEAN Member States necessarily agreed to liberalise their market in order to attract FDI and to solve critical situations. They agreed to waive the 30 percent national equity requirement under the AICO Scheme, in accordance with the AIA short term measures.<sup>568</sup>

The extension of national treatment to the opening-up phase of industries under the AIA greatly modified the previous constraints on foreign investors relating to the right to entry and establishment in certain strategic sectors.<sup>569</sup> However, despite the ambitious objective of full liberalisation, ASEAN Member States realised the impossibility of opening up all industries with total non-discrimination obligations.<sup>570</sup> Hence, against this unbalanced background, the ACIA has attempted to balance between the scope of investors' protection and the regulatory space of the ASEAN Member States.

Consequently, the ACIA is written in a more realistic way. It continues to automatically provide national treatment as a protective standard for admission and post-establishment phases, as well as in dispute settlement. Nonetheless, the ACIA opens up only five strong industrial sectors and not to all investors but only to qualified "ASEAN

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<sup>565</sup> AIA article 7.

<sup>566</sup> The signing date of the AIA Agreement was 7<sup>th</sup> October 1998.

<sup>567</sup> AIA article 7(2)(3)(4).

<sup>568</sup> See AICO Scheme in Chapter 2. The Sixth ASEAN Summit, 1998, held in Hanoi, Vietnam, adopted "Hanoi Plan of Action" and agreed to launch "Bold Measures" for speedy recovery from the financial crisis. The "Short Term Measures to enhance ASEAN Investment Climate" included a suspension of laws regulating equity joint venture between foreign and local enterprises and 100% foreign equity was allowed. Laws restricting foreign shareholders in national companies were also deregulated.

<sup>569</sup> Yue, C.S. (1998), *Foreign and Intra-regional direct investment in ASEAN and Emerging ASEAN multinational in ASIA and Europe: Beyond Competing Regionalism*, OECD, p.72.

<sup>570</sup> Jarvis, D.S.L. (2008), "FDI and Investment Liberalization in Asia: Assessing ASEAN's Initiatives", *Australian Journal of International Affairs*, Vol.66, Issue 2, p.236.

investors” and their investments. As a result, the ACIA regime is more restrictive than the AIA regime in terms of scope of application of the national treatment.

Member States must extend non-discriminatory treatments (including MFN and national treatments) first and foremost to ASEAN investors (with limited exceptions) and minimise and, where possible, eliminate such exceptions. Since 2010, investment liberalisation commitments in the goods sector under the ACIA have been remarkably liberal in six ASEAN Member States, using as yardstick a minimum of 70 percent allowable foreign equity.<sup>571</sup> Full realisation of the ACIA, with the removal of temporary exclusion lists in manufacturing, agriculture, fisheries, forestry and mining, is scheduled to occur by 2015 for Cambodia, Lao PDR, Myanmar and Vietnam.<sup>572</sup>

Apart from the general scope of application, the technique of “negative list” exemption is also used in the ACIA to limit the scope of national treatment.<sup>573</sup> This practice appears to have its origins in the United States BITs, followed by the NAFTA, among others.<sup>574</sup> Most investment agreements which provide national treatment allow States to file a list of sectors excluded from the operation of the standard, but subject to the gradual removal of these discriminatory measures. This technique requires the State to assess its capacity to absorb FDI as well as the ability of its domestic firms to withstand foreign full competition in particular sectors.<sup>575</sup> As under other regimes, the use of the national treatment exception under the ACIA is extensive. Pursuant to ACIA article 47(2), the TEL and the SL to the AIA Agreement became the Reservation List of ACIA.<sup>576</sup> Investment restrictions in ASEAN Member States must be eliminated or improved in accordance with a modality which has been set out based on the AEC Blueprint schedules.<sup>577</sup>

### 5.2.2.2 Reservation as Protectionism in Disguise

The national treatment standard is an articulation between the ACIA and national laws. In providing equal treatment to all ASEAN investors, ASEAN Member States lose some controls as regards the entry and the operation of foreign investments. Under the

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<sup>571</sup> ERIA (2012), Mid-Term Review of the Implementation of the AEC, October 2012, Jakarta, ERIA, p.vii.

<sup>572</sup> AEC Blueprint, A.3 Free flow of investment, p.39.

<sup>573</sup> ACIA article 9(1) (Reservations), Article 5 (National Treatment) and Article 8 (SMBD).

See Chapter 2.4.

<sup>574</sup> Subedi, S.P. (2012), *International Investment Law: Reconciling Policy and Principle*, 2<sup>nd</sup> Ed, Hart, p.181.

<sup>575</sup> Muchlinski, P. (2007), *Multinational Enterprises and the Law*, 2<sup>nd</sup> Ed., OUP, p.254.

<sup>576</sup> ACIA article 47(2) Transitional Arrangement.

<sup>577</sup> Modality for the Elimination/ Improvement of Investment Restrictions and Impediments in ASEAN Member States. (Last accessed: 23 September 2015).

<http://www.asean.org/communities/asean-economic-community/category/agreements-declarations-7>

ACIA, States are not allowed to differentiate treatments among investors in the post-establishment phase. Nevertheless, States may treat ASEAN investors and investments differently by creating a list of excepted industries.

A Member State retains the possibility of deciding the level of national treatment it proposes to grant in such sectors by listing specific limitations. Despite the fact that the AEC Blueprint requires ASEAN Member States to complete the final phase of the progressive reduction or elimination of investment restrictions and impediments for eight ASEAN Member States in 2014 and ASEAN-2 (Lao PDR and Myanmar) in 2015,<sup>578</sup> numbers of reservations are scheduled regarding both pre- and post-establishment phase. ASEAN Member States need more time to prepare themselves before fully liberalising certain strategic industries. Therefore, in order for foreign investors to understand precisely how they will be regulated by host States, it is necessary to examine ASEAN States' Schedules<sup>579</sup> and their domestic legislation governing foreign investment process.

ASEAN Member States potentially have a number of existing inconsistent measures as regards entry conditions. Highly selective exceptions to national treatment should be made only on ground of "public interest". These non-conforming measures are diverse, though most of them can be described in terms of requirement of equity participation, minimum capital used at commencement of the business under national laws, permission to own land, foreign exchange transactions for prevention of currency speculation, or flows of portfolio.

In using these measures, the ASEAN Member States must indicate the level of government which issues such measures for the purpose of transparency. The exceptions to national treatment can derive from different levels of government; for example, the central government of Brunei may use the exemption for reason of food security,<sup>580</sup> a regional government of Cambodia may reserve national treatment regarding the use of natural resources associated with land.<sup>581</sup>

The sources and the forms of measures are diverse. They may be constitutions, acts, national development plans, long-term development plans, administrative directives and guidelines. From a survey of reservation lists, a large part of ASEAN Member States' investment restrictions relates to service sector activities, a smaller part relates to primary sector activity, and only a modest number of restrictions involve FDI in manufacturing.

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<sup>578</sup> AEC Blueprint, Priority Action Plan 2014-2015, p.39.

<sup>579</sup> ACIA Reservation List. (Last accessed:18 August 2015)

<http://www.asean.org/news/item/asean-comprehensive-investment-agreement-reservation-list>

<sup>580</sup> Brunei Reservation List No.10.

<sup>581</sup> Cambodia Reservation List No.1.

Some States may reserve some sub-sectors to State-owned enterprises only; for instance, manufacture of pharmaceutical drugs and incidental services in Myanmar.<sup>582</sup>

Apart from exceptions in strategic sectors, the ACIA allows a degree of flexibility in national treatment through exemptions of specific sub-sectors, in order to secure the interests of local entrepreneurs, and the future development and regulatory policies of ASEAN Member States. This approach demonstrates the application of special and differential treatment, which is one of guiding principles of the “ASEAN Way”.<sup>583</sup> ASEAN Member States often employ exceptions to national treatment to protect their local small and medium enterprises (SMEs) because they recognise an economic asymmetry between these SMEs, which are in an economically disadvantageous position compared to ASEAN investors, who may be in control of powerful transnational corporations (TNCs).

Some departures from national treatment are justified by ethnicity. Ethnic groups may be assured of a certain percentage of ownership of various investment projects, most notably those in the natural resources sector. For instance, Malaysia has specially reserved discriminatory treatment of the *Bumiputera* people, and *Bumiputera*-status companies, trust companies and institutions.<sup>584</sup> For them, national treatment may not apply to any measures affecting their land, property and natural resources associated with land, including acquisition, ownership and lease of land and property, or treatment of shares in the share capital of a corporation quoted on the official list of the stock exchange.

Obviously, there is a tension between clauses stipulating national treatment standard and clauses allowing broad exclusion which seek to delimit the scope of the standards. Even though the ACIA’s intent is to discourage discrimination between ASEAN nationals, ASEAN Member States try to keep the level of national competition higher than that of foreign ASEAN nationals. Exemptions to national treatment standard survive as a tool of protectionism for ASEAN Member States, reflecting an unresolved tension between nationalism and regionalism. Repeatedly, the ACIA reveals fundamental tensions between the intent to create standards of equivalency in the treatment of ASEAN nationals and the preservation of national autonomy over investment policy.

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<sup>582</sup> Myanmar Reservation List No.2.

<sup>583</sup> ACIA article 23. See Chapter 2.4.

<sup>584</sup> The term “*Bumiputera*” covers Malays, natives of Sabah and Sarawak, and aborigines. See the Treasury Circular Letter No.4 of 1995 (also known as *Surat Pekeliling Perbendaharaan*).

## Conclusion to Chapter 5

The MFN and national treatment standards are foundational principles for the protection of international investments in the ACIA. The non-discriminatory clauses are one of the tools that allow the ACIA to follow very closely the objectives of the realisation of the AEC. The ACIA has taken into account the flaws of the previous IGA/AIA regime. In its tactics used to clarify the scope of application and subject-matter as well as in the exceptions, conditions, and specific qualifications provided in the explanatory notes, the ACIA's provisions are more precise.

The ACIA is one of the rare investment agreements of developing countries which offers both non-discriminatory standards and which regulates internal and external investment liberalisation, in both pre- and post-establishment phases. All investors are subject to the same rules, level of market access, operational conditions and opportunities. However, given the development gap among ASEAN Member States, the ACIA regime needs to balance protection of investors with margin of appreciation of States in order to regulate the flows.

Both MFN and national treatment have several features in common, namely, beneficiaries, "likeness" test, automatic application, external dimension, and dispute settlement. Nonetheless, their dynamics are opposite. Regarding the MFN treatment, the ACIA has introduced two ASEAN specific features. The MFN treatment follows the extensive approach. It generally allows importing substantive provisions from third-party treaties. ASEAN Member States are neither allowed to be exempted from the MFN application by schedule of reservations nor by the conclusion of agreements with a third party. The only way for substantive exemptions to be accepted is a conclusion of sub-regional agreements among ASEAN Member States for deeper economic integration. The ACIA has also ended the debate on the importation of procedural provisions by explicitly excluding the ISDS provisions from the scope of MFN.

On the contrary, the ACIA approach on national treatment is more restrictive, because every State has set a long list of reservations in its schedule, exempting several sectors from the scope of national treatment, principally in order to safeguard national security and competitiveness of domestic small and medium enterprises. The overuse of national treatment reservation may be counterproductive for regional investment integration under the ACIA regime. If national treatment is understood as a limit on protectionism, its numerous reservations may result in protectionism in disguise.

The ACIA regime is a strong case of non-discriminatory standard, as it mixes the use of MFN and national treatment in the “ASEAN Way”. This approach can be considered a plausible option for the current negotiations of IIAs. By according the MFN standard, the ACIA has become a genuine tool of harmonisation of standards of investment protection for the ASEAN Investment Area. By the national treatment standard, the ACIA maintains ASEAN Member States’ regulatory power to the extent of their national needs. The non-application of the ISDS to disputes arising from the pre-establishment phase, combined with the unqualified term “in like circumstances”, underlines that relative rights depend more on States’ generosity than absolute rights.

## Chapter 6. Dispute Settlement Mechanisms

“Substantive commitments go hand in hand with their enforcement mechanism as two cornerstones of international investment policies”.<sup>585</sup> Before turning to the dispute settlement mechanism (DSM) itself, it should be stressed that the DSM provided in the ACIA does not exist independently but serves as an enforcement tool for an effective guarantee of the substantive rights previously discussed in chapters 4 and 5. The world of IIAs has changed tremendously, regarding both substantive and procedural rights. In the last decade, the number of investment disputes has constantly increased. At the moment, Investor-States Dispute Settlement (ISDS) provided in the investment chapter of major mega-regional economic partnership agreements, such as the Trans-Pacific Partnership (TPP), or Transatlantic Trade and Investment Partnership (TTIP), has proved to be one of the most contentious elements and a major battleground during negotiations.

The procedures of DSM in ASEAN investment agreements have undergone major transformation. While the IGA was written in a minimalistic manner, the ACIA has engaged in a detail-enhancing trend by taking into account the issues of transparency, predictability and policy space. This legal modernisation is in line with the rules-based objective of the AEC. In a broader context, economic integration requires legalisation and judicialisation of the regime.<sup>586</sup> The AEC cannot happen without rules and enforcement. With the realisation of the AEC, the more investments flow, a greater number of disputes may be expected. However, given the “ASEAN Way” of cooperation, the ASEAN Member States have decided to remain flexible and respect the autonomy of disputing parties.

Like the majority of IIAs, the ACIA has both investor-States and State-to-State dispute settlement mechanisms. The ISDS, established under IGA article X has been consolidated into ACIA section B (article 28-41) which allows ASEAN investors to sue an ASEAN Member State in case of a breach of protection obligations under the ACIA. In case of an interpretation or application of the ACIA, a failure of an ISDS or a breach of

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<sup>585</sup> UNCTAD (2014), *Investor-State Dispute Settlement*, UNCTAD Series on Issues in IIAs II, New York and Geneva, p.170.

<sup>586</sup> Kawashima, F. (2005), The Dimensions of Judicialization of the Dispute Settlement Procedures in the WTO: The Operation of the DSU during the First Ten Years (in Japanese), *Annual of Japanese Association of International Economic Law* 14, pp.92-117; cited in Kawashima, F. (2011). *Judicialization of the Dispute Settlement Mechanisms in Asian Economic Integrations?: Expectation, Reality and Ways Forward*. Retrieved from <http://www2.gsid.nagoya-u.ac.jp/blog/anda/publications/files/2011/08/8-kawashima.pdf> (Last accessed: 10 September 2015).



liberalisation obligations, ACIA article 27 incorporates the State-to-State DSMs, previously provided under AIA article 17 and IGA article IX.

ACIA article 27 refers to the 2004 ASEAN Protocol on Enhanced Dispute Settlement Mechanism (“EDSM”), which provides a detailed mechanism specifically addressing disputes relating to ASEAN economic agreements among ASEAN Member States. This State-to-State mechanism is linked to the basic instrument of ASEAN. Chapter VIII of the ASEAN Charter provides a framework for existing and future dispute settlement mechanisms, including the investment ones.

The evolution of ISDS can be associated with the evolution of investment agreements itself. For the first era BITs (before the 1960s), individual investors usually had no rights before international tribunals because this period was dominated by a public international law paradigm which focused exclusively on inter-State treaty relationship and State-to-State arbitration. In other words, investors had been granted substantive rights, but they had no procedural enforcement options. In case of treaty violation, investors needed to request diplomatic protection from its State. However, due to political situation or foreign policy, a home State may refuse to assist its investors to bring suit against a host State. Even if a home State decides to proceed with a claim, this mechanism did not guarantee that the home State would hand over compensation to the wronged investor under its protection. Briefly, the home State had complete discretion over the commencement, prosecution, and settlement of such claims, as well as disposal of any damages awarded.<sup>587</sup>

These concerns led to the second era (from the late 1960s onwards) during which investor-State arbitration clauses were added to investment treaties, resulting in a significant shift away from State-centric and towards investor-centric power. ISDS was defended as a depoliticised neutral system to resolve disputes between foreign investors and host States.<sup>588</sup> The IGA had moved away from the “ASEAN Way” of political and diplomatic channels, and prepared a ground for a rule-based community. ASEAN investors were authorised to bring claims directly before international arbitral tribunals for compensation against an ASEAN host State in response to alleged breaches of investment standards.

Since then, ISDS has become a well-established mechanism, commonly found in bilateral and multilateral investment treaties.<sup>589</sup> It assists investors to protect their investments against political or regulatory instability, and other State-driven risks. ISDS

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<sup>587</sup> Roberts, A. (2014), “State-to-State Investment Treaty Arbitration: A Hybrid Theory of Interdependent Rights and Shared Interpretive Authority”, *Harvard International Law Journal*, Vol. 55, No.1, p.2.

<sup>588</sup> UNCTAD (2012), *Investment Policy Framework for Sustainable Development*, United Nations, p.43.

<sup>589</sup> See generally Dolzer R., Schreuer C. (2012), Chapter X. Settling Investment Disputes, pp.235-310.

has traditional advantages of flexibility, efficiency, and neutrality over national court proceedings.<sup>590</sup> While the role of State-to-State arbitration has been largely ignored, ISDS attracts more attention as a main tool to promote investment flows. One investor-State arbitral award has been issued under the IGA regime,<sup>591</sup> whereas there is no case before State-to-State arbitration.

However, the ISDS is increasingly criticised both from procedural and substantial aspects. Procedural speed and efficiency are sometimes questionable, causing delay of process and significant expenses. Concerning its substantive aspect, criticism is two-fold. Firstly, ISDS confers greater legal rights on foreign investors than those available to domestic investors: national investors have no access to international arbitration. Secondly, investor-State arbitral tribunals are empowered to interpret and apply vague investment treaty standards, which may overly protect economic interests of investors. By that, investors could undermine State policy space and regulatory power to change laws for public needs, such as social, health or environmental protections. Some States (led by Australia,<sup>592</sup> and in ASEAN, led by Indonesia)<sup>593</sup> have recently reversed their BITs practices and disapproved ISDS provisions, as they argue that ISDS has “chilling effect” on State regulatory powers.<sup>594</sup>

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<sup>590</sup> Hamilton, L., Webster, P. (2015), *The International Business Environment*, 3<sup>rd</sup> ed., Oxford, OUP, p.279.

<sup>591</sup> *Yaung Chi Oo v. Myanmar*, ASEAN I.D. Case No. ARB/01/1, Award 31 March 2003. Another case brought under the 1987 IGA, *Cemex v. Indonesia*. The case is reported as settled. See also “Cemex to end ICSID claim against Indonesia”, *Global Arbitration Review*, 30 June 2006.

<sup>592</sup> The Australian Government’s 2011 Trade Policy Statement: Australia would not agree to ISDS in its treaties. In part, this policy, motivated by the Philip Morris claim, was instituted in response to legislation requiring the plain packaging of cigarettes. Since a change of government in 2013, the inclusion of ISDS will be allowed on a case-by-case basis. See Kurtz, J. (2011), “The Australian Trade Policy Statement on Investor-State Dispute Settlement”, *American Society of International Law*, Vol.15, Issue 22, <http://www.asil.org/insights/volume/15/issue/22/australian-trade-policy-statement-investor-state-dispute-settlement> (Last accessed: 30 Aug 2015); Kurtz, J. (2012), “Australia’s Rejection of Investor-State Arbitration: Causation, Omission and Implication”, *ICSID Review* Vol.27, p.65.

<sup>593</sup> From July 2015, the Indonesian Government intended to terminate its 67 BITs and renegotiate them to provide greater capacity to regulate in the public interest for health, the environment or financial reasons. <http://indonesia.nlembassy.org/organization/departments/economic-affairs/termination-bilateral-investment-treaty.html>. See also Sharma, S., Trakman Leon, “Indonesia’s Termination of the Netherlands–Indonesia BIT: Broader Implications in the Asia-Pacific?”, 21 Aug 2014, (Last accessed: 30 August 2015) <http://kluwerarbitrationblog.com/blog/2014/08/21/indonesias-termination-of-the-netherlands-indonesia-bit-broader-implications-in-the-asia-pacific/>

<sup>594</sup> See developing countries position on this issue: UNCTAD IISD, 7<sup>th</sup> *Annual Reform Forum of Developing Countries Investment Negotiators*. [https://www.iisd.org/pdf/2013/7th\\_annual\\_forum\\_report.pdf](https://www.iisd.org/pdf/2013/7th_annual_forum_report.pdf). South American countries (Venezuela, Bolivia, and Ecuador) have recently withdrawn from the ICSID system. See UNCTAD (2010), “Denunciation of the ICSID Convention and BITs: Impact on Investor-State Claims”, IIAs Issues Note No.2 December 2010; Tietje, C., Nowrot, K., Weckernagel, C. (2009) “Once and Forever? The Legal Effects of a Denunciation of ICSID”, *TDM* 1, Investor-State Disputes: International Investment Law. For Venezuela, see: [http://www.pgr.gob.ve/index.php?option=com\\_content&view=article&id=531:gobierno-bolivariano-denuncia-convenio-con-ciadi-&Itemid=23](http://www.pgr.gob.ve/index.php?option=com_content&view=article&id=531:gobierno-bolivariano-denuncia-convenio-con-ciadi-&Itemid=23). (Last accessed: 10 September 2015) For Ecuador, see Nowrot, K. (2011), “International Investment Law and the Republic of Ecuador: From Arbitral Bilateralism to Judicial Regionalism”, *TDM* 1, Latin America.

In the third era (2000s), an effort has been made to correct the unbalanced pendulum of the previous eras, by reengaging States in the investment treaty system.<sup>595</sup> The ACIA has followed a trend towards a more elaborate regulation of ISDS proceedings on many basic issues. This development ensures more transparency, and fairer outcomes, which increases overall legitimacy of the ISDS regime. The ACIA provides for a fully-elaborated ISDS section for claims arising under substantive treaty provisions. However, it mainly refers dispute resolution to external institutional rules. This system of external references gives investors freedom to choose their own appropriate forum. More importantly, the ACIA attempts to balance the scales both by taking into account investors' interests and being sensitive to States' regulatory needs.

As a consequence, the ACIA DSM becomes more politicised. Not only do ASEAN Member States have a prominent role in State-to-State mechanisms, they have also increased their role in order to influence ISDS. ASEAN Member States' intervention is significant in applying and interpreting the ACIA. The State-to-State mechanism is the only forum for sensitive or political disputes, such as liberalisation in the pre-establishment phase. In other words, the ACIA reinserts a dose of the "ASEAN Way" into ASEAN relations.

Under the new balanced approach, the ACIA offers investors and States a myriad of choices ranging from amicable settlements to legally-binding decisions which are expeditiously enforced. This chapter analyses components of the ACIA DSM, examines their potential and limits, and recommends policy options for reform. As the ACIA maintains parallel distinction under the two-pronged approach, this chapter is organised into two sections. Section 6.1 addresses ISDS which is the most crucial tool to protect ASEAN investors under the ACIA. It is noted that, within mainstream practice, several options for each particular clause are available, and different treaties take different approaches.<sup>596</sup> This section discusses options which the ACIA has chosen on selected aspects of arbitral rules and proceedings, in comparison to other prominent models. It is also important to consider the implications of the "hybridity"<sup>597</sup> of DSM in the ACIA, *i.e.*

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See also European Federation for Investment Law and Arbitration (EFILA), A Response to the Criticism Against ISDS, 17 May 2015, pp.26-29.  
[http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2014/130710/LDM\\_BRI\(2014\)130710\\_REV2\\_EN.pdf](http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2014/130710/LDM_BRI(2014)130710_REV2_EN.pdf) (Last accessed: 9 September 2015)

<sup>595</sup> Roberts, A. (2014). "State-to-State Investment Treaty Arbitration: A Hybrid Theory of Interdependent Rights and Shared Interpretive Authority", *Harvard International Law Journal*, Vol.55, Issue 1, p.1-3.

<sup>596</sup> Pohl, J., Mashigo, K., Nohen, A. (2012), *Dispute Settlement Provisions in IIAs: A Large Sample Survey*, OECD WP on International Investment, OECD Publishing, p.10.

<sup>597</sup> Roberts, A. (2014); Roberts, A. (2013), *Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System*, *American Journal of International Law*, Vol.107, Issue 1, p.92.

the potential role of the State-to-State mechanism and its proper relationship with investor-State arbitration.

Section 6.2 addresses in detail the ASEAN Protocol on Enhanced Dispute Settlement Mechanism (“EDSM” or “Vientiane Protocol”)<sup>598</sup> with a mechanism specifically designed for intra-regional economic disputes between ASEAN Member States. Even though the EDSM Protocol does not establish the “ASEAN court”, it provides an enhanced DSM dissimilar to a traditional dispute settlement under public international law. The EDSM can be seen as a vehicle to a deeper economic integration in ASEAN.

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<sup>598</sup> The ASEAN EDSM was signed on 29 November 2004 at Vientiane, Laos.

## Section 6.1 Investor-State Dispute Settlement Mechanisms

Similar to most EU Member States (traditionally) and the United States,<sup>599</sup> ASEAN Member States are in favour of including ISDS in their IIAs because they generally consider that this type of DSM encourages investment flows. When breaches to guaranteed rights are alleged to have taken place, ASEAN investors may have access to various mechanisms, which give rise to complaint and initiation of legal action. Given the ASEAN context, three specific arguments could explain why ASEAN Member States have decided to internationalise and privatise their investment dispute resolution.

Firstly, the ACIA takes into account the fact that ASEAN Member States have diverse legal frameworks and court systems. Due to the different history, economy and political backgrounds of ASEAN Member States, ISDS is preferable in order to reinforce investors' confidence. Traditionally, ISDS has advantages of flexibility, autonomy of the parties, compared to the only option available under domestic court procedure. International dispute settlements are more independent than national courts. The ISDS mechanism depoliticises investment disputes and creates a forum that offers ASEAN investors a fair hearing before an independent, neutral and qualified tribunal. Without requiring permission of their home States, ASEAN investors have discretion over commencement, prosecution, and settlement of a claim. Damages awarded are also paid directly to the wronged investors.

Secondly, the ACIA ISDS applies to intra-regional relations, rather than to external relations as do the TTIP, TTP and CETA. ASEAN Member States would be less concerned about large multinational firms. Better protection of investors' rights will encourage more investment flows, which will strengthen the realisation of the AEC, as well as confirming the character of a rule-based community. However, it must be remembered that the ACIA also covers foreign-owned ASEAN based (FOAB) investments in the definition of "ASEAN investment". Non-ASEAN investors, who own or control a juridical person of an ASEAN Member State with substantive business operations in the territory of such other Member State, may potentially have standing before the ISDS mechanism.<sup>600</sup>

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<sup>599</sup> European Commission, Public consultation on modalities for investment protection and ISDS in TTIP, [http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc\\_152280.pdf](http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf); Office of the United States Trade Representative, "U.S. Objectives, U.S. Benefits in the Transatlantic Trade and Investment Partnership: A Detailed View", <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2014/March/US-Objectives-US-Benefits-In-the-TTIP-a-Detailed-View> (Last accessed: 8 September 2015)

<sup>600</sup> See chapter 3.2.2.2.

Thirdly, it is alleged that ISDS freezes policy settings of States, and has undermined the ability of legislators to enact for public interest purposes, which is the essence of sovereignty.<sup>601</sup> On this issue, reference is made to substantive provisions discussed in Chapters 4 and 5. The ACIA has opted for a narrow approach of investment standards and has provided more policy space for ASEAN Member States. However, the “ASEAN Way” of consensus and flexibility is observed in several aspects of the ACIA ISDS. These aspects are scrutinised in the following sections.

Section 6.1 discusses whether, and to what extent, the DSM practice of the ACIA follows the general trend of more detailed rules. This section shows that the ACIA has a standard structure of ISDS provisions. It is based on the NAFTA model,<sup>602</sup> and has a “system of reference” to the existing arbitration rules under the ICSID<sup>603</sup> and the UNCITRAL.<sup>604</sup> Generally, the ACIA attempts to grapple with some of the inherent concerns of the system that have crystallised over the past decades. It takes account of developments by including an array of provisions to clarify or to renovate the practice under the previous regime.

However, criticisms have been made, for example, over difficulties in correcting erroneous arbitral decisions, independence and impartiality of arbitrators, third-party submissions, requirements for a public and transparent process and the possibility of an appellate mechanism. In the light of up-to-date practice, developments and flaws of the ACIA are addressed in section 6.2. This section attempts to justify the ACIA’s choices. It argues that despite its rules-enhancing approach, the ACIA is concluded in a way to preserve the autonomy of the parties. The ASEAN Member States do not follow every option taken by the newly negotiated IIAs, but rather specifically tailor the ACIA according to the “ASEAN Way” of dispute settlement.

### 6.1.1 General Practice: Towards Rules-Enhanced Procedures

In order to assess the modernisation of the ACIA, an understanding of the general practice of the 1990s-styled BITs is required. There are two major approaches regarding ISDS.<sup>605</sup> The first, traditional, approach is minimalist, exemplified by the IGA and most BITs concluded by ASEAN and European countries. This minimalist approach is generally

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<sup>601</sup> Bell-Pasht, K. (2011), *Report on the Environmental Impact of the CETA*, Toronto, Canadian Environmental Law Association, p.29.

<sup>602</sup> Report of the 2<sup>nd</sup> WG-ACIA, 29-31 January 2008, Kuala Lumpur, Malaysia.

<sup>603</sup> Convention for the Settlement of Investment Disputes between States and Nationals of Other States, opened for signature 18 March 1965, entered into force 14 October 1966. (“ICSID Convention”).

<sup>604</sup> The Arbitration Rules of the UNCTAD.

<sup>605</sup> UNCTAD (2014), ISDS, p.169.

characterised by a broad ISDS scope and limited procedural specifications. Most imperative procedural aspects are left to be determined by the selected rules of arbitration. The second and more recent approach has a more circumscribed scope.<sup>606</sup> A number of new procedural features are regulated by the treaty itself.

The ACIA has opted for a details-enhancing approach, which allows ASEAN Member States to exercise more control over procedural and other aspects of arbitration. These detailed guidelines aim to delineate the scope of ISDS provisions, to optimise cost-effective process, and to legitimise arbitral procedure. More importantly, they limit the discretion of arbitral tribunals in interpreting the scope of the ISDS and in determining procedures of disputes arising out of the ACIA. The complexity of the inclusion of ISDS in the ACIA reflects both offensive (regulatory sovereignty) and defensive aspects (investment-friendly environment) of procedures. Despite all this variation and level of detail, it is crucial to ensure that the whole ISDS regulations under the ACIA create a coherent and functional arbitral process.

The ACIA was not concluded from a capital-exporting perspective, which primarily concerns protection of investors abroad, but rather in a more cautious manner, which concerns preservation of domestic regulatory autonomy. Nevertheless, the inclusion of ISDS in the ACIA has drawn several criticisms, which have effect on the rule-making of the ACIA and on the level of ISDS acceptance in the ASEAN Member States. It is troublesome for ASEAN Member States, to come before arbitral tribunals, especially in times of economic crisis or budgetary restrictions. A dispute could result in extreme costs for a Member State to comply with the awards and to pay legal defence costs.

In order to prevent an unmanageable situation, the ACIA uses numerous techniques to set the scene before and after the initiation of arbitration. As discussed in Chapter 5.1, one of the most effective techniques is an explicit exemption of the ISDS from the scope of MFN application. ACIA Section B has created indispensable elements for the operational ISDS (*i.e.* State's consent to arbitration, amicable or alternative dispute resolutions, scope of the ISDS mechanism, available arbitration forums, constitution of tribunals, selection of arbitrators, and awards and their recognition and enforcement). Other complementary issues (*i.e.* regional centres of arbitration, interpretation mechanism, and transparency) depend more on specific policies and concerns of the ASEAN Member States. As a whole, the ISDS under the ACIA regime is specifically tailored to reflect the "ASEAN Way".

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<sup>606</sup> *Idem*, p.170.

### 6.1.1.1 State's Consent as Substantive Scope of ISDS

Identifying the scope of the ISDS is clearly a key matter to be determined by the ACIA. Generally, the scope of ISDS depends greatly on the scope of the investment agreement. However, ASEAN Member States have given their consent only to specific types of claims. Before the initiation of a procedure, parties must be clear who could potentially invoke the mechanism and on which grounds, in order to protect their rights and benefits granted under the ACIA.

Traditional BITs usually have a broad, open-ended formulation.<sup>607</sup> They extend ISDS to all kinds of disputes “related to” or “in connection with” an investment arising between an investor and the host State. Breaches may be alleged of the State regarding its own domestic law, an investment contract or even customary international law. Other BITs,<sup>608</sup> including the ACIA, have opted for a narrow approach. ACIA article 29 determines the scope of consent to arbitration that ASEAN Member States have given in advance to ASEAN investors. The scope of ISDS envisages narrowing down the range of situations in which investors may resort to ISDS. Accordingly, certain types of claims are expressly excluded from the scope of the ISDS. The ACIA has set a three-fold substantive limit to investor's access to the ISDS mechanism, with respect to subject matter, time and claimant's identity.

#### (1) *Ratione Materiae*

ACIA article 32(b) emphasises that the violation of a treaty obligation must result in losses or damage to the investor. Disputes in the 1970s were initially limited to claims arising under expropriation and compensation clauses.<sup>609</sup> Subsequent treaties, such as the IGA, provided for ISDS in claims arising under other substantive treaty provisions.<sup>610</sup> Under the ACIA, disputing investors may submit a claim to arbitration on numerous grounds, *i.e.* under articles 5 (National Treatment), 6 (MFN), 8 (Senior Management and Board of Directors), 11 (Treatment of Investment), 12 (Compensation in Cases of Strife), 13 (Transfers) and 14 (Expropriation and Compensation) relating to the management, conduct, operation or sale or other disposition of a covered investment.<sup>611</sup> In line with general practice, these enumerated grounds concern only protection obligations in the post-

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<sup>607</sup> See *e.g.* 2009 China-Peru FTA article 139.

<sup>608</sup> See *e.g.* 2009 India-Korea FTA article 10.21.

<sup>609</sup> Pohl, J., Mashigo, K., Nohen, A. (2012) *Dispute Settlement Provisions in IIAs: A Large Sample Survey*, p.16.

<sup>610</sup> IGA article X.

<sup>611</sup> ACIA article 32.



establishment phase, the pre-establishment phase or liberalisation obligations cannot be invoked by investors against ASEAN Member States.

## **(2) *Ratione Temporis***

The ACIA sets the time limit within which a claim may be brought before the arbitral tribunals.<sup>612</sup> The claims must arise out of events which occurred, or were raised, after the entry into force of the ACIA. They must also take place within three years of the time at which the disputing investor became aware, or should reasonably have become aware, of a breach of an obligation under the ACIA.<sup>613</sup> This time limitation narrows down the scope of the ISDS into a reasonable period of an awareness of loss or damage to the disputing investor or a covered investment.

## **(3) *Ratione Personae***

ACIA article 28(b) defines the meaning of “disputing investor”. The ACIA permits ISDS claims to be submitted by ASEAN investors. In addition, where an investor owns or controls an enterprise in the host State, the ACIA allows an enterprise to bring claims in its own name or allow the investor to bring claims on behalf of such an enterprise. Article 29(2) stresses that a natural person possessing nationality or citizenship of a Member State may not pursue a claim against that Member State under the ISDS Section.<sup>614</sup>

Like other traditional BITs, the ACIA does not exclude the possibility of multi-party proceedings, it is doubtful whether the ACIA tribunal will allow this kind of representation. As the ICSID Convention is silent on whether “class action”-type arbitrations are allowed under the Convention, arbitral opinions are divided. For instance, the majority of the tribunal in *Ambiente Ufficio v. Argentina* interpreted the ICSID Convention in favour of a plurality of claimants jointly submitting a claim to ICSID,<sup>615</sup> while the dissenting arbitrator expressed “total disagreement” with the conclusion of the majority on this point.<sup>616</sup> The newly negotiated EUSFTA has solved this potential problem. Its footnote 23(b) to article 9.16 paragraph 1 explicitly prohibits “class-action” claims. This rule aims to prevent fraudulent or manipulative claims.<sup>617</sup> For more certainty, the ACIA should expressly exclude

<sup>612</sup> ACIA article 29(3).

<sup>613</sup> ACIA article 34(1)(a).

<sup>614</sup> See also Schreuer, C. (2009), “Nationality of Investors: Legitimate Restrictions vs. Business Interests”, *ICSID Review, Foreign Investment Law Journal*, Vol.24, Issue 2, pp.521-527.

<sup>615</sup> *Ambiente Ufficio S.p.A. v. Argentine*, ICSID Case No. ARB/08/9, Decision on Jurisdiction and Admissibility, 8 February 2013, para.146.

<sup>616</sup> *Idem*. Dissenting Opinion of Santiago Torres Bernardez, para.81.

<sup>617</sup> The making of an investment or business re-organisation for the purpose of bringing a case, as Philip Morris has allegedly done to bring its case against Australia, is explicitly prohibited. See *European Commission, Investment Provisions in the EU-Singapore FTA: Summary*, [http://trade.ec.europa.eu/doclib/docs/2014/october/tradoc\\_152845.pdf](http://trade.ec.europa.eu/doclib/docs/2014/october/tradoc_152845.pdf)

“class action” as inadmissible. This exclusion would release ASEAN Member States from the possibility of being challenged by a class composed of an undetermined number of unidentified claimants.

#### **6.1.1.2 Non-Confrontational Settlement Attempts**

Generally, treaties with ISDS provisions require that disputing parties must initially attempt to settle their dispute amicably. The ACIA promotes amicable resolutions by mandating consultations and negotiations. Its article 31 sets a non-confrontational dispute settlement as a condition precedent, before an ASEAN investor may proceed to the adjudicatory stage. The non-confrontational mechanism includes consultation and negotiation, and other non-binding third-party procedures. These alternative dispute resolutions (ADR) resonate with the tradition of “ASEAN Way” of dispute settlement, because they deprioritise investor-State arbitration mechanism, thus reinforcing the function of arbitration as a measure of last resort.<sup>618</sup> The ADR may also reduce ASEAN Member States’ financial liabilities arising from ISDS awards and save resources of both parties.

As transparency is not required, these procedures can be totally confidential, including any advice or proposed solution.

In order to make sure that an issue is truly unsolvable, ACIA article 32 sets six months as a “cooling-off period”, starting from the date of the receipt by a disputing State of a request for consultation. ACIA article 30 stipulates “conciliation” as a parallel means of dispute settlement which the disputing parties may begin and terminate at any time. The procedures for conciliation may continue even if the disputing parties decide to submit a claim to an arbitral tribunal and while the arbitral proceedings are in progress. As the conciliation is a voluntary means, the positions taken during these proceedings are without prejudice to the legal position of either disputing party in any further arbitral proceedings.

In fact, there is room for improvement regarding the use of non-binding third-party procedures in the ACIA. The newly negotiated texts, for example, the text on ISDS for EU Agreements,<sup>619</sup> and the CETA,<sup>620</sup> contain a specific annex on mediation, detailing the initiation of the procedures, selection of the mediator, rules of the procedures, implementation of a mutually agreed solution, and general provisions on confidentiality and relationship to other dispute settlement procedures. If the ASEAN Member States

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<sup>618</sup> UNCTAD (2014), ISDS, p.176.

<sup>619</sup> EU ISDS Text, Annex I: Mediation Mechanism.

<sup>620</sup> CETA Annex III: Mediation Procedure, Article 33, Dispute Settlement.

consider the ADR as preferable means to cope with intra-ASEAN disputes, they should improve the ADR mechanism of the ACIA, for instance, by providing a specific annex on the issues. For the purpose of impartiality, a mediator must not act as an arbitrator in any future investor-State arbitration relating to the same dispute, unless agreed by the parties; and not serve as a panellist in the subsequent State-to-State proceedings involving the same matter for which he or she has been a mediator.

### 6.1.1.3 Choice of Forum

When a matter cannot be solved amicably within a given time, the ACIA further provides adjudicatory means of dispute settlement for ASEAN investors. Practice in this area varies amongst countries.<sup>621</sup> Currently, most IIAs, including the ACIA, dispense with the duty of exhaustion of domestic remedies. An investor has a “choice of forum”, either international arbitration or domestic courts. Normally, submission to arbitration requires consent of the parties to the dispute. The ACIA ISDS contains States’ advance consent, thereby giving a disputing investor a choice to initiate arbitration. The institution of proceedings constitutes the investor’s acceptance of the offer of consent.<sup>622</sup> An ASEAN investor can choose to submit a dispute to courts or administrative tribunals of the disputing Member State; or under the ICSID Convention and the ICSID Rules of Procedure for Arbitration Proceedings; or under the ICSID Additional Facility Rules; or under the UNCITRAL Arbitration Rules. References to these external institutions rules are commonly found. The ACIA also mentions specifically regional centres for arbitration in ASEAN; or if the disputing parties agree, to any other arbitration institution.<sup>623</sup>

The ICSID is a self-contained system without interference of national courts. It has an enforcement mechanism of arbitral awards in all ICSID Convention Contracting States. Regarding its jurisdiction, ICSID Convention article 25 requires three main elements: (1) *ratione materiae*, a dispute directly arises out of an “investment”; (2) *ratione personae*, the investor’s country of origin and the State complained against are both parties to the

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<sup>621</sup> For instance, Canada, France, Germany and the United Kingdom rarely mention access to domestic remedies in their ISDS clause, while ISDS clauses in treaties concluded by Argentina, Brazil, Chile, Greece and Korea consistently refer to domestic proceedings. See Pohl, J., Mashigo, K., Nohen, A. (2012), p.12.

<sup>622</sup> See generally, Dolzer, R., Schreuer, C. (2012), pp.254-263.

<sup>623</sup> ACIA article 33(1)(a-f) Submission of a claim.

Convention,<sup>624</sup> and (3) a written consent of the parties to submit legal disputes to ICSID arbitration. Disputing parties must satisfy the “double keyhole” test, *i.e.* the claimant must be qualified both under the ACIA and the ICSID Convention.<sup>625</sup> At present, only six ASEAN Member States are contracting parties of the Convention.<sup>626</sup> So this Convention can only be used in disputes involving investors from ACIA-ICSID Parties. Instead, non-ICSID parties may choose the ICSID Additional Facility Rules (AFR), the UNCITRAL Rules, or the regional arbitration Rules. The non-ICSID forums allows for more involvement of ASEAN Member States’ courts, such as reviews of arbitral awards at the seat of arbitration or enforcement of awards in the country where enforcement is sought.<sup>627</sup>

The ACIA also adopts a “sequencing” approach in order to coordinate ISDS and State-to-State mechanisms. In line with ICSID Convention article 27, ACIA article 34(3) excludes State’s interference with the ISDS proceedings. A home State is prohibited from providing any form of diplomatic protection, or bringing an international claim, once a dispute has been referred to investor-State arbitration. Nevertheless, diplomatic protection does not include informal diplomatic exchanges for the sole purpose of facilitating a settlement of the dispute.

#### 6.1.1.4 Constitution of Tribunals

Once an investor chooses to initiate a claim under particular institutional rules, such rules will apply as default. In case that any of these rules is in conflict with a mandatory provision of the ACIA from which the parties cannot derogate, that provision prevails.<sup>628</sup> In constituting a tribunal, ACIA article 33(4) gives disputing parties discretion to waive or modify applicable arbitral rules by written agreements. The agreed rules are binding on the relevant tribunal, and on individual arbitrators serving on such a tribunal.

##### (1) Composition of Arbitral Tribunals

ACIA article 35(1) follows the ICSID approach, where a three member arbitral panel is set as default. Each party in dispute designates one arbitrator and the parties agree

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<sup>624</sup> ICSID Convention article 25(2): the claimant is required to establish that it is a national investor of an ASEAN Member State who is party to the ICSID Convention on two different dates: the date at which the parties consented to ICSID jurisdiction *and* the date of the registration of the request for arbitration.

<sup>625</sup> See the definition of “investor” and “investment” under the ACIA in Chapter 3.

<sup>626</sup> ICSID members are Brunei Darussalam, Cambodia, Indonesia, Malaysia, Philippines, Singapore. Thailand has signed it but not yet ratified. See List of Contracting States and Other Signatories of the Convention, as of 18 April 2015. (Last accessed: 30 Aug 2015). <https://icsid.worldbank.org/apps/ICSIDWEB/icsidocs/Documents/List%20of%20Contracting%20States%20and%20Other%20Signatories%20of%20the%20Convention%20-%20Latest.pdf>

<sup>627</sup> Schreuer, C.H. et al (2009), *The ICSID Convention: A Commentary*, 2<sup>nd</sup> Ed., p.900.

<sup>628</sup> See 2010 UNCITRAL Arbitration Rules article 1(3) Scope of application, Section I. Introductory rules; SIAC Rules article 1, 1.1 Scope of Application and Interpretation.

upon the chair of the tribunal.<sup>629</sup> The ACIA also provides an option of sole arbitrator, particularly for small or medium-sized enterprises whose compensation or damages claimed are relatively low. The arbitral tribunal is constituted within 75 days from the date of submission of a claim. In the event that the given period has passed and in the absence of any other relevant arrangement, “the Appointing Authority, on the request of a disputing party, shall appoint, in his or her discretion, the arbitrator or arbitrators who have not been appointed.”<sup>630</sup> The meaning of the “Appointing Authority” varies, depending on the forum of the case.<sup>631</sup>

## **(2) Place of Arbitration**

The treaties usually contain language on the place (*situs*) of arbitration. The *situs* may have an impact on the applicable arbitration rules and may influence enforcement possibilities. According to ACIA article 36(5), the tribunal determines the place of arbitration in accordance with the applicable arbitration rules, provided that the place is in the territory of a State that is a party to the 1958 UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards (“New York Convention”).<sup>632</sup> This article, however, opens a possibility for disputing parties to agree otherwise.<sup>633</sup>

Presently, every ASEAN country is a contracting party to the New York Convention; this is a significant step by the ASEAN Governments in creating an attractive legal environment for foreign investments. Myanmar is the last ASEAN Member State to accede to the Convention (15<sup>th</sup> July 2013).<sup>634</sup> The most urgent task for the Myanmar Government is to enact new arbitration legislation which incorporates the provisions of the New York Convention into Myanmar’s domestic laws, because its 1944 Arbitration Act only provides for domestic arbitration and does not provide a framework for the recognition and enforcement of foreign arbitral awards. Theoretically, the parties are assured of the enforceability of the award taking place in any ASEAN Member State.

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<sup>629</sup> ICSID article 37(2)(b); UNCITRAL Arbitration Rules article 9 set similar composition except that the two party-designated arbitrators, rather than the parties, choose the third arbitrator as their chair.

<sup>630</sup> ACIA article 35(3).

<sup>631</sup> ACIA article 28(a).

<sup>632</sup> ACIA article 36.

<sup>633</sup> Other treaties may require arbitration to be held in a specific State or city. For instance, NAFTA article 1130, unless otherwise agreed, requires the place of arbitration must be in the territory of a country that is a party to both NAFTA and the New York Convention.

<sup>634</sup> List of the Contracting States (Last accessed: 30 Aug 2015)

See <http://www.newyorkconvention.org/contracting-states/list-of-contracting-states>

### 6.1.1.5 Selection of Arbitrators: Qualifications and Challenges

The disputing parties' power to select arbitrators is a major advantage of arbitration over litigation before domestic courts, because the selection relies on the self-interest of the parties as a basis of winning the case. "The choice of persons who compose the arbitral tribunal is vital and often the most decisive step in an arbitration. It has rightly been said that arbitration is only as good as the arbitrators".<sup>635</sup> Regardless of the applicable rules discussed *supra*, appointing the right arbitrator(s) maximises the quality of the process and its outcome. ACIA article 35(2) sets two types of qualifications that arbitrators must possess: (1) expertise and knowledge and (2) independence and impartiality.

It is paramount that arbitrators possess certain technical or legal expertise or experience. The ACIA generally requires knowledge in public international law, international trade or international investment rules. The ACIA could have added the awareness of ASEAN legal instruments, with a further option to require specialised expertise for certain categories of cases, for instance, financial services, oil and gas. While the ACIA does not require specific qualifications, the disputing parties can seek to appoint ASEAN-wise arbitrators, if they deem appropriate. Furthermore, as ASEAN people speak different languages, the linguistic ability of arbitrator is imperative.<sup>636</sup> The parties should also choose an arbitrator who can dedicate sufficient time to the case and be available for hearings and meetings. The wrong choice of arbitrators could affect the cost and time of proceedings.

Along with the expertise and knowledge requirements, the integrity of the arbitrator is also required. The arbitrators must be, and remain, independent from the parties, and impartial in deciding the case. Generally, all appointed arbitrators must be independent and serve in their individual capacities and must not take instructions from any organisation or government with regard to matters in the dispute, or be affiliated with the government of any disputing party.<sup>637</sup> The ACIA concerns specifically conflict of interest induced by nationality and permanent residence. In fact, the ACIA is one of the rare investment agreements which address the question of permanent residence of arbitrators.<sup>638</sup> It requires that the presiding arbitrator cannot have the nationality of, or have permanent residence in, either the home or host States.<sup>639</sup>

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<sup>635</sup> Lalive (1989), *Melanges en l'Honneur de Nicolas Valticos*, Droit et Justice, Editions Pedone, p.289.

<sup>636</sup> ASEAN Charter article 34, English is working language of ASEAN.

<sup>637</sup> AANZFTA article 23, EU Draft on ISDS article 8(7).

<sup>638</sup> The criterion of permanent residence is indeed similar to the criteria that the ACIA uses for the definition of investor. Previously, ASEAN IGA article X(3) did not set the condition of the non-permanent residence.

<sup>639</sup> ACIA article 35(1)(b).

The ACIA does not contain specific provisions on the challenging process.<sup>640</sup> Like common BITs, the ACIA simply prescribes the appointment procedure of the replacing arbitrator.<sup>641</sup> An arbitrator must be replaced where anyone appointed resigns or becomes unable to act. The replacing arbitrator is appointed in the same manner as the original arbitrator, and has similar powers and duties. In general, an arbitrator must resign when he/she discovers or is discovered to have any incompatibility with arbitral functions. The challenging process could refer to the applicable arbitration rules under which the tribunal has been constituted.<sup>642</sup>

More recent investment agreements, for example, the EU draft text on the ISDS and the CETA, have created a “code of conduct” of members of arbitral tribunals and mediators, as an annex to the agreements in case of “justifiable doubts” as to the impartiality or independence of arbitrators; for example, when an arbitrator has a significant financial or interest in the matter at stake.<sup>643</sup> This code of conduct may be used to challenge arbitrators. It provides responsibilities to process, disclosure obligations, duties of members, independence and impartiality, obligations of former members, and confidentiality.

In order to reinforce States’ participation in proceedings and to solve conflicts of interests of arbitrators, a mixed approach on the constitution of the tribunal has recently been introduced by the EU Draft on ISDS.<sup>644</sup> The EU Commission generally follows the ICSID approach on appointment of arbitrators. However, this traditional approach is complemented with the creation of a roster of at least 15 individuals to serve as arbitrators in investment disputes involving the EU or EU Member States. For this purpose, each Party to the treaty must propose at least five individuals to serve as arbitrators and select one who is not a national of either party to act as chairperson of the tribunal. Therefore, despite the discretion of disputing parties under the traditional rules, the availability of potential arbitrators is limited to the proposed individuals in the roster. On this matter, the ACIA allows more flexibility for disputing parties, because States could not intervene in or have influence on the constitution of the tribunal by setting a list of arbitrators beforehand.

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<sup>640</sup> Rogers, C.A. (2005), “The Vocation of the International Arbitrator”, *American University International Law Review*, Vol. 20, Issue 5, Article 4, p.957-1020; Daele, K. (2012), *Challenge and Disqualification of Arbitrators in International Arbitration*, Series International Arbitration Law Library 24, Kluwer Law International; Rosenberg, C., Tupa, Fernando, “Challenges to Arbitrators: Should the Challenge Process be Overhauled?”, in Laird, I.A., Sabahi, B., Sourgens, F.G., Weiler, T.J. (Eds.) (2015), *Investment Treaty Arbitration and International Law*, Volume 8, New York, Juris Net LLC, pp.67-98.

<sup>641</sup> ACIA article 35(7).

<sup>642</sup> See e.g. UNCITRAL Arbitration Rules article 11-13 Disclosures by and challenge of arbitrators.

<sup>643</sup> EU ISDS Text Annex II; CETA Annex II to Chapter 33.

<sup>644</sup> EU ISDS Text article 8.

### 6.1.1.6 Awards and Their Recognition and Enforcement

The issuance of awards, followed by their recognition and enforcement, is the last but not least important stage in the ISDS proceedings. “The enforcement process is sometimes considered the weakest link in the entire chain of international dispute resolution”.<sup>645</sup> More precisely, State immunity from execution in the collection of awards rendered in international investment arbitration is the “Achilles’ heel” of the investor-State arbitration system.<sup>646</sup> At this stage, the role of ASEAN Member States is key to make the ISDS awards effective, because they may refuse to recognise and enforce the awards.

#### (1) Awards

In line with the ICSID Convention and the UNCITRAL Arbitration Rules, the ACIA has provisions on interim and final awards, as well as the revision or annulment of the awards. The objective of investor-State arbitral awards differs from litigation between States under the WTO DSU.<sup>647</sup> The purpose of the WTO DSU award is to make a State revoke non-compliant measures, or to authorise countermeasures, whereas investor-State arbitration focuses on recompensing the wronged foreign investors who have been substantially affected by the host State’s measures.

#### (a) Provisional Remedies

ACIA article 34(2) allows investors to seek interim relief before courts or administrative tribunals of the disputing Member State, without prejudice to their rights to arbitration. Where the situation is urgent, a national tribunal may order an interim measure of protection to preserve the rights of a disputing party from irreparable harm.<sup>648</sup> In principle, the ACIA allows the investor to seek interim relief at all times, *i.e.* at the initiating or continuing stage of action. Interim relief must be sought for the sole purpose of preserving the disputing investor’s rights and interests, and not involve the payment of damages or resolution of the substance of the matter in dispute. An interim award can be subject to the review procedure.<sup>649</sup>

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<sup>645</sup> Blessing, M. (1996), “The New York Convention: The Major Problem Areas”, in *The New York Convention of 1958*, ASA Special Series No.9, p.20.

<sup>646</sup> Gerlich, O. (2015), “State Immunity from Execution in the Collection of Awards Rendered in International Investment Arbitration: the Achilles’ Heel of the Investor-State Arbitration System?”, *ARIA*. Vol.26, No.1, Juris Publishing; Bjorklund, A.K. (2009), “State Immunity and the Enforcement of Investor State Arbitral Awards”, in Binder, C., Kriebaum, U., Reinisch, A., Wittich, S. (Eds.) (2009), *International Investment Law in 21<sup>st</sup> Century: Essays in Honour of Christoph Schreuer*, pp.303, 315 -317.

<sup>647</sup> Katia, Y.-S. (2010), *Arbitration under IIA: A Guide to the Key Issues*, OUP, Oxford.

<sup>648</sup> *Tethyan Copper Company v. Pakistan*, ICSID Case No.ARB/12/1, Decision on Provisional Measures, 13 December 2012, para.118.

<sup>649</sup> ACIA article 41(6).



### **(b) Final Awards**

ACIA article 41 provides for an award having binding force for the disputing parties. Disputing parties are expected to comply with an award without delay. Under the ACIA, an award is considered final after 120 days have elapsed in the case of ICSID, or 90 days in the case of UNCITRAL. During this period, the disputing parties may request review or annulment of the award, under limited circumstances. The review process is permitted according to agreed arbitral rules, such as the ICSID annulment process,<sup>650</sup> and domestic court review at the seat of arbitration and place of enforcement for non-ICSID awards.

At the end of the review period, the investor may request enforcement of the award.

In practice, reviews are likely to focus on fundamental standards of procedural fairness, and not on the substance of the decision. This concern has led to a conclusion of several IIAs, most by the United States, which address the potential establishment of a standing body to hear appeals from investor-State arbitration.<sup>651</sup> The ACIA does not mention any consideration on setting up an appellate body which would be able to perform an

in-depth scrutiny of the award and correct substantive errors in the interpretation and application of the ACIA. The ACIA remains of traditional view of final and binding award.

### **(2) Post-Award Phase**

After the issuance, the recognition and enforcement of awards is categorised into two tracks: ICSID and non-ICSID. While the ICSID Convention has a unique system of review and enforcement of arbitral award,<sup>652</sup> non-ICSID awards are subject to the “New York Convention”. Pursuant to ACIA article 41(8), “a claim that is submitted for arbitration... shall be considered to arise out of a commercial relationship or transaction for purposes of Article 1 of the New York Convention”.

#### **(a) Enforcement of the Awards**

As long as an award is not subject to a review process, the parties are under a legal obligation to comply with it. For ICSID awards, “each Contracting State shall recognise an award... as binding and enforce the pecuniary obligations... within its territories as if

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<sup>650</sup> ICSID Convention article 52(3), Special “Ad Hoc Committee” decides on applications of annulment of an award.

<sup>651</sup> See *e.g.* Chile-United States FTA article 10.19(10); Annex 10-F CAFTA. UNCTAD (2014), ISDS, p.193.

<sup>652</sup> ICSID Convention, Article 50-52, Section 5 Interpretation, Revision and Annulment of the Award; Article 53-55, Section 6 Recognition and Enforcement of the Award.

it were a final judgment of a court in that State”.<sup>653</sup> For non-ICSID awards, the conditions for recognition and enforcement of arbitral awards are provided for in the New York Convention and in national law. ACIA article 41(9) confirms general obligation for the Contracting States under Article I of the New York Convention, and provides for a connexion of the national authority and international arbitration, by stating that “each Member State shall provide for the enforcement of an award in its territory”.

Due to the private nature of arbitral awards, national courts are necessarily involved in the process. Footnote 15 to ACIA article 41 remarks that “the Parties understand that there may be domestic legal and administrative processes that need to be observed before an award can be complied with.” However, national law must not stipulate conditions for foreign arbitral awards which are substantially more onerous than those applicable to domestic ones.<sup>654</sup> National rules may relate, for example, to discovery of evidence, estoppel or waiver, set-off or counterclaim against the award, entry of judgment clause, period of limitation for enforcement of an award under the Convention and interest incurred on the award.<sup>655</sup>

#### **(b) Limit to Enforcement of Awards**

The enforcement proceedings depend not only on national rules which differ in many aspects in ASEAN Member States, they also depend on national courts which retain power to refuse to recognise and enforce awards. A court seized with a request for the recognition and enforcement of a foreign arbitral award cannot examine an award on its merits. It may, however, refuse to recognize or enforce ICSID awards on grounds of State immunity,<sup>656</sup> and non-ICSID awards on grounds enumerated in New York Convention article V.

The list of grounds for refusal under the New York Convention is exclusive: the court may not base its refusal on any other ground. These grounds must be interpreted restrictively in accordance with the purpose of the New York Convention. The grounds may be divided into two categories. The first category (article V(1)) provides for procedural protection and may be invoked by the parties.<sup>657</sup> The second category (article

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<sup>653</sup> ICSID Convention article 54(1).

<sup>654</sup> NYC Article III.

<sup>655</sup> UNCTAD (2003), *Recognition and Enforcement of Arbitral Awards: The New York Convention*, Dispute Settlement International Commercial Arbitration, United Nations, p.23.

<sup>656</sup> ICSID Convention article 55: “Nothing in Article 54 shall be construed as derogating from the law in force in any Contracting State relating to immunity of that State or of any foreign State from execution.”

<sup>657</sup> NYC article V(1) refers to: (a) incapacity of the parties and formal invalidity of the arbitration agreement; (b) violation of due process; (c) excess of authority by the arbitrator; (d) infringement of the composition of the arbitral tribunal or of the arbitration proceedings; and (e) the award has not yet become binding or has been set aside or suspended.

V(2)) may be invoked *ex officio* by the court, as it serves vital interests of the forum country: (a) non-arbitrability of the subject-matter; and (b) violation of the public policy of the law of the country where recognition and enforcement is sought. Among these grounds, the public policy ground has increasingly been invoked by the State and has caused considerable controversy. The New York Convention does not define or provide guidelines on what shall be considered “public policy”. Hence, local courts have a significant degree of discretion in interpreting public policy under their own jurisdiction.

Due to inconsistent approaches taken by local courts, many foreign awards remain unenforceable, making the whole ISDS process purposeless. In the case where the ISDS is unsuccessful, or more precisely when a State fails to comply with the award, wronged investors may turn to their home State for protection. By turning an ISDS into a State-to-State dispute mechanism, investors may mitigate the problem of sovereign immunity against execution of investment arbitral awards.

To summarise, section 6.1.1 illustrates that the ACIA has adopted a detail-enhancing approach for several core aspects of arbitral procedures. This approach may lead to harmonisation of regional, or even international, rules in investment arbitration.

### **6.1.2 Specificities: the ASEAN Way of ISDS**

The ASEAN Way of ISDS is a mixed approach. The ACIA has concurrently attempted to insert States’ regulatory power and to preserve the disputing parties’ autonomy. While following a detail-enhanced approach, the ACIA has provided four specific features in its text. Firstly, it employs three techniques to limit a proliferation of claims: (1) a “forks-in-the-road” provision; (2) a preliminary objection; and (3) a consolidation. Secondly, the ACIA is equipped with a mechanism of “joint decision” as one of “governing laws”. This mechanism reallocates interpretative power of the ACIA provisions between tribunals and ASEAN member States. Thirdly, the ACIA provides for regional arbitration centres, whose rules and institutions accommodate ASEAN-specific needs. Fourthly, while the ACIA follows a global movement towards transparency, the level of transparency required is relatively small. This emphasises that the ACIA respects the confidentiality of the parties, and by that, leaves more policy space for both States and investors. In this regard, the ACIA preserves advantages of arbitral procedures, especially consensus and flexibility. Section 6.1.2 argues that all these specificities of the ACIA reveal the “ASEAN Way” of dispute settlement.

### 6.1.2.1 Techniques for Limiting the Proliferation of Claims

#### (1) Fork-in-the-Road Clause: the “Exclusive” Approach

Regardless of the choice of forum, once an investor decides to submit a claim before any forum, this investor is barred from the other forums. The investor must file a waiver abandoning any other parallel claim in which the investor may have sought damages related to the identical measures.<sup>658</sup> The investor may not initiate international arbitration proceedings once bringing a case to domestic courts, and *vice versa*. The ACIA uses a technique, called the “fork-in-the-road” provision, to prevent the possibility of “parallel proceedings” which may result in duplication and inconsistency of awards.<sup>659</sup> An ASEAN investor should decide which option is best, by considering efficiency, location, cost, confidentiality, and the level of party control over the proceedings.

Indeed, this “fork-in-the-road” provision is simply an indication of a non-requirement of the exhaustion of domestic remedies. The ACIA does not define a chronological sequence to make both adjudicative avenues successively available. It allows ASEAN investors to resort directly to international arbitration (without having to first go through the domestic judicial system and to prove the domestic system’s ineffectiveness or bias). In case of monist States, domestic courts may have jurisdiction to rule on alleged breaches of the ACIA itself. However, most ASEAN Member States are dualist, where domestic courts are not obliged to take the ACIA into account when they decide cases.<sup>660</sup>

#### (2) Preliminary Objection and Frivolous Claims

When issues relating to jurisdiction or admissibility are raised, ACIA article 36 mandates tribunals to hear preliminary objections separately, prior to the merits of the case.<sup>661</sup> In line with ICSID Rule 41(5), this mechanism allows for expedited dismissal of “frivolous claims”, or parts of them, at an early stage of the proceedings, in order to ensure that the process will not be abused.<sup>662</sup> The tribunal, first of all, decides whether the claim is “manifestly without merit”, or is “not within the jurisdiction or competence of the

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<sup>658</sup> ACIA article 34(1).

<sup>659</sup> “Parallel proceedings occur when the same cause of action is adjudicated in more than one forum, either before multiple domestic courts, domestic and international courts, or before multiple international forums. Parallel proceedings are problematic at both the national and international levels as they waste money and conflicting results undermine legal certainty.” See Shookman, J. (2010), “Too Many Forums for Investment Disputes? ICSID Illustrations of Parallel Proceedings and Analysis”, *Journal of International Arbitration*, Issue 4, pp.361-378.

<sup>660</sup> See p.32.

<sup>661</sup> ACIA article 36(1).

<sup>662</sup> “Frivolous Claims in International Adjudication: A Study of ICSID”, Rule 41(5) and of Procedures of Other Courts and Tribunals to Dismiss Claims Summarily, *Journal International Dispute Settlement* (2012) Vol.3, No.1, pp.137-168.

tribunal”. The disputing parties are given a reasonable opportunity to present their views and observations to the tribunal, before the tribunal renders an award to that effect.

Tribunals may shift the costs and fees incurred in submitting or opposing the objection for frivolous claims to the claimants.<sup>663</sup> In the case where the issues are inextricably intertwined with the merits of the case or tribunals need more evidence, a bifurcation of the case may not be warranted. It is observed that the ACIA requirement is stronger than Canada’s Model BIT (2004) which simply allows (but does not mandate) separate consideration of preliminary objections by respondent States.

While the ACIA has a specific mechanism for preliminary objection, it does not explicitly mention corruption as a ground to hear preliminary objections. Corruption is a concern especially for developing countries where institutions are weak and the rate of corruption is high.<sup>664</sup> Even though the ACIA covers only investment which is admitted according to domestic laws, it is doubtful that this requirement could prevent bribery occurring in the process of approval of foreign investment. In fact, “[s]uch corruption is an international evil; it is contrary to good morals and to an international public policy common to the community of nations”.<sup>665</sup> The report on “ASEAN Integrity Community: A vision for transparent and accountable integration” also warns that spreading corruption across the Southeast Asia region threatens to derail plans for greater economic integration.<sup>666</sup> Some arbitral cases refer to the concept of “international public policy”. However, the use of this concept does not seem very clear and consistent.<sup>667</sup>

In order to better prevent corruption, the OECD countries have adopted the “Anti-Bribery Convention”,<sup>668</sup> and anti-corruption issues have been recently mentioned in a few IIAs.<sup>669</sup> For instance, CETA article X.17(3) provides that “[f]or greater certainty, an investor may not submit a claim to arbitration under this Section where the investment has been made through fraudulent misrepresentation, concealment, corruption, or conduct

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<sup>663</sup> ACIA article 36(4).

<sup>664</sup> Cambodia, Laos and Myanmar figure among the highly corrupted countries, while Vietnam, Philippines, Thailand, Indonesia are in the middle rank. Singapore and Malaysia are the cleanest countries in terms of corruption. See the 2014 statistics at <http://www.transparency.org/cpi2014/infographic/regional/asia-pacific>. (Last accessed: 10 September 2015).

<sup>665</sup> Judge Lagergren’s Award in ICC Case No.1110 (1963), 10(3) Arb.Int’l 282, para.20.

<sup>666</sup> See Transparency International (2015), *ASEAN Integrity Community: A Vision for Transparent and Accountable Integration*, p.6.

<sup>667</sup> *Siemens v. Argentina*, ICSID Case No.ARB/02/08, Award, 6 February, 2007; *Plama v. Bulgaria*, ICSID Case No.ARB/03/24 Decision on Jurisdiction, 8 February 2005.

<sup>668</sup> The Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (1997). It is the first and only international anti-corruption instrument focused on the “supply side” of the bribery transaction, meaning investors. See more at <http://www.oecd.org/corruption/oecdantibriberyconvention.htm>

<sup>669</sup> Gordon, K. (2008), *IIAs: A survey of Environmental, Labour and Anti-corruption Issues*, International Investment Law: Understanding Concepts and Tracking Innovations, OECD.

amounting to an abuse of process”.<sup>670</sup> In the same vein, ASEAN States may consider include a non-bribery requirement in ACIA article 34 on conditions and limitations on submission of a claim. Alternatively, ACIA article 36 on conduct of the arbitration could be amended, so that tribunals are mandated to treat corruption as a jurisdictional or preliminary objection. Otherwise, to balance the corrupt behaviour of investors with the breach of international obligation of States at the merits stage would place arbitral tribunals in a very sensitive position.<sup>671</sup>

### **(3) Consolidation**

The ACIA has predicted the possibility of multiple proceedings and potential contradictory awards. Its article 37 provides consolidation proceedings for overlapping or related claims in a single proceeding, which may render arbitral procedures more reasonable and efficient. This is one of the techniques that the ACIA uses to limit the proliferation of claims, apart from the scope of ISDS application, the “forks-in-the-road” provision, and the sequencing rule, discussed *supra*.

However, unlike the other techniques, consolidation is an option and not an obligation, and claims will only be consolidated at the discretion of the parties, “in any manner they deem appropriate”.<sup>672</sup> Moreover, consolidation can be problematic in the case of proceedings based on different IIAs, because the obligations contained in the ACIA and in other IIAs may differ. The question remains to be answered, on case-by-case basis, whether a consolidation will be more or less beneficial to the relevant parties.

In the case where the parties decide to consolidate claims, the ACIA leaves the remaining process to the parties to decide, for example, how to coordinate existing and new tribunals. The ACIA approach is very flexible, compared to the treaties which specially require a constitution of a “consolidation tribunal” with the authority to decide whether consolidation is appropriate and which tribunal should hear the consolidated case.<sup>673</sup> In fact, it is not necessary for the ACIA to include this consolidation provision, given the fact that consolidation will always be possible with the consent of the disputing parties.

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<sup>670</sup> CETA Chapter 10 Investment, Scope of a Claim to Arbitration.

<sup>671</sup> Yackee, J.W. (2012), “Essay: Investment Treaties and Investor Corruption: An Emerging Defense for Host States?”, *Virginia Journal of International Law*, Vol.52, p.741.

<sup>672</sup> ACIA article 37.

<sup>673</sup> See *e.g.* NAFTA article 1126: request of consolidation, jurisdiction of the tribunals, stay of the proceedings, *etc.*

### 6.1.2.2 Joint Decision as a Governing Law

Traditional BITs, such as the IGA, do not usually have specific provisions on governing laws. Unless a BIT specifies otherwise, arbitral tribunals have the obligation to interpret BITs – similar to that for any other international treaty – in accordance with the general international law rules of treaty interpretation, which are primarily embodied in the Vienna Convention on the Law of Treaties (VCLT).<sup>674</sup> More modern BITs have provisions on governing laws, while continuing to provide a generous role to tribunals in their interpretation of treaties. In the interpretation of the protection standards of the ACIA, even though ASEAN Member States have delegated the task of resolving investor-State claims to tribunals, the interpretive authority of tribunals is not absolute.<sup>675</sup> Arbitral tribunals and ASEAN Member States have shared authority.

In order to guide arbitrators in their decision making, the ACIA specifies the sources of law applicable to disputes. Pursuant to ACIA article 40, tribunals decide the issues in dispute in accordance with five governing laws, namely: (1) the ACIA; (2) any other applicable agreements between the Member States; (3) the applicable rules of international law; (4) where applicable, any relevant domestic law of the disputing Member State; and (5) “a joint decision of the Member States” declaring their interpretation of a provision of the ACIA. Whereas the other governing laws are more general, the fifth one is specifically found in a minority of IIAs. Based on the ideas of the interpretation mechanism found in the NAFTA,<sup>676</sup> US Model BIT,<sup>677</sup> and Canada FIPA,<sup>678</sup> the ACIA has innovatively introduced its own joint decision mechanism.

Traditionally, by virtue of general public international law, ASEAN Member States retain the power to clarify the proper meaning of the provisions of BITs. Even without an express mechanism, they may always issue an authoritative interpretation to clarify the meaning of a treaty’s provisions,<sup>679</sup> both in *abstracto* and *in concreto*.<sup>680</sup> For the drafting

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<sup>674</sup> Gardiner, R.K. (2008), *Treaty Interpretation*, New York, OUP, pp.20ff.

<sup>675</sup> UNCTAD (2011), *Interpretation of IIAs: What States can do*, IIAs Issues Note No.3, December 2011, p.3.

<sup>676</sup> NAFTA article 1311.

<sup>677</sup> US Model BIT (2004) (2012) article 30(3).

<sup>678</sup> Canada FIPA article 40(2).

<sup>679</sup> The Permanent Court of International Justice (PCIJ) noted “the right of giving an authoritative interpretation of a legal rule belongs solely to the person or body who has power to modify or suppress it.” *Jaworzina*, Advisory Opinion, 1923, PCIJ, Series B, No.8, p.37; Yearbook of the International Law Commission (1966), Vol.II, p.221, para.14; *Kasikili/Sedudu Island (Botswana/Namibia)*, ICJ Judgement 13 December 1999, para.63. For arbitral awards, see, for example *ADF v. United States*, ICSID No.ARB(AF)/00/1, 9 January 2003, para.177.

<sup>680</sup> It has been suggested that an interpretation of IIA provisions could have retrospective effect and, by that, might be relevant for determining the current claim. See Voon, T., Mitchell, A. (2011), “Time to quit? Assessing International Investment Claims against Plain Tobacco Packaging in Australia”, *Journal of International Economic Law*, Vol.14, No.3, p.529.

of the ACIA, ASEAN Member States have taken a more proactive attitude by addressing one of the current challenges facing the IIA regime. The ACIA has introduced a joint interpretation mechanism into its text. This mechanism asserts the interpretative power of ASEAN member States in a particular case before a tribunal. In terms of the hierarchy of the ACIA governing laws, joint decisions issued under interpretative mechanism trump the others, because joint decisions are genuine and authoritative interpretations of the meaning of the ACIA provisions. Joint decisions may also elucidate how ASEAN Member States understand the relationship between the ACIA and the other governing laws.

Alongside treaty renegotiations and amendments, the allocation of interpretive authority in a joint decision mechanism is one of the techniques used to reinsert a State element into ISDS. Once an interpretation of an ACIA provision is given, it will legitimately bind future cases concerning the same provision. The interpretation will shape the protective scope of the ACIA, and lead, to some extent, to consistency in the ACIA regime. Unlike old-styled BITs, interpreting the ACIA is not a monologue by arbitral tribunals, but a “constructive dialogue between investment tribunals and treaty parties”.<sup>681</sup>

The most obvious example of “authentic interpretation” in the area of international investment law is the mechanism of binding interpretation made by the NAFTA Free Trade Commission (FTC).<sup>682</sup> The FTC is composed of cabinet level representatives of the NAFTA parties or their designees.<sup>683</sup> It has the power to supervise the implementation of the NAFTA, oversee its further elaboration, and “resolve disputes that may arise regarding its interpretation or application”. Pursuant to NAFTA article 1131, Chapter Eleven tribunals are required to apply governing law, which includes binding interpretations issued by the FTC.<sup>684</sup>

The ACIA does not set out the process of “joint decision”. Under the ACIA, there is no “standing committee”, similar to the NAFTA FTC, which is permanently vested with authentic interpretative power. The process of issuing a joint decision is *ad hoc*. ACIA article 42 provides that the AIA Council and the ASEAN Coordinating Committee on Investment (CCI) are responsible for the overall implementation of the ACIA. They must facilitate the avoidance and settlement of disputes arising from this agreement. However,

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<sup>681</sup> Roberts, A. (2010), “Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States”, *American Journal of International Law*, Vol.104, No.1, p.225.

<sup>682</sup> See Corazon, M.A., Dichosa, H., “The NAFTA Free Trade Commission and the Peer Review Mechanism”; Kaufmann-Kohler, G. (2011), “Interpretive Powers of the Free Trade Commission and the Rule of Law”, in *Fifteen Years of NAFTA Chapter 11 Arbitration*, JurisNet, LLC, p.175.

<sup>683</sup> NAFTA article 2001(2)(c).

<sup>684</sup> NAFTA article 1131, Governing Law; For example, the NAFTA FTC used the interpretation mechanism in interpreting the concepts of “FET” and “full protection and security” under NAFTA article 1105. FTC Note of Interpretation of 31 July 2001.



the AIA Council and the ASEAN CCI do not have any interpreting power in ISDS proceedings.<sup>685</sup>

A “joint decision” is an express preliminary reference procedure between investor-State tribunals and State Parties. Pursuant to ACIA article 40(2), when a claim is submitted under ACIA article 33, “the tribunal shall, on its own account or at the request of a disputing party, request a joint interpretation of any provision of the ACIA that is in issue in a dispute”.<sup>686</sup> The Member States must submit in writing any joint decision declaring their interpretation to the tribunal within 60 days of the delivery of the request.<sup>687</sup> Article 40(3) states that in the case that all Member States declare their interpretation of a provision within the time limit, this joint interpretation becomes the authentic interpretation and has binding force on a tribunal. As a result, any decision or award issued by a tribunal must be consistent with that joint decision.<sup>688</sup>

Pursuant to ACIA article 40(2), if the ten Member States fail to issue such a decision within the time limit, any interpretation submitted by an individual Member State must be forwarded to the disputing parties and the tribunal. Despite the fact that interpretation thus rendered could be highly persuasive for future tribunals, it is not considered authentic interpretation. In this case, the tribunal regains full power of interpretation and decides the issue on its own account.<sup>689</sup> In other words, an interpretation of one or some Member States may only help the tribunal to decide a current dispute, but cannot help ASEAN build up the *corpus* of ASEAN investment law. While the ACIA does not specifically allow *amicus curiae* (non-disputing parties: individuals) in its text,<sup>690</sup> interpretation of ACIA provisions under ACIA article 40(2) may be comparable to a “Participation by a Party” under NAFTA Article 1128; where a NAFTA Party (a non-disputing State) is allowed to make submissions to a Tribunal on a question of interpretation of the NAFTA agreement.<sup>691</sup>

The ACIA joint decision and interpretation mechanism is clearly an innovation, compared with the conventional consultation mechanism in the IGA.<sup>692</sup> Nevertheless, this mechanism has both pros and cons. As mentioned above, it has the advantage of promoting

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<sup>685</sup> Annex 4 Report of the 2<sup>nd</sup> ACIA WG, 29-31 January 2008, Kuala Lumpur, Malaysia.

<sup>686</sup> ACIA article 40(2).

<sup>687</sup> As the ACIA sets the time limit for the submission of joint decisions, the Member States cannot abuse this mechanism to delay arbitral proceedings. The use of the joint decision mechanism may assure investors’ expectations, to a certain extent, that States will not abuse this joint interpretation mechanism in their favours in a particular dispute.

<sup>688</sup> ACIA article 40(3).

<sup>689</sup> ACIA article 40(2).

<sup>690</sup> See also p.199.

<sup>691</sup> Similar provisions are found in 2003 US-Chile FTA, 2003 US-Singapore FTA, 2004 CAFTA-DR FTA.

<sup>692</sup> IGA article XI Consultation.

consistency and certainty in the system. It controls the power of arbitrators and ensures that the ACIA provisions are interpreted in conformity with the intention of the ASEAN Member States to the greatest extent possible. States, as negotiators, have a unique perspective on how the treaty should be interpreted.<sup>693</sup> This mechanism allows States to retain their determinative role.

That being said, ASEAN Member States' involvement in the interpretation of the ACIA can be controversial. Hence, at least two potential limitations need to be considered, in order that this mechanism will not be used to undermine ASEAN investors' legitimate expectations. Firstly, since ASEAN Member States play a "dual role" in investment law,<sup>694</sup> the interpretative statements may be perceived as self-serving and determined by a desire to influence the tribunal's decision in favour of States offering the interpretation,<sup>695</sup> and perhaps to the detriment of the other party. The question arises as to the sincerity or good faith of the ASEAN Member States and the equality of arms between the disputing parties. In a concrete case, a home State may protect its national investors and their investments, whereas a host State may protect its regulatory freedom and policy space. Therefore, States, as actual or potential respondents, should not abuse the mechanism in order to limit their liability in the face of existing or future claims.

Secondly, ASEAN Member States must not issue joint decisions which resemble amendments of the ACIA. Interpretation of the ACIA has to be distinguished from amendments, which typically requires formal adoption, for instance, through domestic ratification of contracting States.<sup>696</sup> In principle, joint decision should be confined to clarifying the terms of the ACIA. This mechanism should not be intended to add new meaning to the ACIA provisions, or to extend or narrow the scope of the ACIA. ASEAN Member States should use an amendment procedure under ACIA article 46 to add new provisions or modify existing ACIA obligations. Notwithstanding this, the borderline between interpretation and amendment, in practice, may be blurred.<sup>697</sup>

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<sup>693</sup> OECD (2012), *Government Perspectives on Investor-State Dispute Settlement: a Progress Report*, Freedom of Investment Roundtable 14 December 2012, Paris, p.18. <http://www.oecd.org/daf/inv/investment-policy/ISDSprogressreport.pdf> (Last accessed: 10 September 2015).

<sup>694</sup> Roberts, A. (2010), "Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States", pp.201-202.

<sup>695</sup> Dolzer, R., Schreuer, C. (2012), p.32.

<sup>696</sup> VCLT article 39 General rule regarding the amendment of treaties, article 40 Amendment of multilateral treaties.

<sup>697</sup> It must be, however, noted that such State practice may be highly controversial. In the past, international courts and tribunals have accepted interpretations amounting to a *de facto* amendment. For example, *Legal Consequences for States of the Continued Presence of South Africa in Namibia (South West Africa) Notwithstanding Security Council Resolution 276* (1970), Advisory Opinion (21 June 1971), para. 22. Case concerning the Dispute Regarding Navigational and Related Rights (Costa Rica v. Nicaragua), Judgment of

Compared to complicated and time-consuming treaty renegotiation, modification or denunciation, “joint decision” under the ACIA may be an efficient alternative to improve predictability of arbitral awards. This interpretation mechanism is a tool to prevent disputes and to strengthen the public policy dimensions of the ACIA. Nevertheless, it is reminding that NAFTA, for example, is composed of only three Member States, whereas the ACIA is comprising ten Member States with diverse cultures and backgrounds. It is unlikely that this joint decision mechanism will be effectively used in practice. This mechanism, claimed to add more regulatory space for ASEAN Member States, may remain a paper tiger. Therefore, while the “joint decision” mechanism has added more value to the ACIA, this innovation remains to be tested in its practical application.<sup>698</sup>

### 6.1.2.3 Regional Centres for Arbitration

Apart from international institutions, the ACIA also provides a regional centre for arbitration. Malaysia managed to insert the Regional Centre for Arbitration at Kuala Lumpur (KLRCA), the first regional arbitration centre in ASEAN,<sup>699</sup> as a choice of forum in the ACIA. Another regional centre, considered one of the leading international arbitral institutions, is the Singapore International Arbitration Centre (SIAC).<sup>700</sup> Both institutions have their own rules, the 2012 KLRCA Rules<sup>701</sup> and the 2013 SIAC Rules,<sup>702</sup> respectively. These Rules were adopted on the basis of the UNCITRAL Arbitration Rules, as revised in 2010. The regional Rules contain provisions which guarantee a basic level of fairness to the parties and the process. Their structural framework typically describes the lifecycle of arbitration; most features are virtually common to all modern institutional rules. They are, however, sufficiently flexible to accord disputing parties substantial leeway to tailor the process according to their needs. These Rules improve some technical features of the

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the International Court of Justice (13 July 2009), para. 64. UNCTAD (2011), *Interpretation of IIAs: What States can do*, IIAs Issues Note No.3, December 2011, p.5.

<sup>698</sup> In an arbitration proceedings, the ACIA also has specific mechanism regarding the interpretation of taxation measures, which also asserts the interpretative role of the ASEAN Member States. Where a taxation measure is a disputing issue, ACIA article 36(6) and (7) stipulate that the ASEAN host State (the disputing party) and the home State (the non-disputing party) must hold “consultations” to determine whether such measure is a taxation measure, and whether it has an effect equivalent to expropriation or nationalisation. The outcome of the consultation is apparently not binding; nonetheless, pursuant ACIA article 36(8), the tribunal must accord serious consideration to the decision of both Member States. See also p.100.

<sup>699</sup> The KLRCA was established in 1978 under the auspices of the Asian-African Legal Consultative Organisation (AALCO). See AALCC Resolution XIX (7), 1978.

<sup>700</sup> More details: <http://www.siac.org.sg/>

<sup>701</sup> KLRCA Arbitration Rules (revised 2012).

<sup>702</sup> SIAC Arbitration Rules (5<sup>th</sup> Ed.), 1 April 2013.

proceedings, such as rules on competence-competence,<sup>703</sup> or correction of awards and additional awards.<sup>704</sup>

In 2010, the SIAC was the first international arbitral institution in Asia to introduce some innovative features, such as “expedited procedure”<sup>705</sup> and “emergency arbitrator”.<sup>706</sup> In the meanwhile, the KLRCA Rules are more sensitive to the ASEAN Member States’ needs, and have introduced some ASEAN-specific elements, namely the KLRCA Islamic Model Arbitration Clause (“KLRCA i-Arbitration Rules”). As the majority of some ASEAN countries are Muslims,<sup>707</sup> these specific rules, which are a modified version of the UNCITRAL Arbitration Rules, provide for disputes arising out of commercial agreement which are based on *Shariah* (Islamic Law) principles. These regional arbitration centres provide institutional support as a neutral and independent venue. With the rule of law tradition, their national courts also offer maximum judicial support of arbitration and minimum intervention in the conduct of international arbitration. For example, Malaysian and Singaporean Governments exempt foreigners from applying for a work permit to carry out arbitration services, and withholding tax are not be imposed on arbitrators.

The KLRCA and the SIAC have proved that they are effective and reliable. These centres are beneficial at two levels. Firstly, they improve the reputation to the ASEAN Community that ASEAN has an international legal infrastructure and expertise which creates an investment-friendly environment. Secondly, they benefit both States and investors by giving them strong sense of arbitration at home, and minimising arbitration costs by reducing distance travel to major centres of arbitration.

Besides the KLRCA and the SIAC, there are more national arbitration centres in other ASEAN Member States, for instance, Indonesia National Board of Arbitration (BANI), Thailand Arbitration Centre (THAC), or Vietnam International Arbitration Centre (VIAC), Cambodia Commercial Arbitration Centre. There are, however, scepticism regarding their independence and lack of experience. These centres need to upgrade their arbitration rules and institutions so as to meet up with the international standard, given the

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<sup>703</sup> UNCITRAL Rules article 23(1), Pleas as to the jurisdiction of the arbitral tribunal; SIAC article 25 Jurisdiction of the Tribunal.

<sup>704</sup> UNCITRAL Rules articles 38-39; SIAC article 29.

<sup>705</sup> SIAC Rule 5.1 allows the parties to conduct the arbitration in an expeditious and cost-effective manner. This procedure is available at any time before the constitution of the tribunal, provided that one of three criteria is satisfied, that is, where: (a) the aggregate amount in dispute does not exceed \$5,000,000 Singaporean Dollars; (b) the parties agree; or (c) in cases of “exceptional urgency”. See SIAC 2014 Annual Report.

<sup>706</sup> SIAC Rule 26.1 Emergency Arbitrator.

<sup>707</sup> Three ASEAN Member States (Indonesia, Malaysia and Brunei) have Muslim-majority populations, while they are the minority in the other ASEAN States.

increasing demand of the ASEAN Economic Community for investment dispute resolution.

#### 6.1.2.4 Transparency in Arbitral Proceedings

Arbitration is popular for investment dispute settlement because of the privacy it affords to each party. The policy of confidentiality serves to expedite arbitration, as well as to protect the confidentiality of information and reputation of both investors and States.<sup>708</sup> Confidentiality is considered to be one of the crucial features of commercial arbitration. The arbitration – the existence of a dispute, its documents and pleadings, and often its decisions – is not required to be made public, because the dispute settlement involves private parties, mainly on technical legal grounds, and not public policy issues.<sup>709</sup> However, there is no recognition of a duty of confidentiality in arbitration.

For investment arbitration, most arbitration rules referred to in investment treaties concluded in the last century were based on international commercial arbitration. Under the IGA, no investor-State arbitration rules had mandated transparency or disclosure in the arbitral process. The disputing parties and the tribunal had significant latitude to determine the degree of openness of proceedings. Investment arbitrations on mega-investment projects have greater repercussion on public interests, because one of the disputing parties to the ISDS proceedings is a government. In the case that the government loses, it has to pay a huge amount of money to compensate the wronged investors.<sup>710</sup> Apart from economic concerns, investment projects often have impacts on other public concerns, such as environment, human rights, or social issues.<sup>711</sup> As a result, there is a tension between transparency for public interests and confidentiality perceived as contributing to efficient

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<sup>708</sup> See generally in OECD (2005), *Transparency and Third Party Participation in Investor-State Dispute Settlement Procedures Statement*, WP on International Investment No. 2005/1.

<sup>709</sup> UNCTAD (2005), *Investor-State Disputes Arising from Investment Treaties: A Review*. UNCTAD Series on International Investment Policies for Development.

<sup>710</sup> In three awards dated 18 July 2014, an UNCITRAL arbitral tribunal under the auspices of the Permanent Court of Arbitration (PCA) ordered Russia to pay over US\$50 billion in compensation for the indirect expropriation of OAO Yukos Oil Company. This has been the largest damages award in investment treaty arbitration. See *Hulley Enterprises Limited (Cyprus) v. Russia*, PCA Case No.AA 226; *Yukos Universal Limited (Isle of Man) v. Russia*, PCA Case No.AA227, *Veteran Petroleum Limited (Cyprus) v. Russia*, PCA Case No.AA 228.

<sup>711</sup> Simons, P., “Selectivity in Law-Making: Regulating Extraterritorial Environmental Harm and Human Rights Violations by Transnational Extractive Corporations”, in Grear, A., Kotz, L.J. (2015), *Research Handbook on Human Rights and the Environment*, Cheltenham, Edward Elgar Publishing Limited, p.489-497; Lester, S., Mercurio, B. (Eds.) (2009), “Social Issues: Labour, Environment and Human Rights” in *Bilateral and Regional Trade Agreements: Commentary and Analysis*, CUP, pp.342-366; Puvimanasinghe, S.F., (2007), *Foreign Investment, Human Rights and the Environment: A Perspective from South Asia on The Role of Public International Law for Development*, Leiden, Martinus Nijhoff Publishers.

and effective arbitration. Over the past fifteen years, the demand for greater transparency has become one of the biggest challenges of ISDS.

At present, the trend represents a shift in the underlying presumption from privacy toward openness in response to the key criticism that investment tribunals frequently decide matters of public importance behind closed doors. Transparency in ISDS also reflects a broader trend which recognises the importance of transparency as a tool for promoting and ensuring effective democratic participation, good governance, accountability, predictability and the rule of law.<sup>712</sup> Arbitration process has become increasingly open over the past several years.

In order to address governance and legitimacy issue of ISDS, the ACIA has incorporated transparency provisions, aiming at ensuring access to information in the ISDS proceedings. ACIA article 39 requires that “the disputing Member State *may* make publicly available all awards, and decisions produced by the tribunal”. This means that the publication of awards is not an obligation but depends on the parties and the arbitral rules that the parties have chosen.<sup>713</sup> The term “award” should be read broadly to include interim, partial, procedural and final awards. The ACIA does not mention publication of other documents.

Publication of awards and decisions under the ACIA is subject to some exceptions for protected information. The confidential information is designated by the investors, law enforcement, the Member State’s law protecting Cabinet confidences, personal privacy or the financial affairs and accounts of individual customers of financial institutions, or essential security. The tribunal must make appropriate arrangements to protect this information from disclosure to the public. In practice, it is ASEAN Member State’s legislation on freedom of information which determines the arbitral proceeding’s transparency. The respondent State has a self-judging power against disclosure of information that it considers contrary to its essential security interests. As a result, it is possible that only significant extracts of the awards and decisions will be published, without any further detail information of the case.

The “Rules on Transparency” were adopted in July 2013 by the UNCITRAL. The new Rules came into effect on 1<sup>st</sup> April 2014. They set up a process and institutional framework and provide for a significant degree of openness throughout the arbitral

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<sup>712</sup> Report of the UN Secretary-General (2012), *Delivering Justice: Programme of action to strengthen the rule of law at the national and international levels*, A/66/749.

<sup>713</sup> UNCITRAL Rules article 34(5) requires the consent of both parties for the award to be made public; Amendment to Arbitration Rule 48, ICSID 2005, the ICSID Secretariat has the authority to publish significant extracts of decisions, even where the parties do not agree to publish an award.

proceedings.<sup>714</sup> Having been carefully negotiated and widely approved,<sup>715</sup> the new UNCITRAL template can serve as a model of how to conduct investor-State arbitrations transparently. Furthermore, the UN Convention on Transparency in Treaty-Based Investor-State Arbitration, which provides additional scope for the application of the UNCITRAL Arbitration Rules, was opened for signature on 17<sup>th</sup> March 2015.<sup>716</sup> It provides an efficient and flexible mechanism for States to apply the Transparency Rules to disputes arising under the investment agreements in force. By the 17<sup>th</sup> March 2015, ten countries had signed the Convention; none of them is an ASEAN Member State.

Along with the development at ICSID and at UNCITRAL toward more robust transparency rules, the practice of countries, such as the United States, Canada, and the EU, is integrating transparency rules into their investment treaties. For example, the newly negotiated CETA refers to the UNCITRAL Rules on Transparency regarding the disclosure of information to the public;<sup>717</sup> the EU ISDS Draft Text includes the Annex III “Rules on public access to document, hearings and the possibility of non-disputing parties to make submissions”.

According to the UNCITRAL Rules on Transparency, transparency is no further an option but the rule. Hence, on top of arbitral decisions, a wide range of documents must be made available to the public, including other submissions by disputing and non-disputing parties and third persons, as well as expert reports and witness statements.<sup>718</sup> The notice of arbitration itself will be subject to automatic mandatory disclosure, but only after constitution of the tribunal.<sup>719</sup> However, the rule is limited by two categories of exception: (1) confidential or protected information; and (2) integrity of the arbitral process.<sup>720</sup>

This thesis finds that the ACIA does not require as much transparency as the title “Transparency” of the article 39 suggests. Unlike under the other treaties mentioned in the preceding paragraphs, the publication of awards and decisions is the only stage to which

<sup>714</sup> The Rules provide, *inter alia*, for publication by a central repository of basic information about filed cases; public release of key documents, including tribunal’s decisions, and statements of claim and defence; submission by a third persons and participation of non-disputing third parties in certain circumstances; and open hearings.

<sup>715</sup> The work has been done by delegations to UNCITRAL comprised of 55 Member States, additional observer States and observer organisations.

<sup>716</sup> The “Mauritius Convention on Transparency” had been prepared by UNCITRAL since 2013 and was formally adopted by the General Assembly on 10 December 2014.

<sup>717</sup> CETA article X.33, Transparency of Proceedings.

<sup>718</sup> UNCITRAL Transparency Rules: Publication of information at the commencement of arbitral proceedings (article 2), Publication of documents (article 3), Submission by a third person (article 4), Submission by a non-disputing Party to the treaty (article 5).

<sup>719</sup> *Idem*, articles 2 and 3 on Publication of documents classes three categories of document: (1) *mandatorily* and *automatically* disclosed; (2) documents to be *mandatorily* disclosed once any person requests their disclosure from the tribunal; and (3) other documents depending on the exercise of the tribunal’s discretion.

<sup>720</sup> *Idem*, article 7 Exceptions to transparency.

transparency applies. The ACIA does not require transparency during the proceedings at all. This approach illustrates that the ACIA keeps the conventional style of arbitration, which advocates confidentiality, and transparency is exceptional. The ACIA gives the disputing parties maximum discretion on their privacy of arbitration. While the ACIA takes on the transparency trend, it has chosen only the elements which disputing Parties can control, such as publication when the proceedings have reached the end. In the light of the UNCITRAL Rules on Transparency, the deficit of public and transparency in the ACIA is obvious. Arguably, the ACIA does not give much regard to the transparency issue, because it was concluded before transparency increasingly caught global attention by the new UNCITRAL Rules on Transparency.

In order to make the ISDS more transparent throughout the proceedings, ASEAN Member States may consider incorporating the UNCITRAL Rules on Transparency,<sup>721</sup> or creating an annex on transparency, or amending ACIA article 39 on the issues that current transparency does not cover, especially, open hearings, submission by a third person or *amicus curiae*, and submission by a non-disputing Party to the treaty.<sup>722</sup>

For hearings, Chapter 11 of the NAFTA and the UNCITRAL Transparency Rules provide a notable departure from other existing arbitration rules, *i.e.* the hearings are, subject to limitations, open to the public.<sup>723</sup> The disputing parties, alone or together, cannot veto open hearings. Given the privacy approach underlining the “ASEAN Way” of relations, it is however unlikely that the ACIA will set public hearings as default rule.

Regarding third party participation, this section refers only to *amicus curiae* intervention,<sup>724</sup> and not non-disputing party intervention which has been discussed earlier under the “joint decision” sub-section.<sup>725</sup> The issue of third party participation raises more complex concerns than open hearings and publication of awards, because it potentially affects the scope, complexity, length and cost of arbitration.

Similar to the NAFTA or the CAFTA, the ACIA allows the disputing parties to request the tribunal to appoint one or more experts to report to the tribunal in writing on any factual issue concerning environmental, public health, safety or other scientific

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<sup>721</sup> UNCITRAL Transparency Rules article 1 Scope of application: the Rules provide an opt-in for the before-2014 treaties, and an opt-out for the after-2014 treaties.

<sup>722</sup> See generally OECD (2005), “Transparency and Third Party Participation in Investor-State Dispute Settlement Procedures”, OECD WP on International Investment, 2005/01, OECD Publishing.

<sup>723</sup> The NAFTA countries announced their intention to consent to open public hearings at all Chapter 11 arbitrations following the 2003 and 2004 NAFTA Commission Meeting. See Department of Foreign Affairs and International Trade News Release No.152, NAFTA Commission Joint Statement, 7 October 2003 and 16 July 2004, Decade of Achievement.

<sup>724</sup> Literally means “friend of the court”.

<sup>725</sup> See 6.1.2.2, p.193.



matters, subject to such terms and conditions as the disputing parties may agree.<sup>726</sup> This is without prejudice to the appointment of other kinds of experts where authorised by the applicable arbitration rules, which may allow the tribunal to call on experts on its own initiative. Expert's reports will ensure that the tribunal reaches a decision with accurate, expert-warranted information, which will also serve to legitimise the arbitral award.

Apart from expert's reports, the ACIA does not mention other third party participation. The text of the ACIA reflects the threshold of the "ASEAN Way", as the ASEAN Member States generally do not trust NGOs or any private organisations to intervene in the State-related proceedings. Nevertheless, the ACIA allows the tribunal to permit *amicus curiae* participation after consulting with the disputing parties, according to their agreed arbitral rules. In other words, even if the ACIA does not address the matter, in a case that ACIA ISDS are operated under ICSID or UNCITRAL Rules, tribunals can always accept *amicus curiae* submissions under those rules.<sup>727</sup> Indeed, ASEAN Member States may make their practice clearer in providing for tribunals to have the authority to accept and consider submissions from third parties and to allow third parties to attend hearings, and to a greater extent, without the need for the tribunal to obtain the consent of both parties.

Generally, most of the OECD countries share the view that, "especially insofar as proceedings raise important issues of public interest, it may also be desirable to allow third party participation, subject however to clear and specific guidelines."<sup>728</sup> The OECD guidelines suggest five criteria for the acceptance of a non-disputing party brief. Firstly, *amicus curiae* participation must assist the tribunal in assessing facts and legal issues by bringing a perspective to the proceedings different than that of the disputing parties. Secondly, the brief must address matters within the scope of the dispute. Thirdly, the *amicus curiae* must have substantive and legitimate interests in the arbitration, and ensure that they are independent and not backed by any of the disputing parties. Fourthly, the subject-matter of the arbitration must contain an element of public interests. And fifthly, such participation must not impose an unfair burden on the disputing parties.

Subject to necessary safeguards for the protection of confidential business and governmental information, an additional transparency is desirable in order to enhance

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<sup>726</sup> ACIA article 38, Expert Reports.

<sup>727</sup> ICSID AR No.37 and AFR No.41; Article 4 UNCITRAL Transparency Rules, Submission by a third person.

<sup>728</sup> See Statement by the OECD Investment Committee, June 2005; OECD (2005) *Report on Transparency and Third Party Participation in Investor-State Dispute Settlement Procedures*, WP on International Investment No.1, p.1.

effectiveness and legitimacy of the use of ISDS under the ACIA regime. While preserving confidential information, the ACIA could give more access to awards and other dispute-related documents, including parties' submissions. The inclusion of more transparency will contribute to a more predictable and consistent application and interpretation of the ACIA, as well as to the development of ASEAN investment law.

## Section 6.2 State-to-State Dispute Settlement Mechanisms

The success of investor-State dispute settlement may limit the need for State-to-State mechanism as a matter of practice, but does not preclude it as a matter of law. The State-to-State mechanism remains a fall-back option, when the effort to resolve investment disputes through ISDS is unfruitful. In fact, any issue could be subject to the State-to-State mechanism. The ACIA does not create a specific State-to-State mechanism for the disputes arising out of the ACIA. Its article 27 wholly refers the matter to the 2004 Protocol on Enhanced Dispute Settlement Mechanism (“Vientiane Protocol” or “EDSM Protocol”),<sup>729</sup> for the “interpretation and application” of the ACIA.

The State-to-State mechanism under the ACIA articulates investment disputes under the ACIA with the overarching dispute settlement regime under the AEC. Its structure is based on the dispute settlement mechanism under the WTO. As a self-contained regime, the EDSM Protocol creates a State-to-State compulsory arbitration and enforcement. This mechanism underlines the shift of ASEAN towards a rules-based organisation. Interestingly, the ASEAN regime goes beyond the WTO model. ASEAN has a system of referral to the ASEAN Summit, which is a political channel. This referral shows that in spite of the constructive effort on the use of legal mechanism, ASEAN remains appreciating the “ASEAN Way” of dispute resolution. Either way, the State-to-State mechanism under the ACIA-EDSM promotes the institutional-building aspect of the AEC.

### 6.2.1 General Practice

Traditionally, an ASEAN home State may bring a diplomatic protection claim on behalf of its investors for a treaty violation, including cases where a recalcitrant State fails to honour an ISDS award.<sup>730</sup> The home State would adopt the wrongful act against its national as a wrongful act against itself and pursue a claim on its own behalf.<sup>731</sup> The State

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<sup>729</sup> The EDSM Protocol was signed by the ASEAN economic ministers at the 11<sup>th</sup> ASEAN Summit in Vientiane, Lao, on 29 November 2004. The EDSM applies to disputes relating to all subsequent economic commitments in ASEAN as well as retroactively to earlier key economic agreements. See Appendix I for the “covered agreements”.

<sup>730</sup> ACIA article 34(3).

<sup>731</sup> *Barcelona Traction, Belgium v. Spain*, Judgment, ICJ, 1970; *Mavrommatis Palestine Concessions*, Greece v. UK, PCIJ, 1924.

could pursue the case on a diplomatic basis or turn it to State-to-State arbitration.<sup>732</sup> For the State-to-State DSM, ASEAN has its own legal framework specifically for economic dispute resolutions among ASEAN Member States. An early reference to State-to-State mechanism can be found in the 1987 ASEAN IGA. However, this agreement did not provide State-to-State arbitration, it provided only amicable settlement through diplomatic channel, *i.e.* the ASEAN Economic Ministers.<sup>733</sup> A proper dispute settlement mechanism, considered the first formal use of non-consensual procedures, was prescribed in the 1996 Protocol on Dispute Settlement Mechanism (“Manila Protocol”). This protocol is also referred by the AIA for any differences between Member States on liberalisation issues. It was replaced in 2004 by the “EDSM Protocol”.

Contrary to the ISDS, the ACIA State-to-State mechanism applies to disputes on the interpretation or application of the treaty in general, without excluding matters that may arise before an investor-State tribunal.<sup>734</sup> Consequently, the State-to-State mechanism in the ACIA is not only supplementary means to the ISDS, but rather concurrent means to deal with the issues out with the scope of the ISDS, especially liberalisation and policy issues. The State-to-State DSM reflects the ASEAN Member States’ attempt to institutionalise their relationship through the ASEAN mechanism.

The re-emergence of State-to-State arbitration represents a milestone towards a third era of the ASEAN investment treaty system. The rights of both ASEAN investors and ASEAN Member States are recognised and valued, rather than one being reflexively privileged over the other. Compared to the IGA and other BITs, the ACIA represents a permissible and potentially progressive mechanism by which ASEAN Member States parties can re-engage with the system, even after the negotiation. By that, the development of ASEAN investment mechanism can be shaped from within, and have greater effect on the ASEAN Economic Community.

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<sup>732</sup> Potestà, M. (2013), “State-to-State Dispute Settlement Pursuant to Bilateral Investment Treaties: Is There Potential?”, in Boschiero, N. et al. (eds.), *International Courts and the Development of International Law- Essays in Honour of Tullio Treves*, T.M.C. Asser Press, The Hague, p.766. See Article 27 ICSID Convention.

<sup>733</sup> IGA article IX.

<sup>734</sup> ACIA article 27.

## 6.2.2 Specificity: ASEAN Protocol on Enhanced Dispute Settlement Mechanism

The EDSM is a result of the paradigm shift from the traditional ASEAN Way, which avoided adjudicatory means of dispute resolution, to a modernised ASEAN Way. The “Enhanced” DSM means that the DSM is highly judicialised, compared to the basic State-to-State mechanism, under the 2010 Protocol to the ASEAN Charter on DSM.<sup>735</sup> The heart of the EDSM is a mandatory dispute settlement process involving panels and an appellate body to assess disputes that cannot be settled through non-adjudicatory mechanisms. Similar to the ACIA ISDS, the EDSM is based solely on legal considerations, and will finally render binding decisions. A large part of its proceedings is depoliticised.

However, the ASEAN Way of dispute resolution has not disappeared. The reference to the EDSM by the ACIA does not mean that ASEAN Member States prefer an adjudicatory mechanism to a non-adjudicatory one. Rather, the ASEAN Way is currently blending the new ingredients of internationally accepted standards with traditional ones, giving a unique “ASEAN way” of investment dispute resolution. The system envisaged by the Protocol obliges the ASEAN Member States to firstly solve the dispute through non-adjudicatory mechanisms, *i.e.* consultations, good offices, conciliation and mediation.<sup>736</sup> The ASEAN Secretariat-General could also offer to be third person in these proceedings, giving him or her a potentially significant role in resolution of such disputes.<sup>737</sup> Only in case of unresolved disputes or non-compliance with the decisions made under the EDSM, ASEAN Member States will return to the political and diplomatic channels.

Contrary to the ACIA ISDS, the EDSM State-to-State mechanism is a self-contained system. The EDSM resembles to WTO DSM, in terms of the degree of delegation, interpretation, and enforcement.<sup>738</sup> The ASEAN DSM Panel has followed the Dispute Settlement Body (DSB) model of the WTO. The EDSM offers a set of procedures at the adjudicatory stage, which include proceeding before the panel, the possibility of

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<sup>735</sup> The Protocol was adopted in Hanoi, Vietnam on 8 April 2010, but not yet into force. It will apply to the ASEAN agreements which do not have a built-in DSM.

<sup>736</sup> Article 4 EDSM.

<sup>737</sup> Jean-Claude, P., Walter, W. (2015), *Towards a Rules-Based Community: An ASEAN Legal Service*, Cambridge, p.78

<sup>738</sup> Vergano, Paolo C., *The ASEAN Dispute Settlement Mechanism and its Role in a Rules-Based Community: Overview and Critical Comparison*, Paper submitted to the Asian International Economic Law Network (AIELN) Inaugural Conference, 30 June 2009, [http://aieln1.web.fc2.com/Vergano\\_panel4.pdf](http://aieln1.web.fc2.com/Vergano_panel4.pdf). (Last accessed: 16 September 2015).

a review of the panel's findings by the Appellate Body, and procedure of compliance monitoring.

### 6.2.2.1 Self-Contained State-to-State Compulsory Arbitration

ASEAN Member States may seek recourse to the procedure of the EDSM Protocol, without prejudice to the rights of ASEAN Member States to resort to other forums for a dispute settlement involving other ASEAN Member States. The EDSM is triggered by a lodging of a request for consultation. After the request, the parties could find a mutually agreed solution by consultation, or alternatively, the parties could agree to adjudication, including the subsequent implementation of the panel and Appellate body reports. These reports are adopted by the Senior Economic Officials Meeting (SEOM) and are binding on the parties. In the case of failure to implement the ruling by the losing party, the winning party has possibility to request compensation and apply counter measures.

Following the WTO DSB model, the EDSM regime is, in effect, a “compulsory arbitration” regime. The EDSM Protocol establishes a default procedure where the decisions establishing an arbitral panel and adopting the awards are deemed to be made by the SEOM after the lapse of certain specified time periods, unless the SEOM decides by consensus not to do so.<sup>739</sup> This rule is called “negative” or “reverse” consensus.<sup>740</sup> This means that unless all ASEAN Member States agree otherwise, compulsory and binding arbitration will take place. No disputing party can unilaterally block arbitration without the consent of the other disputing party.

This mandatory dispute settlement of the EDSM may be regarded as an improvement of the ASEAN Way of settling disputes among ASEAN Member States. The EDSM Protocol is the only ASEAN agreement where State-to-State compulsory arbitration is found. In the 2010 DSM Protocol to the ASEAN Charter, arbitration is not a default procedure. In order to refer the dispute to arbitration, a positive consensus must be taken by the ASEAN Coordinating Council (“ACC”), which comprises the Foreign Ministers of the ASEAN Member States.<sup>741</sup> So each disputing State has the ability to block recourse to arbitration.<sup>742</sup> In addition, the EDSM provides an appellate body for the State-to-State DSM, whereas the ACIA does not provide a direct appeal mechanism for its ISDS.<sup>743</sup> After

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<sup>739</sup> See Appendix II to the EDSM Protocol on the composition of panels and panel proceedings.

<sup>740</sup> The rule of “negative” consensus is originally found in article 6.1 WTO DSU.

<sup>741</sup> ASEAN Charter article 8(1) ASEAN Coordinating Council.

<sup>742</sup> ASEAN DSM Protocol article 9.

<sup>743</sup> However, the investors can appeal the decision in case that applicable arbitral rules provide appeal mechanisms.

the EDSM panel has made a report and recommendations to SEOM, a party may notify its decision to appeal. Appeals, which are limited to issues of law and interpretation, go to an appellate body established by the ASEAN Economic Ministers Meeting.<sup>744</sup>

The next issue lies in the effective implementation and compliance by the ASEAN member countries.<sup>745</sup> Under the EDSM, the disputing parties are obliged to accept the report unconditionally. SEOM oversees the compliance.<sup>746</sup> Non-compliance attracts sanctions under the Protocol. Where the findings or recommendations are not implemented within a specified time, a complaining party may negotiate for compensation or may request authorisation from SEOM to temporarily suspend concessions or other obligations under the ACIA against the non-compliant States.<sup>747</sup>

Based on the findings of the panel or appellate body, a member State may be requested to take measures to bring itself into conformity with the ACIA. This is where the EDSM is different from the ISDS and the normal State-to-State litigations; because the ISDS and the normal State-to-State litigations, while awarding compensations to the wronged investors, cannot bring the non-compliant measures to the conformity. In this sense, the ASEAN EDSM has clear similarities to the WTO DSM. This shows that the 2004 EDSM is less politicised, more legalised, and better ensures the protection of foreign investment in ASEAN than the general DSM (under the 2010 ASEAN DSM Protocol).

#### **6.2.2.2 Referral to ASEAN Summit: Return to Political Channel**

On top of the WTO-inspired mechanism, the ASEAN EDSM has developed additional steps which turn legal disputes into international political matters under the 2010 DSM Protocol to the ASEAN Charter. In the case where the offending party continues to be recalcitrant, the matter may be referred to the ASEAN Coordinating Council (ACC).<sup>748</sup> When the ACC is unable to resolve the matter, the dispute may eventually be referred to the ASEAN Summit, the supreme policy-making body of ASEAN.<sup>749</sup> Procedural provisions have been set out under the “Rules for Reference of Unresolved Disputes to the

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<sup>744</sup> EDSM articles 6(1), 7, 9(1), 12.

<sup>745</sup> Hew, D. (2005), “Towards an ASEAN Charter: Regional Economic Integration”, in *Framing the ASEAN Charter: An ISEAS Perspective*, Severino R. (ed.), pp.33-40.

<sup>746</sup> EDSM article 15(6).

<sup>747</sup> EDSM article 16(2). See also Recommendations of the High-Level Task Force on ASEAN Economic Integration, 7 October 2003.

<sup>748</sup> EDSM article 9 Reference to the ASEAN Coordinating Council.

<sup>749</sup> ASEAN Charter article 7(1): “The ASEAN Summit shall comprise the Heads of State or Government of the Member States”.

ASEAN Summit” or the “Rules for Reference of Non-Compliance to the ASEAN Summit” for a decision under ASEAN Charter articles 26 and 27(2), respectively.<sup>750</sup>

The political reference mechanism, as a last resort, is set up for unresolved or non-compliance matters. Despite how advances the legal frameworks are, the “ASEAN Way” of dispute resolution may not easily disappear. At the beginning of the realisation of the AEC, ASEAN needs political will to drive legal formation at regional level. It is possible that investors affected by such claims may support or sponsor their home States. Therefore, the State-to-State DSM under the ASEAN investment regime will not only be developed by ASEAN Member States but also by individuals. The co-existence of investor-State and State-to-State DSM reflects the complex trilateral balance which the ACIA attempts to strike between the interests of ASEAN investors, ASEAN Member States, and the ASEAN Community as a whole.

## Conclusion to Chapter 6

The DSM is one of the most important elements of the ACIA. Investment arbitral awards may have a significant impact, at national level, on the ASEAN Member States’ future conduct, national budget and welfare of people; and at regional level, on the formation of ASEAN investment law. In designing DSM, the ACIA also has answered the guiding question of balancing the investors’ and States’ interests. The ACIA sets up a new framework that can capture the hybrid nature of the investment treaty system. The ACIA has created a dual-track system, the investor-State mechanism and the State-to-State mechanism. It also offers both non-adjudicatory and adjudicatory rights to assure ASEAN investors’ confidence. In fact, the investor-State arbitration is expected to be the primary mechanism for investment disputes. However, in theory, the State-to-State mechanism remains always an option.

While the inclusion of ISDS is currently debatable, the ACIA provides ISDS not only to effectively guarantee investors’ rights, and by that, to attract the investment flows, but also to improve the rule of law and legal certainty of the ASEAN Economic Community. Compared to traditional BITs, the ACIA is a well-designed and details-enhanced agreement. It incorporates a number of important elements to improve investor-State dispute settlement. Notably, it gives more details than previous ASEAN BITs, enhances transparency in the process, improves independence requirements for arbitrators, and provides significant institutional basis. On the contrary, no detail is given where the

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<sup>750</sup> ASEAN Charter article 26 Unresolved Disputes, article 27 Compliance. These Rules are Annexes 5 and 6 of the 2010 ASEAN DSM Protocol.



ASEAN Member States decide to preserve their policy choice. Consequently, the ACIA gives disputing parties, to a large extent, discretion to agree on applicable arbitral rules which will apply to their own case. Autonomy and privacy of the parties are imminent.

The ACIA could have added more States' elements to balance the autonomy and privacy of the disputing parties. Numbers of modification can be proposed. Firstly, public transparency is one of the responses to the legitimacy problem of the investor-State arbitration, which is mainly addressed by the 2013 UNCITRAL Rules on Transparency. The ASEAN Member States should integrate more transparency elements by amending the ACIA text or by formulating annexes, for example, on third party participation. Secondly, the ACIA ISDS broadly refers to external institutional rules. The ASEAN Member States should put an effort to "ASEANise" their ISDS, particularly the non-adjudicatory procedures. The ACIA may adopt similar approach to the 2010 ASEAN DSM Protocol which contains ASEAN-specific detailed provisions governing the use of good offices, mediation, and conciliation.<sup>751</sup> Thirdly, a "code of conduct" is necessary to assure the impartiality and independence of the members of arbitration panels and mediators. Lastly, regarding consistency, apart from the "joint interpretation" mechanism, the ASEAN Member States may consider having a roster system, setting up a Committee for the ISDS, and a possibility of an appellate mechanism. All of these proposals would make the ACIA more in consistence with the current international practice.

In parallel with the ISDS, the ACIA provides for State-to-State DSM. This mechanism does not come into play only when the ISDS attempts have failed, but also tackles more sensitive issues which are out of the scope of the ISDS. Being inspired by the WTO DSM, the EDSM is a self-contained regime, including automatic establishment of the panel, independent panelists and members of the Appellate Body, as well as compensations and retaliation against non-compliance. Contrary to the ASEAN Way of dispute settlement, the EDSM enhances the ACIA with some realistic and powerful enforcement mechanism. Despite all, in case unresolved disputes or non-compliance, the matters may turn into regional political problems, for which the ASEAN Charter sets up a system of reference to the ASEAN Summit.

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<sup>751</sup> Annex 2. Annex 3. Annex 4. ASEAN DSM Protocol

Despite the judicialisation of the ASEAN DSM, no case has yet been found under the ACIA regime. The question arises how to assess its effectiveness. Perhaps, the success of a DSM can rather be measured by the scarcity of the cases.<sup>752</sup> Many potential economic disputes among the ASEAN member States have been resolved without recourse to formal dispute settlements. The ASEAN Secretariat may well have succeeded in preventing foreseeable disputes, by enabling their amicable settlement between ASEAN Member States.<sup>753</sup>

Problematically, the ASEAN Way may also explain this phenomenon. ASEAN Member States have avoided bringing disputes to adjudicatory States because of the less confrontational ASEAN nature, and procedural and institutional shortcomings.<sup>754</sup> Apart from Singapore, and Malaysia to some extent, ASEAN Member States should enhance their capacity to deal with complex disputes. At the advent of the AEC, ASEAN concerns about the change of attitude towards a more rules-based community, ASEAN need the inducement of compliance and harmony, than the imposition of sanctions and involuntary measures of constraint.<sup>755</sup> The first application of the ISDS or the EDSM under the ACIA regime is highly anticipated.

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<sup>752</sup> Woon, W. (Ed.). (2009). *The ASEAN Charter Dispute Settlement Mechanisms*: World Scientific Publishing; Toohey, L. (2011), "When 'Failure' indicates Success: Understanding trade disputes between ASEAN Members" in Buckley, R.P, Weixing Hu, R., Arner, D.W. (eds.), *East Asian Economic Integration: Law, Trade and Finance*, Cheltenham, Edward Elgar, p.150.

<sup>753</sup> Sucharitkul, S. (2003), *Dispute Settlement Regional Approach 6.3 ASEAN*, UNCTAD, p.17.

<sup>754</sup> Vergano, P.R. (2009), *The ASEAN Dispute Settlement Mechanism and its Role in a Rules-Based Community: Overview and Critical Comparison*. Paper presented at the Asian International Economic Law Network (AIELN) Inaugural Conference. [http://aieln1.web.fc2.com/Vergano\\_panel4.pdf](http://aieln1.web.fc2.com/Vergano_panel4.pdf) (Last accessed: 18 September 2015).

<sup>755</sup> *Idem*.

## **Part IV. Thesis Conclusion**

### **Chapter 7. ASEAN Investment Regime as Promising Pathway to ASEAN Economic Community**

This thesis on the “ASEAN Way of investment protection” has assessed the ACIA, which is the latest version of the intra-ASEAN investment treaties, against past and current investment treaty practice. It focuses on the question of balance of ASEAN investors’ and ASEAN Member States’ interests in the post-establishment phase. This thesis considers the ACIA as a third generation of the intra-ASEAN investment treaties, after the intra-ASEAN BITs and the IGA/AIA regime.

The “ASEAN Way” of investment protection reflected in the ACIA has advanced concerns on protection of States’ interests, compared to the previous regimes. This balance emphasises the respect of sovereignty of States, which has been one of the principles of the “ASEAN Way” underlining the ASEAN structure. This thesis finds that even though the objectives of ACIA are to liberalise and to protect ASEAN investors and their investments, the ACIA recognises that ASEAN Member States need quality investments for sustainable development, and need more regulatory space to carry out public-purpose measures, especially in extraordinary circumstances.

This thesis acknowledges that the ACIA has improved investment provisions of the IGA/AIA. It has enhanced the “ASEAN Way” of investment protection by including clearer substantive provisions and establishing more comprehensive dispute settlement mechanisms. With the realisation of the AEC, the ACIA will create a more competitive and more attractive ASEAN Investment Area, which will also restore ASEAN investors’ confidence after the 1997 Asian financial crisis.

This thesis has discovered several ASEAN-specific elements in the ACIA, which mirror the “ASEAN Way” of investment protection. These elements illustrate the ACIA’s attempt to strike a balance between the sovereign right of ASEAN host States and protection of investors’ interests. This new balance is also in line with the general IIA trends towards detailed-enhanced approach. From these findings, this thesis recommends improvement for the intra-ASEAN investment legal framework, and may assist ASEAN Member States to plan their investment laws and regulations according to regional investment obligations.

Despite the fact that the ACIA has modernised the “ASEAN Way” of investment protection, several issues have not received much attention. These issues are perceived when the ACIA is assessed against the newly negotiated IIAs or on-going negotiations in the 2010s, especially mega-regional investment-related agreements, such as the TTP, TTIP, CETA, RCEP. While these IIAs are pushing for a more balancing approach, they put clearer rights and obligations on both investors and States, particularly on the transparency issue. This enhancement of transparency and sustainable development constitutes a challenge that ASEAN Member States should overcome in order that the ASEAN investment regime gains more legitimacy and is able to stand among state-of-the-art investment agreements.

In addition to legal challenges, the ACIA should be addressed in terms of integration challenges. In accordance with the AEC Blueprint, the ACIA aims to establish a single market and production base, and to help transform ASEAN into the ASEAN Economic Community (AEC) by the end of December 2015. Deeper investment integration encourages capital flows, knowledge-transfer and movement of labour which will eventually lead to the transformation of others pillars of the ASEAN Community, namely, the socio-cultural and the political-security pillars, according to the post-2015 agenda.

In concluding the ACIA, ASEAN Member States have used several techniques in asserting their roles in the interpretation of the ACIA, as well as in preserving their policy and regulatory spaces. More legal certainty in the interpretation resulting from the detailed approach in the ACIA may lessen the attractiveness of the ASEAN Investment Area and narrow down investors’ legitimate expectations. This is even more so as the ACIA takes into account the development gap among ASEAN Member States, and grants more flexibility, especially for CLMV countries. The development gap concern is reflected in the principle of special and differential treatment, which tribunals should take into account in the interpretation of the ACIA provisions.

Despite all, legal certainty for ASEAN Member States also means legal certainty for ASEAN investors, as the latter can be assured of their particular rights and obligations. This thesis has demonstrated that the ACIA has created an authentic ASEAN-specific investment regime, which makes the ASEAN comprehensive investment regime a strong and promising pillar for the realisation of the AEC.

## Section 1. The ACIA and Legal Challenges

The ACIA has modified the “ASEAN Way of investment protection”. The previous IGA/AIA agreements may be categorised as IIAs in the 1990s. These ASEAN agreements enshrined several important but undefined treatments which were open to an extremely broad interpretation of investment protection at the expense of States. On the contrary, the ACIA recognises more public interests of ASEAN host States. The ACIA is not only a repackaging of the IGA/AIA regime but a real paradigm shift towards a better even balance of States’ and investors’ interests. In making this shift, the ACIA extends the scope of ASEAN investment practice to cover both direct and portfolio investments. Meanwhile, it provides specific details and clearer rules in order to assure certainty of interpretation by way of detailed provisions, footnotes, and explanatory annexes.

### 1.1 ASEAN Specificities

The ACIA guarantees investor’s rights in a way comparable to international standard practices. Most of the ACIA provisions are based on the NAFTA and 2004 US model BIT which have been globally accepted and adopted by significant numbers of investment treaties. The ACIA approach is developed on the basis of these models and the ASEAN background. The ACIA version of investment protection is named, by this thesis, the “ASEAN Way of investment protection”. The ASEAN specificities have been detected in the ACIA from the admission of investment phase to the dispute of settlement phase.

The ACIA defines the terms “covered investment” and “investors” in an ASEAN specific way. Investments are admitted into the territory of ASEAN Member States according to criteria set out in the ACIA. Investments must be accepted in conformity with the host State’s law and, where applicable, must comply with the procedure of approval in writing. ACIA Annex 1 explains the procedures relating to specific approval in writing. This Annex calls for due process and transparency of domestic procedures.

The ACIA extends the term “covered investment” to cover portfolio investments. The term “investment” also means foreign-owned ASEAN-based (FOAB) investments. As a consequence, the ACIA, which is an intra-ASEAN treaty, has an external dimension which covers non-ASEAN investors through FOAB construction. Hence, there will be more investment flows in the ASEAN Investment Area. This approach demonstrates the ASEAN Open Regionalism policy, according to which ASEAN Member States remain reliant on external investment flows.

ASEAN investors and “covered investments” admitted in ASEAN territory are granted substantive and procedural rights. Substantive rights are divided into absolute and relative rights. The three important absolute rights selected for this study are unlawful expropriation, FET and transfers. Provisions on unlawful expropriation are specifically detailed for the determination of indirect expropriation and non-discriminatory regulatory measures. On this matter, ACIA Annex 2 goes beyond the NAFTA/US models. Annex 2 clarifies a vague concept of “legitimate expectation” by referring to a government’s prior binding written commitment. It also clarifies the term “character” of a government’s actions by linking this term with the objective and the proportionality of State’s measures.

The content of FET has been controversial because of its vagueness, and tribunals have been required to interpret the meaning of what constitutes a “fair and equitable” treatment. The ACIA has attempted to solve this debated issue by proposing a very narrow reading of the FET standard. ACIA article 11 specifies that FET only requires each Member State not to deny justice in any legal or administrative proceedings in accordance with the principle of due process. The ACIA renounces the broad reading of FET which usually refers to another ambiguous concept, that of the “legitimate expectation” of investors. The ACIA assures the certainty of the interpretation of the FET standard. It enhances also the transparency of domestic laws by requiring ASEAN Member States to publish all laws and regulations relating to foreign investments.

Apart from general exceptions and security exceptions which are usually found in modern IIAs, the ACIA expressly includes economic exceptions. ACIA article 13 guarantees transfers of funds to all covered investments. However, as ASEAN Member States suffered the ASEAN Economic Crisis in 1997 and most of them are developing countries, the right to transfers are limited by certain circumstances, specifically listed in ACIA articles 13 and 16. Transfer exceptions are found in some recent economic treaties. Under the ACIA, these exceptions are specifically allowed for two reasons. Firstly, an ASEAN Member State may adopt or maintain restrictions on payments or transfers related to investments in the event of, or the threat of, external financial difficulties and serious balance-of-payments. Secondly, exceptions are allowed for ASEAN Member States which are in the process of economic development and may necessitate the use of restrictions to ensure the maintenance of a level of financial reserves. As a result, the ACIA grants States more space to regulate foreign investments. Nevertheless, these exceptions must be used according to the criteria set out in the ACIA, requiring the State to justify its necessity.

This thesis observes that while the ACIA perceives these absolute rights in a narrow way, it apprehends relative rights in a more liberal manner. The ACIA grants both MFN and national treatments to ASEAN investors and their investments in both pre-establishment and post-establishment phases, while these rights sometimes disappear altogether in other BITs. The ACIA provides national treatment to all ASEAN investors, in like circumstances, without the reciprocity requirement. However, given the development gap among ASEAN Member States, the ACIA allows ASEAN Member States to reserve the application of national treatment in specific schedules, subject to reduction or elimination in accordance with the three phases of the Strategic Schedule of the AEC Blueprint.

Any preferential treatment granted by a Member State to any investor, either ASEAN or non-ASEAN investor, and to its investments, under any existing or future agreements or arrangements, must be extended automatically on a MFN basis to all Member States. While other investment agreements, especially BITS of developing countries, include MFN, they usually set third-party exceptions to the MFN treatment. In contrast, the ACIA does not allow third-party exceptions but allows exception for sub-regional arrangements between and among Member States. This aims for deeper economic integration for particular intra-ASEAN projects. Furthermore, while the MFN application to the dispute settlement mechanism is controversial in the investment treaty practice, the ACIA has set an example of explicit exclusion of ISDS procedures from the MFN application.

In order to guarantee the effectiveness of substantive rights, the ACIA establishes dispute settlement mechanisms between investors-States and between ASEAN Member States. The inclusion of ISDS is controversial in on-going negotiations of investment agreements. ISDS is, however, included in the ACIA. While ISDS rules mostly refer to external rules and institutions such as the ICSID Conventions or UNCITRAL Rules, the ACIA also expressly refers to ASEAN arbitration centres and their rules. For instance, the Singapore International Arbitration Centre (SIAC) is a leading arbitration institution and has a set of innovative rules. The Kuala Lumpur Regional Centre for Arbitration (KLRC) in Malaysia has specific rules for disputes under Islamic law. For more effective arbitral proceedings, the ACIA also includes new provisions, such as a fork-in-the-road provision, a mechanism for dealing with frivolous claims, and consolidation proceedings.

The ACIA inserts a mechanism of joint-decision in ISDS in order to ensure that the ACIA provisions will be interpreted in accordance with the intention of ASEAN Member States. This technique preserves the role of ASEAN Member States in the interpretation of

the ACIA before a concrete case. Tribunals should defer to joint decisions of States. The ACIA does not opt for the establishment of an investment committee which has power of interpretation both *in abstracto* and *in concreto*. ASEAN Member States prefer basing the interpretation on the circumstances of each case. As this approach requires a joint decision of ten Member States, it may not be an easy tool to make the formation of the *corpus* of ASEAN investment jurisprudence.

Finally, in the case that disputes before an ISDS remaining unresolved, the ACIA provides a State-to-State dispute settlement mechanism which refers a legal dispute to the ASEAN Summit, the highest political entity of ASEAN. This political reference is an ASEAN-specific way of dispute resolution, which is neither common to other BITs, nor resembles the European Court.

On balance, this reading of the ACIA can be summarised as the concept of the “ASEAN Way of investment protection”. While the ACIA attempts to guarantee the maximum level of investment protection standards, it retains prerogatives for ASEAN Member States to regulate, in the form of exceptions and carve-outs, as well as limitations on the exercise of investors’ rights in the ISDS system and the containment of arbitral powers. The “ASEAN Way” has underlined the ASEAN structure since the beginning of cooperation; its principle of non-interference of domestic affairs and respect of States’ sovereignty has been inserted into the ACIA in order to balance regional attractiveness as a single market and production base with the sovereign rights of ASEAN Member States. These ASEAN specificities may serve as guidelines for on-going negotiation of IIAs, or for the interpretation of other investment treaties.

## 1.2 Legal Challenges

In spite of the innovations which make the ACIA more certain and more transparent, this thesis finds that the “ASEAN Way of investment protection” still lacks some key elements concerning public transparency and corruption, sustainable development and corporate governance. In preparation for realisation of the AEC, ASEAN Member States should look beyond the balance of investors’-State’s rights in the ACIA. States should take into account various stakeholders, especially the ASEAN peoples. This lack shows that the characteristics of old-version BITs persist in the ACIA, or perhaps the ACIA over-asserts interests of direct beneficiaries and undervalues those of indirect beneficiaries. This shortcoming may lower the quality of the ACIA standards.

This thesis notes the room for development of the intra-ASEAN investment regime. The enhancement of these elements which are lacking forms part of the legal challenge for



ASEAN Member States and ASEAN investors. ASEAN Member States should emphasise more the balance between the economic dimension of the ACIA international investment regulations and the social dimension, particularly regarding the interests of investors, States and all other parties who may be potentially affected by the ACIA.

Firstly, the tension between public transparency and confidentiality of arbitration is currently one of the biggest challenges of ISDS. Some newly negotiated agreements tend to refer to the 2013 UNCITRAL “Rules on Transparency” and the 2014 “Mauritius Convention on Transparency” in order to provide for a significant degree of openness throughout the arbitral proceedings. The ACIA requires public transparency merely for publication of awards and decisions. This thesis recommends that ASEAN Member States include the above mentioned transparency rules or amend the ACIA to expressly require more public transparency, especially for publication of documents and for *amicus curiae* participation, and for open hearings. In addition, ASEAN Member States may consider setting a code of conduct for arbitrators and more detailed rules on alternative dispute settlements.

Secondly, in connection with the transparency issue, ASEAN Member States may use the ACIA as a tool to prevent corruption in their national administrative activities, especially in the process of approval of foreign investment. They may include an anti-bribery provision in the ACIA as conditions and limitations on submission of a claim, so that tribunals are mandated to treat corruption as a jurisdictional or preliminary objection.

Thirdly, the ACIA should address more the tension between economic growth and sustainable development.<sup>756</sup> The attraction of investment flows is the most important objective of the ACIA. Nevertheless, a true balance of human development could not be reached by leaving social and environmental dimensions out of the equation.<sup>757</sup> The Bali Concord III declares that in order to realise an ASEAN Community, an ASEAN Member State needs to strengthen its “bonds of regional solidarity”, that is by becoming more “politically cohesive, economically integrated and socially responsible”.<sup>758</sup>

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<sup>756</sup> Nipawan P., “The Quest of Sustainable Development in the ASEAN Investment Area”, article presented in the 2014 Inaugural Asian Conference on the Social Sciences and Sustainability (ACSUS), 1-3 December 2014, Hiroshima, Japan. [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2523352](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2523352) (Last accessed: 16 September 2015). See also Nowrot, K. (2014), “How to Include Environmental Protection, Human Rights and Sustainability in International Investment Law?”, *JWIT*, Vol.15, Special Issue: The Anatomy of the (Invisible) EU Model BIT, pp.612-644.

<sup>757</sup> See ASEAN Charter article 1, Purposes (9),(13); OECD (2014), Report *Towards Green Growth in Southeast Asia: Solutions for Policy Makers*. <http://www.oecd.org/dac/environment-development/Final%20SE%20Asia%20Brochure%20low%20res.pdf> (Last accessed: 16 September 2015)

<sup>758</sup> Bali declaration on ASEAN Community in a global community of nations (2011), signed at the 19th ASEAN Summit on 17<sup>th</sup> November 2011 in Bali; “Bali Concord III” Plan of Action 2013-2017, November 2012.

The ACIA gives a great room for manoeuvre to ASEAN Member States to issue regulatory measures of public purposes, and allows them to exercise their sovereign power in extraordinary circumstances. However, these mechanisms may not be sufficient to restrain ASEAN governments to “race to the bottom”<sup>759</sup> by lowering standards of decent environment, labour standards, consumer protection or public health regulations, in order to attract investment flows. Many types of environmental provisions may be brought to the attention of the ASEAN Member States negotiators; for example, the “not lowering environmental standard” type of clause in the MAI<sup>760</sup> and in the Japan-Malaysia or Thailand-Japan FTAs. The 2014 EUSFTA may provide a useful example for “Trade and Investment Promoting Sustainable Development” provisions, and mechanisms and institutions to implement these provisions.<sup>761</sup>

Fourthly, ASEAN Member States may consider strengthening the concept of corporate and social responsibility (CSR) in the ACIA. “Unlike environment and labour provisions, the inclusion of explicit references to CSR in investment agreements is a relatively recent phenomenon”.<sup>762</sup> The imbalance occurs with reference to the main providers of investments. The multinational enterprises (MNEs) enjoy the granted rights without any obligations being imposed,<sup>763</sup> while their activities may have repercussions on a wider climate of environment and society. Hence, investors should not adopt a “profit-maximisation” approach, but a “profit-optimisation” approach which would yield long-term benefits for the investor.<sup>764</sup>

In conclusion, the balance between investors’ and States’ rights in the ACIA has rendered the current ASEAN investment regime less attractive than the previous regime. Also, the recommended inclusion of stronger environmental and societal protection provisions would make the balance of investors’-States’ interests more problematic. Furthermore, due to the economic and social development gaps among ASEAN Member States, the idea of transparency and sustainable development may be difficult to conceive.

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<sup>759</sup> Muthukumara, M., Shreyasi, J. (2006), *Trade liberalization and the environment in Vietnam*, World Bank Policy Research WP No.3879, Washington DC, World Bank. April.

<sup>760</sup> OECD, Preamble to the MAI and Provision on Not Lowering Standards, Drafting Group No.3 on Definition, Treatment and Protection of Investors and Investments, Note by the Chairman, DAF/MAI/DG3(97)5, 20 February 1997.

<sup>761</sup> EUSFTA Chapter 13, The Review of Impact on Sustainable Development (article 13.14), Government Consultations (Article 13.16), Institutional Set up and Monitoring Mechanism (article 13.15).

<sup>762</sup> UNEP (2011), *Corporate Social Responsibility and Regional Trade and Investment Agreements*, Several references to CSR are made in the IIAs, for instance, article 810 in the investment section of the 2009 Canada-Peru agreement, and an annex to the 2009 US-Peru TPA.

<sup>763</sup> Davarnejad, L.(2008), Strengthening the Social Dimension of IIAs by integrating Codes of Conduct for Multinational Enterprises, OECD Global Forum on International Investment, 27-28 March 2008.

<sup>764</sup> Mujih, E.C. (2012), *Regulating Multinationals in Developing Countries: A Conceptual and Legal Framework for Corporate Social Responsibility*, Gower Applied Research.

It is expected that more-balanced provisions between investment flows and sustainable development will be present in the next rounds of negotiation. For the moment, the regional legal framework is expected to create an investment-friendly legal environment in ASEAN. These legal lacunae may rather be perceived as cooperative requirements among ASEAN Member States and ASEAN investors. Overall, the dilemma of the ACIA's effectiveness and its impact on AEC integration does not exist at the regional level. The problem lies in the implementation of regional obligations by ASEAN Member States.

## Section 2. The ACIA and Integration Challenges

Despite the fact that the “ASEAN Way of investment protection” in the text of the ACIA has undergone significant transformation, the challenge of ASEAN integration remains in the implementation of the ACIA at national level. According to the AEC Blueprint, the ACIA serves primarily as a tool to achieve one of the AEC objectives, *i.e.* a single market and production base. By the integration of trade and investment, the single market and production base will be the first official move toward the realisation of the AEC, whereas the other objectives, namely, freedom of movement of labour, capital, services, are more arduous to achieve.

The realisation for the more ambitious goals is set at 2020. To be attractive at regional level, ASEAN member States have put in place a three-fold connectivity strategy, namely, physical infrastructures (transport, ICT, energy), soft infrastructures (legal, institutional, capacity-building), and people-to-people connectivity (education and culture tourism).<sup>765</sup> The implementation of the AEC strategy is challenged both at regional and domestic levels. On the one hand, ASEAN investors should be informed of the potential to invest in the ASEAN Investment Area. On the other hand, the ASEAN Member States should make an effort to implement the ACIA obligations.

### 2.1 Regional Awareness of ASEAN as an Integrated Investment Area

It is worth remembering that the ACIA has four objectives: protection, liberalisation, facilitation, and promotion. As discussed *supra*, the protection pillars of the ACIA may be considered successful with the entry into force of the ACIA. Meanwhile, the

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<sup>765</sup> See interaction between ASEAN Connectivity and ASEAN Community Building in ASEAN Secretariat (2011), Master Plan for ASEAN Connectivity, ASEAN Publications; See also Bhattacharyay, B. N. (2009), Infrastructure Development for ASEAN Economic Integration, ADBI WP138, Tokyo, ADB Institute; ERIA (2010), ASEAN Transport Strategies 2010-2015, Final Report.  
<http://www.eria.org/ASEAN%20Strategic%20Transport%20Plan.pdf> (Last accessed: 16 September 2015)

first use of the dispute settlement mechanism provided under the ACIA is expected. In practice, more tangible achievement on investment liberalisation pillar remains to be seen. The ACIA has opened up only five industrial sectors and services incidental to these sectors. These sectors are also subject to a long list of reservation of national treatment, and senior management and board of directors. According to the principle of gradual liberalisation, it will take some time for ASEAN Member States to get ready to open up more sectors and gradually eliminate their reservations schedules.

While ASEAN Member States focus on liberalisation and protection provisions, the inclusion of promotion and facilitation provisions seems to be understated. ACIA article 24 emphasises that ASEAN Member States must promote investment flows by cooperating in “increasing awareness of ASEAN as an integrated investment area”; for example, encouraging the growth and development of ASEAN SMEs, enhancing industrial complementation and production networks among multi-national enterprises.<sup>766</sup> ASEAN citizens should be informed about this enormous economic potential of the AEC. Particularly, young entrepreneurs from SME sectors should be promoted to reach out to partners in ASEAN Member States to build synergies in the region.<sup>767</sup>

ACIA article 25 states that Member States must “endeavour to cooperate” in the facilitation of investments into and within ASEAN, by creating the necessary environment for all forms of investments; streamlining and simplifying procedures for investment applications and approvals; promoting dissemination of investment information, including investment rules, regulations, policies and procedures; establishing one-stop investment centres; and providing advisory services to the business community of the other Member States.<sup>768</sup> This is not an obligation. Nonetheless, ASEAN Member States should provide public access to all the laws, regulations and administrative guidelines of general application that affect investments in the territory of a Member State. Moreover, ASEAN States should inform the ASEAN Investment Area Council<sup>769</sup> about any new law or modification of laws, regulations or administrative guidelines affecting investments in the country. Each State should also appoint an agency responsible for investment information. ACIA article 26 further indicates that Member States should “endeavour to harmonise”, where possible, investment and industrial policies and measures; and build and strengthen

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<sup>766</sup> ACIA article 24, Promotion of Investment.

<sup>767</sup> ASEAN Secretariat (2014), *Thinking Globally, Prospering Regionally: AEC 2015*, Indonesia, ASEAN Publications.

<sup>768</sup> ACIA article 25, Facilitation of Investment.

<sup>769</sup> ACIA article 42, Institutional Arrangements.

the capacity of Member States, including human resource development, in order to enhance ASEAN economic integration.<sup>770</sup>

ASEAN Member States have large differences in language, culture, political and economic models. They also have no institution like the EU Commission, which has competence in investment issues instead of the EU Member States. These two facts emphasise the importance of the promotion and facilitation pillars of the ACIA. Even though these cooperation provisions are not legally enforceable under the ISDS mechanism, they are important to the contribution of an investment-friendly environment for both intra-ASEAN and extra-ASEAN investment flows into the ASEAN Investment Area.

Furthermore, although ACIA institutions do not exercise investment competence instead of the ASEAN Member States, they should conscientiously carry out their functions. The ASEAN Coordinating Committee on Investment (CCI) and the ASEAN Investment Area Council should oversee, coordinate and review the implementation of the ACIA, provide policy guidance on global and regional investment matters, and report the up-to-date situation to the ASEAN Economic Ministers (AEM).<sup>771</sup> The promotion of the ACIA, the facilitation of investment, and the proactive approach of the ACIA institutions, so combined, will make the ASEAN Investment Area countries an attractive alternative location for investment flows.

## 2.2 Domestic Implementation

The implementation of the ACIA is not an easy task because it requires ASEAN Member States to change domestic laws or even national constitutions. A cross-national empirical analysis finds that “although ASEAN countries on the whole tend to provide a positive macroeconomic environment, attractive to foreign investment, most of them are relatively poor institutionally”.<sup>772</sup> This analysis also finds that, with respect to institutional development, the diversity within ASEAN Member States reflects great differences in their government effectiveness and legal environment.

Sporadic failures in implementing certain specific ACIA obligations are not as concerning as the structural incapacity of ASEAN Member States, which is more obstructive to successful integration. Several impediments may be named: absence of

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<sup>770</sup> ACIA article 26, Enhancing ASEAN Integration.

<sup>771</sup> ACIA article 42, Institutional Arrangement.

<sup>772</sup> Buracom, P. (2014), “ASEAN Economic Performance, Institutional Effectiveness, and Foreign Direct Investment”, *Asian Affairs: An American Review*, Vol.41, No.3, pp.108-126.

transparency and predictability in government regulations and their modalities of implementation, inaccessibility and lack of updated and readily available information. Hence, States should not push forward the AEC with only short-term solutions, such as the change of macroeconomic policy, or gradual elimination of restrictions on foreign investments. Long-term solutions are needed, including substantial structural reforms for greater functional harmonisation.

Moreover, the lack of dispute settlement related legal capacity and the lack of budget for the operations of ASEAN-specific activities are particularly worrisome in the CLM countries. Therefore, improving institutional quality and reducing disparities in institutional performance among ASEAN Member States should be set as a priority which underlines ASEAN economic integration.<sup>773</sup> A national coordinating mechanism should be set up to avoid potential redundancies and contradiction in the process.

The realisation of the ambitious regional goals calls for sincere and effective implementation of the ACIA obligations by ASEAN Member States. ASEAN Member States should think more in terms of regional prosperity, and not only of their domestic interests. In the AEC Era, the principle of non-interference in domestic affairs, which has characterised the “ASEAN Way” of cooperation, should be no more a convenient pretext for non-compliance with the ACIA obligations.

In parallel to the legal environment, the political situation has also affected investment flows in the emerging markets. For example, despite favourable business regulations, recent political turmoil in Thailand has increased the risk of doing business and has agitated the expectations of some investors. In contrast, foreign investment in Vietnam is showing a strong recovery. Meanwhile, Cambodia, Laos and Myanmar are gaining more attention from investors, because of their low-cost labour and richness of natural resources.

In preparation for the full-fledged realisation of the AEC, enhancing the capacity of domestic dispute settlement bodies may be a further plausible approach to balance national policy space and developmental goals against investment protection and liberalisation of the region. From now till 2020 is the transitional period for ASEAN Member States to reform their legal and institutional structures, including rule simplification, enhancement of transparency and regulatory coherence for trading and investment. It is also critical for them to open-up industrial sectors in the right sequence in order to avoid economic vulnerabilities.

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<sup>773</sup> *Idem.*

Additionally, ASEAN Member States should put their efforts into developing portfolio investment instruments, and into designing more sophisticated mechanisms and institutions to deal with these instruments. This may ease the implementation of the ACIA regarding portfolio investment flows which have newly been included in the scope of the ACIA. ASEAN governments should leave the most sensitive sectors till last. Once the economic pillar is stable, ASEAN could advance its challenges to the socio-cultural and political-security pillars.

On a final note, ASEAN Member States should have more trust in the intra-ASEAN relationship. They should not overly rely on external relations and ignore their closest neighbours. The new “ASEAN Way” should not be seen a display of political solidarity as it was in the 1960s. The realisation of the AEC in 2015 is not a final destination of ASEAN. Rather it is a milestone on the long journey towards the complete integration process of the ASEAN Community. The most important consideration is to include all ASEAN Member States in the process in a significant way. ASEAN should promote dispute settlement mechanisms, whether judicial or alternative procedures. Their legal and institutional infrastructure and the rule of law must be strengthened for all members of ASEAN. As a result, despite all diversities, the new “ASEAN Way of Investment Protection” may create a sustainable investment-friendly environment and encourage intra-ASEAN investment flows throughout the region.

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