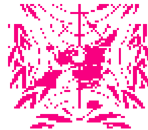
UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

SCOPE AND DEFINITION

UNCTAD Series
on issues in international investment agreements



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Two dots (..) indicate that data are not available or are not separately reported. Rows in tables have been omitted in those cases where no data are available for any of the elements in the row;

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A slash (/) between dates representing years, e.g. 1994/95, indicates a financial year;

Use of a hyphen (-) between dates representing years, e.g. 1994-1995, signifies the full period involved, including the beginning and end years.

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IIA Issues Paper Series

The main purpose of the UNCTAD Series on issues in international investment agreements is to address key concepts and issues relevant to international investment agreements and to present them in a manner that is easily accessible to end-users. The series covers the following topics:

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Scope and definition
Social responsibility
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Taxation
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Preface

The United Nations Conference on Trade and Development (UNCTAD) is implementing a work programme on a possible multilateral framework on investment, with a view towards assisting developing countries to participate as effectively as possible in international investment rule-making at the bilateral, regional, plurilateral and multilateral levels. The programme embraces capacity-building seminars, regional symposia, training courses, dialogues between negotiators and groups of civil society and the preparation of a series of issues papers.

This paper is part of this series. It is addressed to government officials, corporate executives, representatives of non-governmental organizations, officials of international agencies and researchers. The series seeks to provide balanced analyses of issues that may arise in discussions about international investment agreements. Each study may be read by itself, independently of the others. Since, however, the issues treated closely interact with one another, the studies pay particular attention to such interactions.

The series is produced by a team led Karl P. Sauvant and Pedro Roffe, and including Victoria Aranda, Anna Joubin-Bret, John Gara, Assad Omer, Jörg Weber and Ruvan de Alwis, under the overall direction of Lynn K. Mytelka; its principal advisors are Arghyrios A. Fatouros, Peter T. Muchlinski and Sanjaya Lall. The present paper is based on a manuscript prepared by Kenneth J. Vandevelde. The final version reflects comments received from Mark Koulen and Manfred Schekulin. It was desktop published by Teresita Sabico.

Funds for UNCTAD's work programme on a possible multilateral framework on investment have so far been received from Australia, Brazil, Canada, the Netherlands, Norway, Switzerland, the United Kingdom and the European Commission. Countries such as India, Morocco and Peru have also contributed to the work programme by hosting regional symposia. All of these contributions are gratefully acknowledged.

Rubens Ricupero
Secretary-General of UNCTAD

Geneva, February 1999

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Executive summary

In furtherance of their economic development policies, most countries have entered into one or more investment agreements that in various ways liberalize, promote, protect or regulate international investment flows. Such agreements typically apply to investment in the territory of one country by investors of another country.

The scope of investment agreements is delimited primarily through definitions of key terms, such as "investment" and "investor". By themselves and in conjunction with the operative provisions, these definitions may play one or both of two critical functions in an agreement: they identify those assets to which the treaty applies; and they may determine the nature of the obligations created by the treaty. The terms "investment" and "investor" are the principal focus of this paper. The discussion will consider both how these terms have been defined in existing investment agreements and how these definitional provisions interact with key operative provisions of investment agreements.

Investment agreements often define "investment" in a way that is both broad and open-ended. The broadest definitions embrace every kind of asset. They include in particular movable and immovable property, interests in companies (including both portfolio and direct investment), contractual rights (such as service agreements), intellectual property, and business concessions.

Each of these types of investment has different economic and development implications for home and host countries. The parties to an investment agreement thus may not wish to liberalize, promote, protect or regulate all investment flows in the same manner or to the same extent. For example, the economic development policies of treaty parties may call for excluding certain assets from coverage by a particular investment agreement or for treating certain assets differently under the agreement.

Many investment agreements have therefore narrowed the definition of investment in various ways in furtherance of the parties' economic policies, including development policies. For example, they often exclude from the definition investment not established in accordance with host country legislative requirements, which tend to reflect a country's development policy. They may exclude investment established prior to the entry into force of an investment agreement or the host country's foreign investment law, again because the investment may have been established outside the framework of the host country's development policy; certain types of investment, such as portfolio investment or short-term contracts (which may be regarded as less desirable than direct investment for the purposes of long-term economic development) or investments that do not meet certain minimum capital requirements or that are in certain industries of the economy. All of these limitations have appeared in at least some investment agreements, generally in furtherance of the economic development policies of some or all of the parties.

Alternatively, a host country seeking to exclude or regulate certain types of foreign investment may decide to impose conditions on the establishment of particular foreign investments or to exclude them from its territory entirely. Furthermore, a host country may prefer language limiting the applicability of specific provisions to certain types of investment.

Investment agreements usually define "investor" to include both natural persons and legal entities. Both are considered "investors" within the meaning of an agreement if they have the nationality of a particular State or are otherwise linked to that State, such as through domicile or residence. For legal entities, the criterion for determining nationality is usually based on the country of organization, the country of the seat or the country of ownership and/or control of the entity.

INTRODUCTION

This paper analyses the scope and definitions of investment agreements. Investment agreements must specify not only their geographical and temporal coverage, but, most importantly, their subject-matter coverage. This is done primarily -- though as this paper will show -- not exclusively, through the provisions on definition, especially the definitions of the terms "investment" and "investor".

The terms "investment" and "investor" lend themselves to a significant variety of definitions, resulting in distinct drafting choices. In particular, this paper identifies a range of alternatives from wide to narrow definitions and shows how these might affect, on the one hand, the extent of treaty coverage granted to foreign investors and, on the other, the degree of host State discretion in directing and implementing its foreign investment policy.

Of particular importance in this regard is an understanding of approaches to definitions. In the case of "investment" is the term defined by reference to types of assets that, in theory, could amount to an "investment", or does one also refer to the underlying transaction in which those assets are involved? In the case of the term "investor", is this term defined by reference to categories of legally recognized persons or on the basis of the transactions involved, regardless of the legal status of the person or entity undertaking that transaction?

The answers to such questions materially affect the actual role of the agreements. Indeed they guide the structure of the present paper which, in section I, elaborates on these initial conceptual issues. Section II then provides a stocktaking and analytical background: it describes how these terms have been defined in existing international instruments and explains the rationales for various definitions. Section III analyses the interaction of these definitions with some of the other issues addressed by investment agreements. It is here that the interaction between the scope of

the definitions used -- and the means by which other concepts further affect the operation of definitional terms -- is considered. Thereby the full range of concerns relevant to determining the subject-matter of an investment agreement is shown. Finally, the concluding section assesses the development implications behind the wider and narrower definition clauses identified in section II.

Section I

EXPLANATION OF THE ISSUE

A. Scope of international investment agreements

The scope of an international investment agreement[1] is delimited in at least three ways:[2]

- **By its geographical coverage.** The geographical scope of an investment agreement is determined, to begin with, by the number and identity of the States that are party to it. It is also determined by the territorial limits of the States concerned. The definition of the term "territory" is important in this respect and will be briefly addressed later.

- **By its temporal application.** To ascertain the exact temporal scope of an agreement, its date of entry into force with respect to each party and its duration has to be determined. Apart from such general international law questions, the temporal scope of an agreement raises two main issues: the first is whether the agreement applies to an investment established prior to its entry into force; this issue often is addressed in the definition of "investment" and will be discussed in connection with that term. The second issue is whether an agreement's provisions continue to apply to an investment subsequent to its formal termination. This issue generally is not addressed in provisions on definitions and will not be discussed here.[3]

- **By its subject matter.** The subject matter scope of an investment agreement is determined by the definition of two terms in particular: "investment" and "investor". These terms refer to major dimensions of the economic activities to which the provisions of an agreement apply. Accordingly, they play

an important role in determining the normative content of an instrument. Typically, an international investment agreement applies only to certain types of investment. One important feature of such investment is that it must be "foreign", that is to say, investment by investors from one country in the territory of another. The definition of the term "investor" therefore supplements in an important manner the definition of "investment". This paper discusses these terms at length. The term "returns" is occasionally relevant to the subject-matter scope of specific provisions of some investment agreements and is discussed briefly.

In short, while there are at least three dimensions to the scope of an investment agreement, it is chiefly with respect to the subject matter of an instrument that definitions are important. The geographical and temporal scope are not usually determined by means of definitions, but through specific provisions (usually among the instrument's "final clauses"). This paper addresses in the main the problems of definitions, and especially those of the terms "investment" and "investor", around which cluster most of the important questions.

It should be noted at this point that the terms "investment" and "investor" are not defined in every investment instrument; the discussion in this paper does not presuppose that these terms should be defined in every case. Whether the instrument includes explicit definitions or not, however, its application requires that the parties use some working definition of these terms. Some appreciation of the meaning of the terms is thus essential to an understanding of the scope of any investment instrument.

B. Definitions of key terms

Definitions serve many purposes. In international agreements, they raise difficult policy issues and are often the subject of hard bargaining between the negotiating parties. Accordingly, they should be seen not as objective formulations of the meaning of terms, but as part of an agreement's normative content, since they determine the extent and the manner in which the other provisions are to be applied. Thus, the decision on a definition of terms will be made on a case-by-case basis, taking into account the purpose and circumstances of the negotiations at stake.

1. *Investment*

a. Historical context

There is no single, static conception of what constitutes foreign investment. Rather, the conception has changed over time as the nature of international economic relations has changed.

Prior to the middle of the nineteenth century, trans-frontier capital flows typically assumed the form of lending by European investors to borrowers in other European States (Kindleberger, 1993, pp. 208-224). The difficulties involved in travel and communication over long distances were a strong impediment to foreign direct investment (FDI).

In that period, foreign-owned property in a country often took the form of merchandise imported for sale to the domestic market or vessels that had shipped the merchandise. Foreign nationals -- more often than not, resident in the home countries -- might also hold bonds that had served to finance foreign manufacturing and transportation enterprises. In addition, foreign nationals residing abroad generally owned for their personal use and consumption a certain amount of personal and real property in the host country where they resided. International investment law was thus concerned principally with the protection of tangible property against seizure and the right of creditors to collect debts. Some countries negotiated treaties that protected foreign property, such as merchandise and vessels, against expropriation.[4]

In the late nineteenth century, improvements in transportation and communication facilitated the management of enterprises owned by foreign nationals, in natural resources, in public utilities or in large manufacturing plants. In all three cases, major capital investments as well as advanced technology were required, which were often not available to local entrepreneurs. At the same time, use of the corporate form of business organization became more widespread and securities markets emerged (Cameron, 1997, pp. 213-214, 308). The result was that a number of countries developed the economic and legal foundations necessary for the establishment of foreign-owned investment in companies.

Traditionally, investment in companies has been categorized as either direct or portfolio investment. An investment is considered direct when the investor's share of ownership is sufficient to allow control of the company, while investment that provides the investor with a return, but not control over the company, generally is considered portfolio investment.[5] Because an investor may be able to control a company with less than the majority of the stock, the degree of ownership required for investment to be regarded as direct may vary with the circumstances. In some instances, investment may be defined as direct if it is to be of lasting duration.

In the nineteenth century, because of the difficulties of controlling an enterprise from abroad, the dominant form of investment in foreign companies was portfolio investment, with the principal exceptions being in specific sectors (e.g., public utilities, natural resources). By the mid-twentieth century, however, with further improvements in transportation and communication, the stock of FDI exceeded the total amount of foreign portfolio investment. The protection of foreign investment in the form of equity stock in companies became an increasing concern of foreign investment law. Since much FDI was in the primary sector, concession agreements for natural resource extraction became a matter of importance in international investment law.[6]

In the late twentieth century, the forms of foreign investment have become more diverse. As technological innovations have spread around the world, the producers of technology have sought to protect their patents and copyrighted materials against infringement. The consolidation of business enterprises to form transnational corporations (TNCs) with global name recognition has given great value to certain trademarks that are associated with high quality and/or high demand goods. Thus, the regulation of intellectual property is a concern of growing importance to national and international law. Many developed economies that had concentrated their productive resources in the manufacturing sector in the nineteenth century began to shift a large portion of these resources to the services sector, and continuing improvements in communication and transportation made it feasible for service providers to render services to clients in foreign countries. As this suggests, changing circumstances create new ways of investment in foreign countries. In other words, there is an increasing array of foreign-owned assets

that have economic value and thus may be regarded as foreign investment.

b. Impact on investment definitions

This brief foray into the history of the matter helps explain another aspect of the topic at hand, namely, the relatively recent emergence of the notion (and term) of "investment" in the language of international agreements and international legal practice in general. Customary international law and earlier international agreements did not generally utilize this notion. They relied instead on the notion of "foreign property", approaching in the same (or similar) manner cases of imported (and invested) capital and cases of property of long-resident foreign nationals, where no transfer of capital took place or the original transfer was lost in history. [7] As a result, the question of whether portfolio investment was an asset protected under traditional rules of customary international law has been an open question. The outcome of the Barcelona Traction case suggests that it might not have been protected (ICJ, 1970). One reason for this possibility is that the risk involved in some portfolio investments for the investor would not be as high as that involved in a direct investment, since the former investment could normally be pulled out of a host country more easily than the latter (Sornarajah, 1994). Similarly, traditionally, such intangible assets as intellectual property were not thought to be assets that came within the ambit of customary international legal protection (Sornarajah, 1994). Earlier instruments and practice are thus of little help in addressing the issue of the definition of "investment" today, although they may account in part for the emphasis on assets in such definitions that later discussion will show.

The important issue to be looked at in addressing the issue of definition, with a view towards establishing the subject matter scope of an agreement, is which of the many types of investment activities that are of value in the modern economy should be included within the definition of "investment". Because that definition will specify the economic activities to which the operative provisions of agreements apply, the terms of the definition are as important to the normative content of the agreement as the terms of the operative provisions and reflect the investment policies of the parties. An assessment of the economic implications of various alternative definitions of "investment" in the context of an agreement's

operative provisions is therefore important.

A detailed analysis of possible definitions (and categories of definitions) of investment is undertaken in concrete context in the next section, where existing investment instruments are reviewed. At this point, it is necessary to point out that an "investment" may, in the language of the agreements, be itself a legal person. For instance, a corporation established in the host country by a foreign investor is, in effect, the foreign investor's "investment". Yet the foreign investor, if it is a parent company, is itself a corporation. Furthermore, should the corporation in the host state make its own investments -- as through acquisitions, joint ventures or the establishment of a local subsidiary -- it too becomes an "investor". Thus both "investors" and "investments" can in practice possess legal personality.

As will be seen later, moreover, different types of international investment flows have different economic implications. In implementing their economic and development policies, countries thus may wish to accept different rules concerning the treatment of different types of foreign investment. In other words, countries may be willing to assume certain obligations only with respect to foreign investment that has specified economic implications. Thus, the scope of the definition of "investment" generally will depend upon the purpose and the operative provisions of an investment agreement. For example, an investment agreement that deals with rules on the admission of investment may define "investment" differently from one that deals with post-admission treatment.

2. Investor

Investment agreements generally do not apply to all investment. Rather, they typically apply only to investment by investors who are connected with at least one of the other treaty partners through nationality or other links, according to the agreement's provisions. The definition of the term "investor" thus can be critical to determining the scope of an investment agreement.

Two general issues arise in defining the term "investor": what types of person or entity may be considered investors? And what

are the criteria that determine that a person is covered by an agreement?

a. Entities considered "investors"

Two types of entity may be included within the definition of "investor": natural persons or individuals and artificial or legal persons, also referred to as legal or juridical entities. Sometimes, the term "investor" is not used. Instead, agreements refer to "nationals" and "companies", with the former defined to include natural persons and the latter defined to include a range of legal entities.

The category of natural persons requires no elaboration. The only issue that arises in determining whether a natural person is covered by an agreement concerns the qualifying links of the person with the State party to the agreement, such as nationality.

The category of legal entities, by contrast, can be defined to include or exclude a number of different types of entities. Entities may be excluded on the basis of their legal form, their purpose or their ownership. These, too, are discussed in more detail in the next section.

Differences in the legal form of an entity may be important to a host country in a variety of circumstances. The form of the entity determines, for example, which assets may be reached by creditors of the entity to satisfy debts and perhaps the extent to which the entity can be sued in its own name in the courts. A host country may wish to exclude from operating in its territory entities that, because of legal limitations on liability or susceptibility to suit, are insulated from financial responsibility for any injuries that they may cause.

b. Which investors are covered

The second important issue is establishing a link between the States party to an agreement and investors, sufficient to allow them to qualify for coverage under the agreement. The most common link is nationality; but other links, such as permanent residence, domicile, residence or combinations thereof are also in use. For natural persons, the criteria for determining nationality are found

both in customary international law and, in the cases at hand, in the agreements involved. With respect to legal persons, the criteria by which nationality is established vary among countries. Among the criteria in use, the place of incorporation, the location of the company seat and the nationality of the controlling shareholders or owners are prominent.

In policy terms, the issue of establishing the nationality of an investor presents the question of the extent to which the parties to an agreement wish to link the legal coverage of the agreement with the economic ties between the parties and the covered investment. One country may be seeking to establish a generally favourable investment climate and may be prepared to extend treaty coverage to investments that have minimal economic ties with the other party, while another country may wish to extend treaty coverage only to investments with strong economic ties to the treaty parties.

Notes

1 The term "agreement" generally denotes a binding international instrument. The term "treaty" usually has the same meaning, although in a somewhat more formal context. In what follows the two terms are used interchangeably. The term "instrument", on the other hand, covers all kinds of agreements as well as non-binding documents, such as declarations of principles or guidelines. A study of the definition of investment should take account of binding and non-binding instruments alike. After all, any international investment framework, in whatever exact form or at what level, is negotiated in the context of the entire body of existing and emerging norms of international investment law.

Unless otherwise noted, all instruments cited herein may be found in UNCTAD, 1996. All signed bilateral investment treaties (BITs) between specific countries cited herein may be found in ICSID (1972 -).

2 For a detailed analysis of the scope and definitions of international investment agreements, see UNCTAD, 1998a; Parra, 1995; UNCTC, 1990; Sornarajah, 1994.

3 Many BITs provide that investment will be protected for some period of time, often 10 years, following termination of the treaty. This issue has also been addressed in some regional investment instruments.

4 See, e.g., Article 10, General Convention of Peace, Amity, Navigation and

Commerce, United States-Colombia, 3 October 1824 (*United States Treaty Series*, No. 52).

5 The distinction between direct and portfolio investment is not a sharp one. In many companies, no one investor owns a majority of the stock, and effective control rests in the hands of an investor who owns a significant minority of the stock. Thus, a quantity of stock that would constitute portfolio investment in one corporation could constitute direct investment in another. In other words, there is no single quantum of investment that in every case accurately establishes the distinction between direct and portfolio investment. Accordingly, economists often adopt an admittedly arbitrary standard for distinguishing between direct and portfolio investment. For example, ownership of corporate stock sometimes is considered direct investment if the investor owns 10 per cent or more of the outstanding stock.

Investment in companies also is often categorized as either debt or equity investment. A debt investment, which typically is in the form of a bond issued by the company, generally consists of a right to a monetary payment (interest) over some fixed period of time. Equity investment, which typically is in the form of stock in the company, includes a right not only to payment of a monetary return (dividend) for an indefinite period of time, but also a right to participate in the control of the company and a claim on the liquidation value of the company. Debt investment generally is considered portfolio investment, although the terms of the debt obligation may be so restrictive that they give the creditor a very substantial measure of control over the operation of the company. Equity investment may be direct or portfolio investment.

6 See, e.g., Petroleum Development Limited v. Sheikh of Abu Dhabi (ILR, 1951); Sapphire International Petroleum Limited v. National Iranian Oil Company (ILR, 1967); Ruler of Qatar v. International Marine Oil Company Limited (ILR, 1953); Saudi Arabia v. Arabian American Oil Company (ARAMCO) (ILR, 1963).

7 As recent an instrument as the 1967 Organisation for Economic Co-operation and Development (OECD) Draft Convention on the Protection of Foreign Property, adopted by the OECD Council but never opened for signature, relied, as its name shows, on the notion of “foreign property” rather than that of investment. The same was true of the post-Second World War Friendship, Commerce and Navigation treaties of the United States and most, if not all, proposed instruments of the first post-war decades.

Section II

STOCKTAKING AND ANALYSIS

A. Investment

With respect to the definition of "investment", earlier instruments dealing with foreign investment fall in two broad categories:

- Those that concern the cross-border movement of capital and resources, whether in view of its control or of its liberalization. Such instruments usually define foreign investment in narrow terms, insisting on an investor's control over the enterprise as a necessary element of the concept. Such instruments may list the differences between various types of investment of capital, though they may not necessarily apply different rules to each type. A classic definition employing this methodology is the one found in Annex A of the OECD Code of Liberalisation of Capital Movements (box 1).

- Instruments mainly directed at the protection of foreign investment. Definitions of investment in such instruments are generally broad and comprehensive. They cover not only the capital (or the resources) that has crossed borders with a view towards the creation of an enterprise or the acquisition of control over an existing one, but most other kinds of assets of the enterprise or of the investor, such as property and property rights of various kinds, non-equity investment, including several types of loans and portfolio transactions, as well as other contractual rights, including sometimes rights created by administrative action of a host State (licenses, permits, etc.). Such a definition is found, for instance, in the World Bank-sponsored Convention Establishing the Multilateral Investment Guarantee Agency and in BITs.

Box 1. Definition of "direct investment" in the OECD Code

"Investment for the purpose of establishing lasting economic relations with an undertaking such as, in particular, investments which give the possibility of exercising an effective influence on the management thereof:

A. In the country concerned by non-residents by means of:

1. Creation or extension of a wholly-owned enterprise, subsidiary or branch, acquisition of full ownership or an existing enterprise;

2. Participation in a new or existing enterprise;

3. A loan of five years or longer.

B. Abroad by residents by means of:

1. Creation or extension of a wholly-owned enterprise, subsidiary or branch, acquisition of full ownership of an existing enterprise;

2. Participation in a new or existing enterprise;

3. A loan of five years or longer."

Source: Code of Liberalisation of Capital Movements, Annex A, from UNCTAD, 1996, volume II, p. 17.

The rationale for these differing approaches is evident. Capital movement-oriented instruments address investment before it is made, whether with a view towards its control, as was the case in past decades, or with a view towards removing obstacles to its realization, in the current context of liberalization. The resources invested may be of several kinds -- funds, technology or other elements of the package that constitutes an investment. The policy context, and therefore the legal treatment, of each type of resource may differ from that of the others.

Protection-oriented instruments, on the other hand, seek to safeguard the interests of the investors (or, in broader context,

to promote foreign investment by safeguarding the investors' interests). Investment is seen as something that already exists (or that will exist, by the time protection becomes necessary). The older terminology, which referred to "acquired rights" or to "foreign property" (see the 1967 OECD Draft Convention on the Protection of Foreign Property) makes the context clear. The exact character of the particular assets is not by itself important in this case, since protection is to be extended to assets after their acquisition by the investor, when they form part of the investor's patrimony.

Recent practice in international investment agreements that seek both to liberalize investment regulations and to protect foreign investment seems to move in the direction of broad definitions. The most common approach is to define "investment" so as to include certain assets (ICSID, 1998). In many cases, the definition is a broad one that includes all assets in the territory of one party owned by investors of another party. Some investment agreements limit the definition in various ways. They may exclude from the definition, for example, assets that were established prior to a certain date or that are in certain sectors of the economy. Another approach, exemplified by United States BITs is to limit the definition of investment to "every kind of investment owned or controlled directly or indirectly by [a] national or company" followed by an illustrative list of investments based on assets (UNCTAD, 1996, vol. III, p. 196). A further variation is exemplified by the definition considered under the negotiations for a Multilateral Agreement on Investment (MAI) (OECD, 1998). This was in terms of assets but at the same time it was recognised that there was a need for an interpretative note to clarify that "in order to qualify as an investment under the MAI, an asset must have the characteristics of an investment, such as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk". These examples show that investment may need to be defined in terms that go beyond a range of assets though, as will be shown below, some agreements do just that.

One can make few, if any, generalizations about the circumstances under which any of the various limitations will be utilized. There are no consistent patterns, and the limitations do not necessarily appear in standard combinations. An investment agreement may contain a single limitation or multiple limitations in different combinations. Thus, while there is a fairly standard

broad definition of "investment", there is not a typical narrow definition.

There are several reasons for the absence of consistent patterns in the way that the definition of "investment" is limited. As already noted, some agreements do not define the term, and where the parties seek to limit the scope of the agreement, they may seek to do so through its operative provisions, rather than the provisions on definitions. Further, individual countries may have special concerns that cause them to include limitations on the scope of an agreement that reflect their unique situation.

Nevertheless, investment policies differ among countries, and these differences are reflected in significant variations in the definitions of "investment" found in investment agreements. This section surveys those variations. It begins with the broad definition and then describes some of the ways in which this definition has been narrowed in specific instruments. Finally, it discusses some of the instances in which investment agreements have adopted an approach different from that found in typical investment promotion and protection agreements.

1. The broad asset-based definitions of investment

Many investment promotion and protection agreements concluded in recent years contain a broad definition of investment. A typical broad definition is that used in article 1(3) of the ASEAN Agreement for the Promotion and Protection of Investments[1] (box 2). This definition indicates the breadth of the term "investment" as used in many such texts. It states, initially, that investment includes "every kind of asset", suggesting that the term embraces everything of economic value, virtually without limitation.

The general definition is followed by an illustrative list of five categories of investment. These five categories are expressly included within the definition of "investment", but the listing is not exhaustive. Accordingly, assets of "every kind" are included, even if they do not fall under the five categories. These categories are typical of those that appear in investment agreements with broad definitions of "investment":

Box 2. Example of a broad definition of investment

"The term 'investment' shall mean every kind of asset and in particular shall include though not exclusively:

a) movable and immovable property and any other property rights such as mortgages, liens and pledges;

b) shares, stocks and debentures of companies or interests in the property of such companies;

c) claims to money or to any performance under contract having a financial value;

d) intellectual property rights and goodwill;

e) business concessions conferred by law or under contract, including concessions to search for, cultivate, extract or exploit natural resources."

Source: ASEAN Agreement for the Promotion and Protection of Investments, article 1(3), from UNCTAD, 1996, volume II, p. 294.

- The first category comprises *movable and immovable property*. Thus, the definition explicitly includes merchandise and other tangible property of the sort that was protected by customary international law centuries ago. The reference to immovable property makes clear that land is included as well. Moreover, "investment" includes legal interests in property that are less than full ownership. This is indicated by the reference to "property rights such as mortgages, liens and pledges".

- The second category comprises various types of *interests in companies*. The language does not require that the investor's interest or participation in the company be a controlling one and, as the explicit reference to debentures shows, it covers debt as well as equity investment. The language in other words is broad enough to include portfolio as well as direct investment. Debt investment may include bonds issued by public agencies. This may occur, for example,

if an investment agreement defines "company" to include public entities. Or, an agreement may explicitly include such bonds directly in the definition of "investment". For example, the Treaty Establishing the Common Market for Eastern and Southern Africa, in article 159.2 (c), defines "investment" to include "stocks, bonds, debentures, guarantees or other financial instruments of a company or a firm, government or other public authority or international organisation".

- The third category includes *claims to money and claims under a contract having a financial value*. This category suggests that "investment" includes not only property rights, but contractual rights as well. Thus, it provides an explicit textual basis for concluding that "investment" may embrace contractual rights for the performance of services, such as, for example, management agreements, contracts for accounting or other professional services, turnkey contracts, and insurance policies. Further, the language does not seem to require that the contracts be long-term contracts. As written, it does not appear to distinguish between transactions that might be regarded as trade in services and those that might be regarded as investment in services. The inclusion of contractual rights in the definition of "investment" raises a number of questions. The performance of a contract in a host country by a foreign entity may involve the creation of an investment and, as such, would be a natural element of a definition of investment. However, it is not so clear whether even in a broad definition of investment all contracts would be included, or a distinction needs to be made between a contract that constitutes trade (e.g., contracts for the sale of goods or services) and those in which an investor has allocated significant financial, technical and/or human resources (Canada, 1998).

- The fourth category comprises *intellectual property rights*. Such rights may include trademarks, trade secrets, patents and copyrights. In some investment agreements[2] the reference to intellectual property explicitly includes "technical processes" and "know-how", which suggests that investment can include at least some forms of valuable information that are not legally protected as traditional forms of intellectual property. This category also includes goodwill, an indication that the protected

assets of a company may include not only its tangible property, but its reputation as well.

- The fifth category is *business concessions, including natural resource concessions*. This category suggests that investment may sometimes include privileges or rights granted to private parties by the government through special adminstrative or legislative action, in addition to more traditional forms of property that are generally acquired through transfer among private parties in accordance with property laws of general application. Indeed, the Energy Charter Treaty, in article 1 (6) (f), defines "investment" to include "any right conferred by law or contract or by virtue of any licenses and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector".

These five categories are common to many investment agreements, although there are numerous variations in the precise language used to describe them. Such variations, however, may be of relatively small importance because the five categories are merely illustrative of the types of interests included within the term "investment". An interest that does not fall within any of the five categories is nevertheless an "investment" if it can be considered an "asset".

Nothing in this broad definition of investment requires that the asset be a monetary one. Some investment treaties state explicitly that it need not be. For example, article 15.3 of the Convention Establishing the Inter-Arab Investment Guarantee Corporation states that "[i]n appraising the eligibility of an investment for the purpose of insurance no distinction shall be made on account of the monetary or non-monetary form of the transaction".

The third category of investment (claims to money and to contract performance) in combination with the first (movable and immovable property) and the fourth (intellectual property rights) suggests that the definition of "investment" used in many investment agreements is quite different from the concept of "capital", as used by economists. Capital is commonly regarded as productive capacity. Yet, the first category indicates that investment may include mere inventory, i.e., finished products stored in a warehouse awaiting sale to consumers. The third category suggests that it

may also include short-term services agreements that ordinarily would be considered current transactions. The fourth category indicates that investment includes technology assets, which economists often distinguish from capital and the other factors of production, land and labour.

Thus, the term "investment" as used in investment agreements is a legal term of art. It is given a certain scope in order to accomplish the economic and political purposes of the treaty parties. It is not necessarily synonymous with the word "investment" as used in other contexts, such as in national income accounting, or with other, related economic terms, such as "capital".

Finally, another approach to a broad definition is to define "investment" so as to include assets generally, without the lengthy enumeration of specific assets. For example, article 1.4 of the Agreement on Promotion, Protection and Guarantee of Investments Among Member States of the Organisation of the Islamic Conference defines "capital" as "[a]ll assets (including everything that can be evaluated in monetary terms) owned by a contracting party to this Agreement or by its nationals, whether a natural person or a corporate body and present in the territories of another contracting party whether these were transferred to or earned in it, and whether these be movable, immovable, in cash, in kind, tangible as well as everything pertaining to these capitals and investments by way of rights or claims and shall include the net profits accruing from such assets and the undivided shares and intangible rights". Like the broad definition discussed above, this definition also encompasses "all assets", but the illustrative listing of assets is not nearly as detailed.

One other question is whether the term "investment" covers **reinvestment**, that is to say, the investment of the proceeds of the initial investment. Those proceeds have presumably been earned in the host country and have not been imported from abroad, as may have been the initial capital (or part of it). To the extent that national or international rules on foreign investment seek to encourage the importation of foreign capital, in whatever form, the reinvestment of earnings may be seen from the host country's point of view as not qualifying. On the other hand, foreign investors, in making investment decisions, will take into account a host country's policies regarding treatment of all their assets and are likely to

prefer that they be treated in the same manner, whether purchased initially by imported capital or financed through subsequent re-investment.

Many BITs provide that reinvestment is covered to the same extent as the original investment. For example, article I (a) of the 1991 United Kingdom model BIT provides that "[a] change in the form in which assets are invested does not affect their character as investments ...". Because this language indicates that reinvestment is covered as "investments" it would seem that any limitations imposed on the scope of covered investment would also apply to reinvestment and that, if investment were covered only if made in accordance with host country law, then reinvestment similarly would be covered only on that condition as well.

To address such concerns, however, some investment treaties state explicitly that reinvestment is covered only if established in accordance with the conditions placed on the initial investment. For example, article 2 of the BIT between the Belgium-Luxembourg Economic Union and Cyprus provides that "[a]ny alteration of the form in which assets are invested shall not affect their classification as investment, provided that such alteration is not contrary to the approval, if any, granted in respect of the assets originally invested".

Reinvestment also may be eligible for benefits conferred by an investment treaty. For example, the Convention Establishing the Inter-Arab Investment Guarantee Corporation provides, in article 15.3, that "[r]einvestment of earnings accrued out a previous investment shall also be eligible for insurance".

2. Narrowing the asset-based definition

In view of the potential breadth of the term "investment", many investment agreements include various limitations on the scope of investment covered. This subsection analyses the more important among the many variations.

a. Limitation to permitted investment under host country laws

Certain investment agreements contain a specification that investment is covered only if made in accordance with the laws

of the host country. For example, the model BIT used by the People's Republic of China, in article 1.1, provides that "[t]he term 'investment' means every kind of asset invested by investors of one Contracting Party in accordance with the laws and regulations of the other Contracting Party in the territory of the Latter ...". In agreements that apply this limitation, investment that was not established in accordance with the host country's laws and regulations would not fall within the definition of "investment" as used in the agreement.

An alternative approach is to include a separate provision stating that an agreement shall apply only to investment made in accordance with the laws and regulations of the host country or previously approved by host state officials. Thus, article II(1) of the ASEAN Agreement for the Promotion and Protection of Investments provides that "[t]his Agreement shall apply only to investments brought into, derived from or directly connected with investments brought into the territory of any Contracting Party by nationals or companies of any other Contracting Party and which are specifically approved in writing and registered by the host country and upon such conditions as it deems fit for the purposes of this Agreement".

Such a limitation in an investment agreement obviously is intended to induce foreign investors to ensure that all local laws and regulations are satisfied in the course of establishing an investment by denying treaty coverage to non-compliant investment. This will have the additional effect of ensuring that both foreign and domestic investors are required to observe the laws of the land, thereby ensuring a "level playing field". Moreover, on the assumption that the host country's investment laws will be written and applied to further its development policy, this limitation also is intended to ensure that investment is covered only if it is consistent with the host country's development policy, and other policies, such as immigration or internal security that impact on investment.

Some investment agreements that require that investment be established in accordance with host country law include a provision stating that investments are included within the definition of "investment" if later approved by the host country's government. For example, article 9 of the Egypt-Germany BIT provides that "[t]he present Agreement shall also apply to investments by nationals or companies of either Contracting Party, made prior to the entering

into force of this Agreement and accepted in accordance with the respective prevailing legislation of either Contracting Party".

Particular attention to this feature of investments, whether strictly in terms of definitions or otherwise, is paid by agreements providing investment insurance or guarantees. For example, article 15.6 of the Convention Establishing the Inter-Arab Investment Guarantee Corporation provides that "[t]he conclusion of insurance contracts shall be subject to the condition that the investor shall have obtained the prior approval of the competent official authority in the host country for the making of the investment and for its insurance with the Corporation against the risks to be covered." And the Convention Establishing the Multilateral Investment Guarantee Agency, in Article 12 (d) on eligible investments, provides that "In guaranteeing an investment, the Agency shall satisfy itself as to: ... (ii) compliance of the investment with the host country's laws and regulations; (iii) consistency of the investment with the declared development objectives and priorities of the host country".

b. Limitations on time of establishment

A second limitation on the definition of "investment" is to exclude investment established prior to a certain date, such as the date on which an agreement is signed or enters into force. For example, article 9 of the Germany-Sri Lanka BIT provides that "[t]he present Treaty shall apply to all investments made on or after November 8, 1963, by nationals or companies of either Contracting Party in the territory of the other Contracting Party consistent with the latter's legislation".

Developing countries sometimes seek to exclude investment established prior to entry into force of an investment protection agreement. Mainly in cases where an agreement offers financial advantages, one theory is that covering such investment constitutes a windfall for the investor who established the investment without any promise or expectation of treaty coverage; some investment agreements may therefore exclude pre-existing investments from financial benefits made available by them.[3] Another reason for the reluctance to cover investments established prior to the entry into force of an agreement is legal certainty. This argument is especially used in situations in which a new agreement supersedes older treaty obligations, potentially giving an investor the right to choose

between different international regimes; some investment agreements therefore cover all investments but exclude claims from arbitration if the events leading to these claims occurred before the entry into force of the agreement. On the other hand, exclusion of pre-existing investment creates the possibility that existing investors will oppose ratification of an agreement by their home State because it provides them no benefits and it may place them at a competitive disadvantage relative to investors who establish investments after entry into force of the agreement. More generally, excluding pre-existing investment may undermine the credibility of a host country's promise to provide a favourable investment climate by implying that the host country is not committed to such a climate as a matter of principle.

Most bilateral investment agreements do not specifically exclude pre-existing investment. Some of them even state explicitly that they do apply to existing investment. For example, article 6 of the BIT between Estonia and Switzerland provides that "[t]he present Agreement shall also apply to investments in the territory of a Contracting Party made in accordance with its laws and regulations by investors of the other Contracting Party prior to the entry into force of this Agreement".

A few investment agreements exclude investment established prior to some other date, such as the date on which the host country's foreign investment law entered into force. For example, article 2 (3) of the BIT between Indonesia and the United Kingdom provides that "[t]he rights and obligations of both Contracting Parties with respect to investments made before 10 January 1967 shall be in no way affected by the provisions of this Agreement". This provision presumably was to exclude investment established prior to the entry into force of Indonesia's Foreign Capital Investment Law No. 1 of 1967.

c. Limitations on the nature of the investment

A third limitation is to exclude certain types of investment. Some investment agreements, for example, specify that they apply to foreign direct, as opposed to portfolio, investment. Thus, the BIT between Denmark and Poland provides, in article 1 (1) (b), that the term "investment" shall refer "to all investments in companies made for the purpose of establishing lasting economic relations

between the investor and the company and giving the investor the possibility of exercising significant influence on the management of the company concerned." This limitation may be included in an agreement intended to facilitate international investment flows where the host country is seeking to attract foreign direct, but not necessarily foreign portfolio, investment or where a host country is concerned about the possible detrimental effects of applying treaty provisions to certain types of investment, such as portfolio investment.

In this context, other definitions of direct investment which do not appear in legally binding agreements need to be mentioned. Thus, the International Monetary Fund defines direct investment as reflecting "the objective of obtaining a lasting interest by a resident entity in one economy in an enterprise resident in another economy...[t]he lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the investor on the management of the enterprise" (IMF, 1993, p. 86); while the OECD benchmark definition "recommends that a direct investment enterprise be defined as an incorporated or unincorporated enterprise in which a foreign investor owns 10 per cent or more of the ordinary shares or voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise" (OECD, 1996, p. 8).

Alternatively, an investment agreement may include portfolio investment, but only if it is long term. In such a definition, the degree of influence the investor has over the investment may not be relevant, but the duration of the investment could be. For example, article 15 of the Convention Establishing the Inter-Arab Investment Guarantee Corporation defines the investments eligible for insurance by the corporation. It states

> "1. [i]nvestments eligible for insurance shall comprise all investments between the contracting countries whether they are direct investments (including enterprises and their branches or agencies, ownership of a part of capital and ownership of real estate) or portfolio investments (including ownership of shares, stocks and bonds). Eligible investments also comprise loans for a term exceeding three years as well as such shorter term loans as the Council may in exceptional cases decide to treat as eligible for insurance. 2. In identifying investments

for the purpose of the preceding paragraph, the Corporation shall be assisted by the guidelines issued by the International Monetary Fund on the Definition of long term assets and liabilities in the context of the preparation of balance of payment statistics."

While short-term investments are not necessarily excluded, this definition indicates a clear preference for long-term investments, though it should be noted that this arises in the context of an investment guarantee agreement.

The North American Free Trade Agreement (NAFTA) includes portfolio investment in its definition of "investment", but excludes debt securities of, or loans to, a State enterprise. The NAFTA also seeks to exclude ordinary commercial contracts (box 3).

Box 3. Scope of investment under NAFTA

"Investment means:

(a) an enterprise;

(b) an equity security of an enterprise;

(c) a debt security of an enterprise

(i) where the enterprise is an affiliate of the investor, or

(ii) where the original maturity of the debt security is at least three years, but does not include a debt security, regardless of original maturity, of a state enterprise;

(d) a loan to an enterprise

(i) where the enterprise is an affiliate of the investor, or

(ii) where the original maturity of the loan is at least three years, but does not include a loan, regardless of original maturity, to a state enterprise;

(e) an interest in an enterprise that entitles the owner to share in income or profits of the enterprise;

/...

(Box 3, concluded)

(f) an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution, other than a debt security or a loan excluded from sub-paragraph (c) or (d);

(g) real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes; and

(h) interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under

(i) contracts involving the presence of an investor's property in the territory of the Party, including turnkey or construction contracts, or concessions, or

(ii) contracts where remuneration depends substantially on the production, revenues or profits of an enterprise;

but investment does not mean,

(i) claims to money that arise solely from

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

(ii) the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraph (d); or

(j) any other claims to money, that do not involve the kinds of interests set out in subparagraphs (a) through (h);"

Source: NAFTA, article 1139(h), from UNCTAD, 1996, volume II, pp. 93-94.

The exclusion of certain types of investment may be found in agreements that regulate, as well as in those that facilitate, international investment. A host country may be concerned that

foreign controlled companies will operate in ways that are inconsistent with domestic policy. These concerns are minimized, however, where the foreign investor does not control the company, as in the case of portfolio investment. Thus, because host country concerns may focus on the problem of foreign control, an agreement regulating foreign investment often will be directed primarily at FDI.

d. Limitation on the size of investments

A fourth limitation is to exclude investments based on their size. For example, article 15 of the Community Investment Code of the Economic Community of the Great Lakes Countries states that, for purposes of inclusion within certain provisions of the code, "[t]he minimum volume of investments is set at one million United States dollars or the equivalent". Such a limitation may be found in agreements seeking to promote foreign investment, where the parties are unwilling to provide certain benefits to foreign investment unless the investment is of such a magnitude that it will be likely to bring significant benefits to the host country. Many countries, however, seek foreign investment from small and medium-sized companies and thus limitations on the size of investment are not common in investment agreements.

e. Limitations on the sector of the economy

Finally, the term "investment" may be limited to investment only in certain sectors of the economy. For example, article 1 of the Energy Charter Treaty provides that "'investment' refers to any investment associated with an Economic Activity in the Energy Sector and to investments or classes of investments designated by a Contracting Party in its Area as "Charter efficiency projects" and so notified to the Secretariat". In this particular case, the agreement was intended to cover only the energy sector and all its provisions were limited to that sector. It cannot be excluded, however, that, particularly in an agreement that liberalizes or promotes international investment flows, a host country may wish to limit treaty coverage to investment in certain sectors of the economy. Such an approach is illustrated by the General Agreement on Trade in Services (GATS). Rather than narrowing the definition of investment it uses, the GATS, by Article XVI, allows signatory states to "opt-in" to sectoral commitments to the extent desired by the State concerned.

3. Other approaches: enterprise-based and transaction-based definitions

As the foregoing discussion indicates, a common approach is an "asset-based definition approach": a broad definition of investment that includes all assets, followed by an enumeration of specific assets covered. Some investment agreements then carve out exceptions.

One alternative approach is to focus on the "business enterprise" or the "controlling interests in a business enterprise". The Canada-United States Free Trade Agreement is an example.[4] The Agreement defines investment as including the establishment or acquisition of a business enterprise, as well as a share in a business enterprise which provides the investor control over the enterprise (Canada - United States, 1988). This type of definition is sometimes referred to as an "enterprise-based" definition. However, distinguishing it from the "asset-based" definition is not without difficulties.

While most asset-based definitions are usually broader than the enterprise-based definition because they include assets other than companies and the enterprise-based definition does not, a number of examples in this paper indicate that some narrower asset-based definitions make the two approaches very similar. Two examples illustrate the difficulty in making the distinction. First, the broad, asset-based definition usually includes "companies", and it is not clear that a company is really different from a business. The term "business" is perhaps narrower than "companies" because it would seem limited to commercial enterprises. But as will be noted in the discussion of the definition of an "investor", some treaties with asset-based definitions of investment define companies to include only those established for a commercial purpose. Second, the Canada-United States agreement seems to limit investment to enterprises that are direct investment and thus excludes portfolio investment. But again, as has already been pointed out, the asset-based definition can also be narrowed, and sometimes is, by excluding various types of assets such as portfolio investment.

Another alternative to the asset-based approach is to omit the reference to assets generally and to include instead an enumeration of the transactions covered. An example of such a "transaction-based" definition of investment is contained in the OECD Code of Liberalisation of Capital Movements. While the Code does not define the term "investment" or "capital" as such, it does contain in Annex A lists of capital movements to be liberalized. The list is quite lengthy and includes a wide variety of capital movements. Among those included is direct investment (box 1).

The transaction-based definition is conceptually different from the asset-based definition in some respects. The OECD Code by its nature applies to transactions, not assets. Because the Code has only one principal purpose -- the liberalization of capital movements -- its approach to investment necessarily considers only the transaction of establishing or liquidating an investment, not the protection of assets. This is where the important point of distinction between asset and transaction based definitions emerges. That point is that the definitions of investment should depend upon the purpose of an agreement and that, if the purpose is to liberalize investment, a country may want a different definition than if the purpose is to protect investment.

B. Investor

Investment agreements apply typically only to investment by investors who qualify for coverage. The definition of the term "investor" is thus as important in determining the scope of an agreement as that of "investment".

1. Entities considered investors

The definition of "investor" normally includes natural persons and artificial or legal persons (or juridical entities). As noted earlier, with respect to natural persons, the only issue that arises is that of determining the relevant link between the investor and the home State party to an agreement. Legal entities, by contrast, can be defined to include or exclude a number of different types of entity. Generally speaking, legal entities may be excluded because of their legal form, their purpose or their ownership.

a. Exclusions based on legal form

The exclusion of entities based on their legal form is rare. The model BIT used by the Swiss Confederation, for example, provides in article I (1) (b) that the term "investor" refers to "legal entities, including companies, corporations, business associations and other organisations ...". This language indicates that all legal entities, regardless of form, may be considered investors. Thus, the term "investors" may include, for example, partnerships as well as corporations.

Differences in the legal form of an entity, however, may be important to a host country in a variety of circumstances. The form of the entity determines, for example, which assets may be reached by creditors of the entity to satisfy debts and perhaps the extent to which the entity can be sued in its own name in the courts.

In many cases, of course, it is the investment and not the investor that is present in the host country, since the term "investment" includes the company or other entity created when the investor's capital is invested. Local businesses often have contracts with the investment, not the investor; damage to local property or to the environment is more likely to be the result of activity by the investment than by the investor. As this suggests, the legal form of the investment may be of much greater importance to the host country than the legal form of the investor. If the investment has limited liability, for example, then it may not matter what the investor does since creditors may have no recourse against the investor.

At the same time, the host country could find that restricting the legal form of the investors may have an adverse impact on its ability to attract certain types of investment. For example, small or medium-sized investors are often organized differently from large investors, making greater use of forms of business associations other than the corporation or *société anonyme*. And, certain types of investments are likely to be associated with certain types of investors. For example, professional service agreements often are associated with partnerships. Thus, a decision to discourage certain forms of investors ultimately may have the effect of discouraging

certain types of investment. Perhaps for all these reasons, the term "investor" usually includes all legal entities, regardless of their form.

b. Exclusions based on purpose

Entities may be excluded because of their purpose. For example, an investment agreement may exclude non-commercial entities, such as educational, charitable or other entities not operated for profit. This is illustrated by article 13 (a) (iii) of the Convention Establishing the Multilateral Investment Guarantee Agency, which defines an eligible investor to include only those juridical entities that "operate[s] on a commercial basis".

In many cases, the State parties to an investment agreement may want to include non-profit entities in the definition of "investor". For example, the 1991 model BIT used by the Federal Republic of Germany, in article 1.4 (a), defines "companies" in respect of Germany to include "any juridical person as well as any commercial or other company or association with or without legal personality . . . irrespective of whether or not its activities are directed at profit". As an initial matter, the kinds of activities in which a nonprofit entity engages may produce desirable forms of investment, such as a research facility. Further, non-profit entities often acquire portfolio investment in commercial enterprises in order to earn revenue to support their charitable or educational activities. In that capacity, non-profit entities are likely to act in the same way as any other portfolio investor and their distinct status as non-profit entities would seem of little significance.

c. Exclusions based on ownership

Legal entities also may be excluded from the definition of "investor" because they are State-owned rather than private.[5] Some investment agreements, of course, make clear that State entities are included. Article 1.4 of the Unified Agreement for the Investment of Arab Capital in the Arab States, for example, provides that "Arab States and bodies corporate which are fully State-owned, whether directly or indirectly, shall likewise be regarded as Arab citizens". Similarly, article 13 (a) (iii) of the Convention Establishing the Multilateral Investment Guarantee Agency defines

eligible investors to include a juridical person "whether or not it is privately owned...".

2. *Establishing the link*

a. Natural persons

Natural and artificial persons are considered "investors" within the meaning of an agreement only if they have the nationality of a particular State, generally another treaty partner or, in a number of cases, if they are linked to that State in another manner, such through permanent residence, domicile or residence. Under customary international law, a State may not be required to recognize the nationality of a person unless the person has a genuine link with the State of asserted nationality.[6] Most investment agreements do not require such a link, at least in the case of natural persons.

Rather, the common practice in investment agreements (as in more general international practice) is that a natural person possesses the nationality of a State if the law of that State so provides. For example, article I (1) of the ASEAN Agreement for the Promotion and Protection of Investments provides that "[t]he term 'nationals' shall be as defined in the respective Constitutions and laws of each of the Contracting Parties". This language clearly does not require that there be a genuine link between the person and the state of asserted nationality.

As noted certain investment agreements require some link beyond nationality. For example, the Germany-Israel BIT provides, in article 1 (3) (b), that the term "nationals" means, with respect to Israel, "Israeli nationals being permanent residents of the State of Israel". On the other hand, a concept like permanent residence can be used not only in addition to a nationality link but also as an alternative. The latter may be especially in the interest of high immigration countries in which a considerable proportion of the economically active population may not yet be full citizens. Such countries (e.g., Australia, Canada and the United States) regularly extend a special legal status to permanent residents. Other investment agreements allow a natural person to claim, for the purposes of the agreement, the nationality of a country or some other basis, such as residency or domicile in that country. For

example, article 3.1 of the Treaty Establishing the Caribbean Community (CARICOM) Agreement on the Harmonisation of Fiscal Incentives to Industry defines "national" to mean "a person who is a citizen of any Member State and includes a person who has a connection with such a State of a kind which entitles him to be regarded as belonging to or, if it be so expressed, as being a native or resident of the State for the purpose of such laws thereof relating to immigration as are for the time being, in force". One question not explicitly addressed by most investment agreements is whether a natural person is a covered investor if he or she possesses the nationality of both the home and the host countries which are parties to the agreement. This issue is likely to arise in particular in an investment agreement that provides for the protection of foreign investment.

Under customary international law, a State could exercise diplomatic protection on behalf of one of its nationals with respect to a claim against another State, even if its national also possessed the nationality of the other State, provided that the dominant and effective nationality of the person was of the State exercising diplomatic protection.[7] This test, however, typically is not found in existing investment agreements, which, as noted, tend to be silent on the matter of dual nationality. One exception is the Convention Establishing the Multilateral Investment Guarantee Agency, article 13 (b), which provides that "[i]n case the investor has more than one nationality [...], the nationality of a member shall prevail over the nationality of a non-member and the nationality of the host country shall prevail over the nationality of any other member".

Article 17.3 of the Convention Establishing the Inter-Arab Investment Guarantee Corporation has similar language, but states even more explicitly in article 17.1 that "[i]n no event shall the investor be a natural person who is a national of the host country or a juridical person whose main seat is located in such country if its stocks and shares are substantially owned by this country or its nationals". Another agreement addressing dual nationality is the Unified Agreement for the Investment of Arab Capital in the Arab States, article 1.7 of which defines an "Arab investor" as "an Arab citizen who owns Arab capital which he invests in the territory of a State Party of which he is not a national".

The literal language of many agreements requires that the host country protect investment owned by nationals of the other

party, and nothing explicitly states that this obligation lapses where the investors happen also to be nationals of the host country. A host country may argue that limitations on the rights of dual nationals are implied, but a country that does not wish to extend treaty coverage to investment owned by dual nationals would be well advised to insert explicit language to that effect in the agreement.

b. Legal entities

In the case of legal entities, most investment agreements use one of three different criteria for determining nationality: the country of *organization*, the country of the *seat* or the country of *ownership or control*. In many cases, they use some combination of these criteria. Other criteria are occasionally used as well.

An example of an agreement using the place of organization as the criterion of nationality is the Energy Charter Treaty, which in article 1 (7) (a) (ii) defines "investor" with respect to a Contracting Party to include "a company or other organization organized in accordance with the law applicable in that Contracting Party". The use of country of organization is consistent with the decision of the International Court of Justice in *Barcelona Traction* (ICJ, 1970).[8]

The advantage of using the country-of-organization test is ease of application, as there usually will not be any doubt concerning the country under whose law a company is organized. Further, the country-of-organization is not easily changed, meaning that the nationality of the investor usually will be permanent under this approach. Because an important purpose of some investment agreements is to attract investment by providing a stable investment regime and because changes in the nationality of an investor will result in the loss of treaty protection for investment owned by the investor, a definition of "investor" that stabilizes the nationality of the investor and thus the protection afforded to investment is particularly consistent with the purposes of investment agreements that seek to promote or protect foreign investment.

The disadvantage of using country-of-organization is that this test relies on a relatively insignificant link between the investor and the country of nationality. Under this test, a company may claim the nationality of a particular country even though no nationals

of that country participate in the ownership or management of the company and even though the company engages in no activity in that country. In effect, the company could claim the benefits of nationality of a particular country, including protection under the treaties of that country, despite the fact that it conferred no economic benefit of any kind on that country.

This should perhaps be of concern principally to the home country, which finds itself protecting an investor that brings it no economic benefit. It may also be of concern to the host country, however. The effect of this test may be that the host country is extending protection to investment ultimately owned by persons who live in a country that extends no reciprocal benefits to the host country's own investors. Indeed, the country of ownership or control may not even have normal economic relations with the host country. For this reason, the model BIT used by the United States, which also uses country-of-organization as the test of nationality, permits the host country to refuse to extend treaty protection to investment owned by investors of the other party if the investors do not have substantial business activities in the territory of the other party or if the country of ultimate control does not have normal economic relations with the host country. For example, article XII of the April 1994 model treaty provides that:

> "Each Party reserves the right to deny to a company of the other Party the benefits of this Treaty if nationals of a third country own or control the company and
> (a) the denying Party does not maintain normal economic relations with the third country; or
> (b) the company has no substantial business activities in the territory of the Party under whose laws it is constituted or organized."

An example of a treaty using the company seat as the basis for attributing nationality is the 1991 German model BIT. That treaty defines "company" in article 1.4(a) to include in respect of Germany "any juridical person as well as any commercial or other company or association with or without legal personality having its seat in the territory of the Federal Republic of Germany ... ".

The seat of a company may not be as easy to determine as the country of organization, but it does reflect a more significant

economic relationship between the company and the country of nationality. Generally speaking, "seat of a company" connotes the place where effective management takes place. The seat is also likely to be relatively permanent as well.

The country-of-ownership or control may be the most difficult to ascertain and the least permanent, particularly in the case of companies whose stock is traded on major stock exchanges. Its principal benefit as a test is that it links coverage by an agreement with a genuine economic link. Perhaps for these reasons, the ownership or control test sometimes is used in conjunction with one of the other tests. Combining the criteria in this way lends a degree of certainty and permanence to the test of nationality, while also ensuring that treaty coverage and economic benefit are linked. For example, the Asian-African Legal Consultative Committee's (AALCC) model BIT includes the following definition of 'companies': "corporations, partnerships or associations incorporated, constituted or registered in a Contracting Party in accordance with its laws [and includes such entites in which nationals of a Contracting Party have substantial interest and majority shareholding]".[9] Including the bracketed language combines the country-of-organization text with the country-of-ownership or control. The United States model language previously quoted combines the country of organization as the criterion for nationality with that of ownership by allowing the host country in any specific case to deny treaty protection to an entity if the country of ownership test is not also met.

Alternatively, the ownership or control criterion may be used in conjunction with the country of the seat criterion. For example, article 17.1 of the Convention Establishing the Inter-Arab Investment Guarantee Corporation provides that "[t]o be accepted as a party to an insurance contract, the investor must either be a natural person, who is a national of a contracting country, or a juridical person whose stocks or shares are substantially owned by one or more of the contracting countries or by their nationals, and whose main seat is located in one of the countries". It should be noted that the Convention authorizes waiver of the company seat requirement for a juridical entity that is at least 50 per cent owned by nationals of the contracting countries.

Just as the ownership or control criterion may be used in conjunction with the country-of-organization or the country of

the seat criterion, the latter two criteria may be used in conjunction with each other. For example, article I (2) of the ASEAN Agreement for the Promotion and Protection of Investments provides that "[t]he term "company" of a Contracting Party shall mean a corporation, partnership or other business association, incorporated or constituted under the laws in force in the territory of any Contracting Party wherein the place of effective management is situated".

Similarly, article 35.6 (a) of the Treaty Establishing the Caribbean Community provides that "a person shall be regarded as a national of a Member State if such person [...] is a company or other legal person constituted in the Member State in conformity with the laws thereof and which that State regards as belonging to it, provided that such company or other legal person has been formed for gainful purposes and has its registered office and central administration, and carries on substantial activity, within the Common Market." Under this language, a legal entity must be organized under the laws of a country and have its seat in the territory of that country to be considered a national of that country.

The Convention Establishing the Multilateral Investment Guarantee Agency also combines the country-of-organization test with the country-of-the-seat test, but allows the use of the country-of-ownership test as an alternative. Article 13 (a) (ii) provides that a legal entity is an eligible investor under the agency's insurance programme provided that "such juridical person is incorporated and has its principal place of business in a member or the majority of its capital is owned by a member or members or nationals thereof, provided that such member is not the host country in any of the above cases".

The Charter on a Regime of Multinational Industrial Enterprises (MIES) in the Preferential Trade Area for Eastern and Southern African States requires that all three tests be met. Article 1 defines a "national" in pertinent part as "any legal person established under the laws of a Member State having its head office or seat in that Member State and having at least fifty one (51) per cent of its equity held by nationals or agencies of the government of that Member State ....".

As these various provisions have shown, although country-of-organization, country of the seat and country-of-ownership are the most common criteria, other criteria are occasionally used.

The Treaty Establishing the Caribbean Community, for example, requires that the legal entity carry on "substantial activity" in the country of nationality. The United States model BIT, although requiring only that a legal entity be organized in the country of nationality, allows the host country to deny treaty protection if the country of ownership is one with which the host country does not maintain normal economic relations.

Finally, it should be noted that a significant number of internationally active enterprises can be excluded from the scope of an investment agreement through the cumulative use of the various above-mentioned criteria. This is a matter of greater importance to bilateral rather than multilateral agreements, because the latter tend to allow for a "cumulation of nationality" among countries party to the agreement.

C. Own or control

One other issue that arises in determining the scope of an investment agreement is the nature of the relationship that must exist between an investment and the investor for the investment to be covered. Typically, investment agreements apply to investment "of" or "by" a covered investor. The obvious inference is that the investment must be owned or controlled by the investor.

Only a few investment agreements define the terms "own" or "control". A relevant definition is found in the GATS (box 4). This definition attempts to describe ownership or control in quantitative terms, such as 50 per cent of the equity interest or the ability to name a majority of directors. Where ownership or control is described in quantitative terms, it is typical to require at least 50 per cent ownership or majority control.

A similar approach is taken in the Agreement for the Establishment of a Regime for CARICOM Enterprises. Article 1.1 defines a "regionally-owned and controlled" company as one in which nationals of at least two member States

> "exercise management and control by beneficially owning shares carrying between them directly or indirectly:

Box 4. GATS definition of control

The GATS defines a juridical person as follows:

"(n) a juridical person is:

(i) "owned" by persons of a Member if more than 50 per cent of the equity interest in it is beneficially owned by persons of that Member;

(ii) "controlled" by persons of a Member if such persons have the power to name a majority of its directors or otherwise to legally direct its actions;

(iii) "affiliated" with another person when it controls, or is controlled by, that other person; or when it and the other person are both controlled by the same person..."

Source: GATS, Article XXVIII(n), from UNCTAD, 1996, volume I, pp. 309-310.

(a) the right to exercise more than one-half of the voting power in that company; and

(b) the right to receive more than one-half of any dividends that might be paid by that company; and

(c) the right to receive more than one-half of any capital distribution in the event of the winding-up or of a reduction in share capital of that company; ...".

Article 6.1 of the proposed Statute for a European Company defines a "controlled undertaking" as any undertaking in which a natural or legal person:

"(a) has a majority of the shareholders' or members' voting rights; or

(b) has the right to appoint or remove a majority of the members of the administrative, management or supervisory board, and is at the same time a shareholder in, or member of, that undertaking; or

(c) is a shareholder or member and alone controls, pursuant to an agreement entered into with other shareholders or members of the undertaking, a majority of the shareholders' or members' voting rights."

An alternative approach is to describe ownership or control in *qualitative* terms. For example, the Protocol to the Egypt-United States BIT defines "control" as having "a substantial share of ownership rights and the ability to exercise decisive influence". Similar is the Draft United Nations Code of Conduct on Transnational Corporations, which speaks of "significant influence".

Definitions of ownership or control in qualitative terms generally do not require majority or any specific quantum of ownership. This approach reflects the fact that effective control of a company often is exercised by shareholders who own less than half of the stock. By lowering the requirement to less than majority ownership, a treaty makes it easier for an investor to have the necessary relationship with an investment to bring the investment within the coverage of the treaty and thus broadens the scope of the treaty. Indeed, the International Monetary Fund, for the purpose of defining FDI, uses a lower threshold, namely, one that "owns 10 per cent or more of the ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated enterprise)" (IMF, 1993, p. 86). Similarly, the OECD provides that "[a]n effective voice in the management, as evidenced by an ownership of at least 10 per cent, implies that the direct investor is able to influence or participate in the management of an enterprise; it does not require absolute control by the foreign investor" (OECD, 1996, p. 8).

A specific problem that may arise is whether a company indirectly owned or controlled by another comes within the scope of an agreement. For example, where company "A" has a controlling interest in company "B" that has a controlling interest in company "C", does that make company "C" an investment controlled by company "A" as well as company "B"? This has particular repercussions where not every country in which the companies operate is a party to an agreement. Thus, to return to the example, should company "B" have the nationality of a country not party to the agreement, while companies "A" and "C" have the nationality of countries party to the agreement, can company "A" still claim

the protection of the agreement despite the fact that its investment in "C" is channelled through "B", i.e. through a non-party? This is an issue that each agreement must address, especially given the proliferation of integrated international production systems established by TNCs.

D. Other terms

1. Territory

Investment generally is covered by an investment agreement only if it is in the territory of one of the State parties to the agreement. Some investment agreements define the term "territory". The most common definition is typified by article 1 (3) of the Chilean model BIT, which provides that "'territory' means in respect of each Contracting Party the territory under its sovereignty, including the exclusive economic zone and the continental shelf where that Contracting Party exercises, in conformity with international law, sovereign rights or jurisdiction."

The Energy Charter Treaty provides a similar, although lengthier, definition in Article 1, para. (10):

> "'Area' means with respect to a state that is a Contracting Party:
>
> (a) the territory under its sovereignty, it being understood that territory includes land, internal waters and the territorial sea; and
>
> (b) subject to and in accordance with the international law of the sea: the sea, sea-bed and its subsoil with regard to which that Contracting Party exercises sovereign rights and jurisdiction."

As is evident, the purpose of the definition of "territory" generally is not to describe the land territory of the parties, but to indicate that "territory" includes maritime zones over which the host country exercises jurisdiction. The significance is that investments located within the host country's maritime jurisdiction, such as mineral exploration or extraction facilities, would be covered by the agreement.

Even where it is completely clear which geographical areas constitute the territory of a party, there may still be uncertainty concerning whether an investment is located in the territory of a party. Because "investment" includes many intangible rights, the location of a particular asset may be difficult to identify. For example, a service provider in one country may sign an agreement with a company headquartered in a second country to perform professional services for a branch of the company in a third country. The definition of "investment" may well include the rights derived from that contract, but it may be unclear which of the three countries should be considered the location of the "investment" of contractual rights. The texts of investment agreements, however, provide little assistance in resolving issues concerning the location of investments.

2. Transnational corporation or multinational enterprise

In some investment instruments, the object of the rights and duties created is not an individual investment, but a group of affiliated entities referred to collectively as a "transnational corporation" (TNC) or a "multinational enterprise" (Muchlinski, 1995, ch. 1, 3). Typically, the affiliation among these entities involves ownership or direction of some entities by another (box 5).

Box 5. Definitions of transnational corporations and enterprises

A. The Draft United Nations Code of Conduct on Transnational Corporations (para. 1) has defined "transnational corporations" to mean:

> "an enterprise, comprising entities in two or more countries, regardless of the legal form and fields of activities of these entities, which operates under a system of decision-making, permitting coherent policies and a common strategy through one or more decision-making centres, in which the entities are so linked, by ownership or otherwise, that one or more of them may be able to exercise a significant influence over the activities of others, and, in particular, to share knowledge, resources and responsibilities with the others." (UNCTAD, 1996, volume I, p. 162).

/...

(Box 5, concluded)

B. The Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices adopted by the United Nations General Assembly on 5 December 1980 provides that the term "enterprises" means:

> "firms, partnerships, corporations, companies, other associations, natural or juridical persons, or any combination thereof, irrespective of the mode of creation or control or ownership, private or State, which are engaged in commercial activities, and includes their branches, subsidiaries, affiliates, or other entities directly or indirectly controlled by them." (UNCTAD, 1996, volume I, p. 136).

C. The OECD Guidelines for Multinational Enterprises (para. 8) describe a multinational enterprise as:

> "These usually comprise companies or other entities whose ownership is private, state or mixed, established in different countries and so linked that one or more of them may be able to exercise a significant influence over the activities of others and, in particular, to share knowledge and resources with others. The degrees of autonomy of each entity in relation to the others varies widely from one multinational enterprise to another, depending on the nature of the links between such entities and the fields of activity concerned." (UNCTAD, 1996, volume II, p. 186).

Definitions of "transnational corporation", "multinational enterprise", or like terms generally must address two issues: the types of entity that may be included; and the nature of the affiliation that must exist among the entities. As the three definitions in box 5 demonstrate, the tendency is to include a wide range of entities. The focus of the definition thus is on the nature of the affiliation that must exist among the entities, which, as noted above, typically is one of interfirm ownership or control. Indeed, it is the fact of several entities controlled in a coordinated fashion by another foreign entity that gives rise to the special concerns that instruments using these definitions are intended to address. Such instruments are often regulatory and multilateral in nature and they seek, through

coordination among governments of different States, to obtain a measure of control over enterprises that involve coordinated entities in the territories of different States.

Because the affiliation is typically one of ownership or control, the definition of these terms becomes of considerable importance for understanding the definitions of "transnational corporation" or "multinational enterprise". The terms "own" or "control" are of importance in other contexts as well. They typically characterize the relationship that must exist between an investment in one country and an investor of another country for the investment to fall within an investment agreement. The definition of these terms is discussed in the next subsection.

Before the discussion proceeds to the definition of "own" or "control", however, the concept of the TNC or multinational enterprise as used here must be distinguished from two related, but different, concepts. The first is the concept of a regional enterprise. A regional enterprise, in broad generic terms, is an entity that generally is owned or controlled by two or more persons that possess the nationality of countries in the region. Several investment agreements confer special privileges such as tax concessions on such regional enterprises, generally as part of a strategy of promoting regional economic integration. For example, the Charter on a Regime of Multinational Industrial Enterprises (MIEs) in the Preferential Trade Area for Eastern and Southern African States provides for the designation of companies as MIEs if they meet several conditions, including capital contributions from nationals of two or more member states accounting for at least 51 per cent of the capital. MIEs enjoy a number of benefits, including access to foreign currency, tax concessions and infrastructural support.

TNCs often have been perceived as presenting a challenge to the sovereignty of the host country, while the regional enterprise generally is perceived as presenting an opportunity for regional development. Thus, while TNCs are typically the subject of a regulatory investment instrument, the regional enterprise is typically the subject of an investment promotion agreement.

The second concept from which the notion of a TNC as used here must be distinguished is that of a strategic alliance (Dunning and Narula, 1996, pp. 16-18). This concept refers to firms of different nationalities that operate in a coordinated fashion, but

without ties of ownership or control among them. Firms that are not linked by common ownership or control may form strategic alliances for a number of reasons, such as to gain access to markets or to create reliable forward and backward linkages. Investment agreements generally do not address strategic alliances as a distinct phenonemon, except perhaps insofar as they may raise issues of competition policy (UNCTAD, 1995, 1997).

3. Returns

Many investment agreements include definitions of the term "returns", that is to say, essentially the earnings from an investment. While returns are typically included in provisions dealing with the transfer of funds, whether "returns" are or are not covered by an agreement makes considerable difference in terms of the extent of the guarantee of free transfer of funds accorded the investor, of the protection against expropriation or other action, or of their coverage for the purpose of the settlement of investment disputes.

The elements of the term "returns" often mirror the elements of the term "investment". "Investment" includes shares in a company, and thus "returns" includes dividends. Because "investment" includes debt, "returns" includes interest payments. Because "investment" includes intellectual property, "returns" includes royalties. And because "investment" includes contracts, such as professional or management service agreements, "returns" includes fees.

E. Summary

To summarize, the principal models of clauses identified in this section are as follows:

Regarding investment

1. A broad, inclusive definition which may simply include every kind of asset and/or contain an illustrative list of categories of investment based on types of asset.

2. A similar model but where the illustrative list is based on types of transaction.

3. A narrow definition which may either:

   - contain a broad definition of investment and then narrow its scope through various limitations; or which

   - has no general definition of investment, but rather specifies the classes of investment, whether by asset or transaction that are covered by the agreement.

Regarding investor

1. This will normally include

   - natural persons, defined by an effective link, usually that of nationality, with a State contracting party to the agreement

   - legal persons possessing such an effective link with a State contracting party.

2. Certain exclusions may be introduced into the agreement based on either

   - legal form of the entity
   - the purpose of the entity
   - the nature of ownership.

3. The crucial drafting issue is to determine which links are to count as effective links for the purpose of the agreement.

Regarding ownership and control

1. Some agreements may introduce a clause defining the control of an investment by an investor.

2. This will usually involve a reference to a prescribed level of ownership from which control can be surmised and/or a definition of functional control. These concepts are derived from widely used general principles of company law.

Other terms

1. The investment must be on the "territory" of a contracting party, though some treaties refer to an "area" as in regional agreements.

2. Some investment agreements refer to "transnational corporations" or "multinational enterprises" as the relevant entity for the purposes of defining the subject-matter of the agreement.

3. Some agreements extend their coverage to reinvestment and returns from investment.

Notes

1 Formerly known as An Agreement Among the Governments of Brunei Darussalam, the Republic of Indonesia, Malaysia, the Republic of the Philippines, the Republic of Singapore and the Kingdom of Thailand for the Promotion and Protection of Investments. The agreement was amended in 1996 and its name changed (see http://www.asean.or.id/economic/agrfin96.htm).

2 See, e.g., the United Kingdom 1991 model BIT, article I (a) (iv).

3 For example, article 15.4 of the Convention Establishing the Inter-Arab Investment Guarantee Corporation provides that investment insurance "shall not be made available except for new transactions commencing after the conclusion of insurance contracts with the exception of operations for which the Corporation has agreed to issue re-insurance".

4 The Canada-United States Agreement is no longer of much importance because of the subsequent entry into force of the NAFTA -- an asset-based definition treaty.

5 The question whether State-owned or controlled enterprises are covered by an investment agreement has to be treated differently from the question whether States parties to the agreement themselves can act as investors. Usually, State enterprises are covered even if not explicitly stated while States themselves tend not to be unless this is expressly provided for.

6 See, e.g., Nottebohm Case (Liechtenstein v. Guatemala), (ICJ, 1955).

7 See, e.g., Esphahanian v. Bank Tejarat, *Iran-U.S. Claims Tribunal Reports*(1983).

8 In that case, Belgium sought to exercise diplomatic protection on behalf of a company, the majority of the stock in which was owned by Belgians, but which was organized, under the law of Canada. The International Court of Justice held that only Canada, the State of the company's nationality, could bring suit for compensation for the injury suffered by the company.

9 The brackets appear in the original AALCC text.

Section III

INTERACTION WITH OTHER ISSUES AND CONCEPTS

Definitions are of great significance to the operation of the provisions of an investment agreement. Such provisions may address a broad array of issues (table 1). This section highlights the issues for which the terms "investment" and "investor" may be of special

Table 1. Interaction across issues and concepts

Concepts in other papers	Concepts in this paper	
	Investment	Investor
Admission and establishment	++	+
Incentives	++	++
Investment-related trade measures	0	0
Most-favoured-nation treatment	++	++
National treatment	++	++
Fair and equitable treatment	++	++
Taxation	0	0
Transfer pricing	0	0
Competition	+	+
Transfer of technology	+	0
Employment	+	0
Social responsibility	0	0
Environment	0	0
Home country measures	+	+
Host country operational measures	+	+
Illicit payments	0	0
Taking of property	++	0
State contracts	+	+
Funds transfer	++	+
Transparency	0	0
Dispute settlement (investor-State)	++	++
Dispute settlement (State-State)	+	+
Modalities and implementation	+	0

Source: UNCTAD.

Key: 0 = negligible or no interaction.
+ = moderate interaction.
++ = extensive interaction.

significance, and it describes the implications of particular definitions of "investment" and "investor" for these issues. The discussion here, however, is not meant to suggest that additional issues are not or should not be included in an investment agreement.

As an initial matter, the breadth of the definition raises a number of potential concerns entirely apart from developmental considerations. For example, the inclusion of contractual claims within the meaning of "investment" could convert government regulatory action affecting the validity of private contracts into an expropriation. The inclusion of trade-related transactions within the meaning of "investment" could result in the submission of a broad range of matters to the special investor-to-state dispute settlement mechanisms created by investment agreements. In short, the interaction of a broad definition of "investment" within the operative provisions of an agreement could result in the application of treaty rules and procedures to a great range of transactions unrelated to FDI.

Further, as investment agreements move beyond the traditional concerns of investment promotion and protection agreements, the broad definition of "investment" could raise other issues. For example, the inclusion of competition policy within the coverage of an investment agreement would require careful consideration of how the competition rules interact with a definition of investment that includes exclusive, potentially anticompetitive rights, such as intellectual property rights and concessions.

This is not to say, however, that broad definitions coupled with broad substantive provisions are necessarily problematic. Ultimately, the scope of the agreement is established by the interaction between all its provisions. In order to achieve a specific policy goal, parties to an agreement can choose, for example, between:

(i) narrowing a definition; or

(ii) narrowing one or more substantive provisions; or

(iii) allowing general and/or sectoral exceptions from treaty obligations; or

(iv) any combination of these approaches.

Thus not only narrow definitions or broad definitions, or narrow or wide substantive clauses, are the solutions available in determining the scope of the agreement. The choice is considerable in these matters.

Turning to interactions with other issues covered in this series:

- **Admission and establishment**. The term "investment" is important to provisions on admission and establishment of investment because it describes the types of activity by foreign investors that the host country must allow (to the extent required by the provision). Where "investment" includes all assets, this provision potentially opens the host country's economy to virtually every form of economic activity. For example, the typical broad definition of "investment" combined with an unqualified right of establishment would grant to foreign investors in principle the right to acquire land and mineral resource rights and form companies or other legal entities to engage in every kind of activity, commercial or otherwise, in which such entities may engage. Further, inclusion of contract rights within the meaning of "investment" would suggest that the right to establish investment might include the right of covered investors (typically entities from the home country) to enter into contracts which generate property interests or assets in the territory of the host country.

  Host country concerns about admission of foreign investment in many cases are industry specific, i.e., the host country may not want foreign investment in some activities of the economy, while not objecting to it in others. To the extent that objections to foreign investment in particular activities are expected to endure over the long term, the host country could qualify the definition of "investment" to include only assets in certain industries or activities of the economy. For example, the Energy Charter Treaty is an agreement applicable only to the energy sector while the GATS only applies to services. Similarly, article III.1 of the BIT between the Belgium-Luxembourg Economic Union and Egypt provides that "[t]he term "investments" shall comprise every direct or indirect contribution of capital and any other kinds of assets, invested or reinvested in enterprises in the field of agriculture, industry, mining, forestry, communications and tourism."

- **Incentives.** Many investment agreements contain a commitment on the part of the host country to encourage inward foreign investment. Often, because the obligation to permit the establishment of foreign investment is subject to local law, the commitment to promote inward investment places few, if any, specific commitments on the host country. The function of such a provision thus is to reflect the host country's policy of encouraging the establishment of foreign investment, even if the host country has reserved the right to prohibit foreign investment in particular cases.

  As has been noted,[1] some investment agreements promote foreign investment by affording special benefits to certain foreign investments, particularly those that are owned or controlled by regional investors. For example, article 4 of the Agreement on Promotion, Protection and Guarantee of Investments Among Member States of the Organization of the Islamic Conference provides that "[t]he contracting parties will endeavor to offer various incentives and facilities for attracting capital and encourage its investment in their territories such as commercial, customs, financial, tax and currency incentives, especially during the early years of the investment projects, in accordance with the laws, regulations and priorities of the host state".

  The term "investment" in these agreements determines the range of entities entitled to special incentives.

- **National treatment and most-favoured-nation treatment**. Investment agreements commonly require the host country to provide investment by investors of the other party with treatment no less favourable than that afforded investment of the host country (national treatment) or investment of any third country (MFN treatment). These provisions are intended to eliminate discrimination among investments based on the nationality of the investor.

  The terms "investment" and "investor" obviously are important in that they describe those activities that are the beneficiary of the host country's obligation not to discriminate. The terms play a special role in the non-discrimination provisions, however, because they also determine the content of the

obligation created by those provisions. The obligation is to treat covered investment as favourably as investment of host-country and third-country investors. Thus, the terms "investment" and "investor" establish the standard against which the treatment of covered investment is to be measured. For example, the term "investor" may include governmental entities. If so, then the national treatment provision may require that foreign private investment be treated as favourably as host-country public enterprises, not merely private enterprises, assuming that there is sufficient "likeness" of the circumstances of the enterprises concerned.

- **General treatment: "Fair and equitable treatment" or "full protection and security".** Many investment agreements contain provisions that specify general standards of treatment that the host country must afford to foreign investment. Such provisions may require "fair and equitable treatment" or "full protection and security". The obligation to provide "full protection and security" requires the host country to exercise reasonable care to protect covered investment. Unlike most investment treaty provisions, this provision requires a host country to protect investment against injurious action by private parties as well as by the State. This provision originally found its principal application in situations involving damage to real or tangible personal property. Because destruction of private property is generally a criminal offence, the question presented by this provision involved the extent of the host country's duty to provide police or fire protection to prevent the damage or at least to apprehend the wrongdoers following commission of a crime. As the term "investment" has expanded to include a broader variety of intangible forms of property, the range of protection that an investor may argue is required by the obligation of full protection and security has potentially expanded. For example, where "investment" includes intellectual property, an investor may contend that the obligation to exercise reasonable care to protect intellectual property against private infringement may require making available some form of remedy against those who infringe copyrights or patents.

- **Taking of property.** Many investment agreements impose restrictions on the right of the host country to expropriate

investment, including in particular an obligation to pay compensation for expropriated investment. The term "investment" indicates the types of interests for which a host country must pay compensation in the event of an expropriation. This is important for two reasons.

First, the interest must be defined before there can be a determination whether the interest has been expropriated. As has been noted, many investment agreements define "investment" to include partial or fragmentary interests. Thus, an expropriation may occur even though the investor had only a partial interest in the asset, as long as the investor's interest has been taken or substantially impaired. For example, the holder of mineral rights in land may claim that a prohibition on mineral exploration constitutes an expropriation of the mineral rights because the investor's entire investment has been rendered worthless. In short, the same act may or may not constitute an expropriation, depending upon how the investment is defined.

Second, the definition of "investment" determines the elements of the expropriated entity that are compensable. For example, many investment agreements define "investment" broadly enough to include debt as well as equity interests. Thus, expropriation of a company could give rise to an obligation to compensate not only the owners of the company, but its creditors as well. Similarly, where the definition of "investment" includes concessions or administrative permits and licenses, action to abrogate such administrative acts may constitute compensable expropriation.

- **Funds transfer.** Many investment agreements guarantee to investors covered the right to free transfer of payments related to an investment. Thus, the term "investor" is of special importance in indicating the identity of those who are entitled to access to foreign currency. The term "investment" indicates the range of activities for which investors may obtain convertible currency. For example, if "investment" includes insurance policies, then the currency-transfer provision in many investment agreements would grant to the owner of the investment, i.e., the insurance company, the right to obtain foreign currency for purposes of repatriating the insurance premiums paid by the insured entity in the host country.

Some investment agreements list the payments that are covered. For example, the model BITs prepared by the AALCC provide for transfer of the investment and "returns", with the latter term defined in article 1(e) to include "profits, interests, capital gains, dividends, royalties or fees".

As this indicates, as a general matter, the broader the term "investment", the greater the host country's potential obligation to provide convertible currency. Of equal importance, however, is the breadth of the term "returns". Repatriation of the returns is a far more common occurrence than repatriation of the liquidated investment and thus on a day to day basis the obligation to permit free transfer of returns may impose a much greater burden on a host country with small foreign currency reserves than the obligation to permit free transfer of the investment itself.

- **Dispute settlement.** Investment agreements frequently include provisions on two different types of dispute-settlement mechanisms, namely, mechanisms and procedures for the settlement of disputes between the parties to the agreement and for the settlement of disputes between an investor and a host country.

  The former provision typically does not use the term "investment" or "investor". It usually provides for arbitration of disputes concerning the interpretation or application of the agreement. Thus, those two terms are usually of importance only to the latter type of provision. However, other relevant terms such as "national" can be of importance to State-to-State dispute-settlement provisions.

  The investor-to-State dispute-settlement provision typically provides for submission to binding, third-party arbitration of disputes "concerning an investment".[2] The term "investment" thus is critical to determining the jurisdiction of the arbitral tribunal. For example, to the extent that the term investment is defined broadly enough to include trade-related assets, the possibility exists that an investor-to-State arbitration provision could be invoked for trade disputes.

Investment agreements usually provide that arbitration provisions

may be invoked by the investor. Thus, the term "investor" or, in some agreements, the terms "national" and "company", are critical to determining who may invoke the investor-to-state arbitration provision.

With respect to investors who are natural persons, the most important issue that arises is perhaps whether dual nationals may submit disputes with the host country to arbitration. As was noted above, many investment agreements ascribe to natural persons the nationality of either party if such persons are nationals under that party's law. Nothing precludes a person from having the nationality of both parties. Further, nothing in the typical investor-to-State dispute provision explicitly prohibits a national of one party, who happens also to be national of the other party, from submitting to arbitration a dispute with the other party. A State that wishes to preclude dual nationals from invoking the investor-to-State dispute provision should include clear language to that effect.

The issue of nationality also may be important with respect to investors that are legal entities. In the case of an investment agreement that uses the country-of-organization test for nationality, nationals of the host country may organize a company under the laws of a treaty partner and thereby create a legal entity that would have the legal capacity to submit an investment dispute with the host country to arbitration. In other words, the country-of-organization test creates the possibility that a host country will be involved in arbitration with an entity that is organized under the laws of another country, but wholly owned by host country nationals. The same possibility arises in the case of an investment treaty that ascribes nationality based on the country of the seat, although the possibility is somewhat more remote because the host country's nationals must establish a headquarters in the other country, a much more difficult task than merely forming a legal entity there. The possibility becomes even more remote where an investment agreement ascribes nationality based on the country-of-ownership. Even then, however, the possibility is not totally eliminated, because nationals of the host country could be minority stockholders in the company that is considered the investor. The fact

that the controlling interest is held by nationals of the treaty partner would permit the company to submit a dispute with the host country to arbitration, but nationals of the host country still would be among the ultimate beneficiaries of an arbitral award.

Notes

1 See the discussion above of regional enterprises in section above.

2 See, e.g., article 8 (1) of the June 1991 United Kingdom model BIT.

CONCLUSION:

ECONOMIC AND DEVELOPMENT IMPLICATIONS AND POLICY OPTIONS

The way in which the term "investment" is defined should be determined by the purpose of an investment agreement. As has been seen, investment agreements may have any combination of four purposes. First, they may protect investment, as in the case of a provision that provides for compensation for expropriation. Second, they may liberalize investment flows, as in the case of a provision that grants to an investor the right of establishment. Third, they may promote investment, as in the case of a provision that facilitates investment insurance. Or, fourth, they may regulate investment, as in the case of a provision that prohibits corrupt practices.

In section II, a number of model clauses for defining the terms "investor", "investment" and other related terms were considered. The most common trend is to have a broad, inclusive definition, which may or may not be subject to limitations. In the case of the term "investment" such a definition could be asset (or enterprise) or transaction based. In the case of the term "investor" the most important element is the link whereby the entity concerned is entitled to enjoy access to the subject-matter of an agreement. Usually, but not always, this is a link of nationality. Such a link could be especially complex in the context of a TNC with affiliates in many countries and a widespread, global, shareholding structure (UNCTAD, 1993, ch. VIII). Other links such as residence or control through ownership and/or functional capacity become significant.

A. Investment

- **Option 1: adopting a broad definition.** A broad and open-ended definition of "investment" has implications for the

development policy of the State parties to an agreement. The developmental concern can be stated quite simply: treaty coverage of all assets included within the definition may not be consistent with a State's development policy at every period in the life of an agreement.

The broad definition of "investment" can be flexible and open ended. There are at least two reasons for this approach. First, as a technical matter, it may be difficult to draft a more precise definition that would cover all the assets that parties wish to be covered by an agreement. Second, because the concept of investment has evolved over time and because many investment agreements are intended to endure for many years, those who draft them appear to seek, as a matter of policy, to utilize language that can extend an agreement to new forms of investment as they emerge, without renegotiation of the agreement. Both of these considerations are particularly important in agreements that are intended to facilitate international investment flows.

The broad, open-ended definition, at the same time, may be undesirable for countries that are concerned about certain effects of foreign investment. The danger of an open-ended definition is that it may commit a host country to permitting, promoting or protecting forms of investment that the host country did not contemplate at the time it entered into an agreement and would not have agreed to include within the scope of the agreement had the issue arisen explicitly. There are several ways to limit the scope of the definition, discussed below as options 2 to 4.

- **Option 2: adopting a narrower definition of investment.** The first alternative is to adopt a narrower definition of investment. As noted in section II, a number of agreements have done so, although there are advantages and disadvantages to any particular narrowing of the definition. Taking each type of narrower definition in turn, the following development implications may be envisaged:

  - A number of agreements exclude portfolio investment because it may be regarded as less desirable than FDI, given that it generally does not bring with it technology

transfer, training or other benefits associated with FDI. Further, portfolio investment is easily withdrawn, thus creating the potential for capital volatility in the event of economic turbulence. In addition, portfolio investment is less easily monitored than direct investment, giving rise to concerns that it may be used as a mechanism for money laundering.

On the other hand, inclusion of portfolio investment can make a positive contribution to development. It is a potential source of capital and foreign exchange. Some investors may not wish to control an investment or even have any kind of equity position in the investment. Further, given that one traditional concern about FDI was that it permitted domestic assets to fall under the control of foreign nationals, there may be sound reasons of national interest to encourage portfolio rather than direct investment in certain enterprises.

- Some investment agreements exclude assets of less than a certain value, perhaps because these investments are considered too small to justify the costs of treaty coverage or perhaps because of a desire to reserve to domestic investors those parts of the economy in which small investments are likely to be made. However, the exclusion of small investments could discourage small and medium-sized investors that some developing countries may be seeking to attract, at least during certain stages of the development process (UNCTAD, 1998b). In such cases a size limitation may not be useful.

- Other investment agreements exclude investments established prior to entry into force of an agreement, in order to avoid bestowing a windfall on the investor. Such an exclusion could be interpreted as calling into question the parties' commitment to investment promotion or protection and in exceptional cases could provide a permanent competitive advantage to investors who invest after the conclusion of the agreement.

- Investment agreements may limit the parts of the economy to which the agreement applies. As noted in section

II, this is the approach to definition taken by the Energy Charter Treaty. It can be envisaged that other sector-specific agreements could adopt a similar approach to definitional issues.

The above analysis suggests that countries need to consider carefully the consequences of including or excluding certain types of investment in the definition of "investment". Critical considerations include the purpose(s) of the investment agreement and the precise nature of the operative provisions to which the definition is applied.

- **Option 3: adopting a broad definition subject to right to screen and conditional entry.** A second alternative is to adopt a broad definition of "investment", but reserve the right to screen or place conditions on the establishment of individual investments. In this way, the host country does not exclude any category of investment a priori, but can exclude any specific investment. This approach is adopted in many investment agreements. It ensures that only those investments that have been approved by the host country are entitled to protection under the investment agreement. Moreover, such screening will usually include a review of the development implications of the investment. Consequently, approval of the investment signifies, in principle, conformity to the host country's development goals.

- **Option 4: adopting a broad definition with limiting substantive provisions.** A third alternative is to adopt a broad definition of investment, but limit the scope of the substantive provisions. For example, if the concern about portfolio investment is that it may be withdrawn quickly, an investment agreement might define "investment" to include portfolio investment, but the currency-transfers provision would apply to investment only if an investment has been established for some minimum period of time, such as one year. Such a limitation would be directed at the volatility of the investment, which may be one particular concern regarding portfolio investment. Similarly, if the concern is that the expropriation provision may lead to claims that ordinary regulatory action is expropriatory and requires compensation, the expropriation provision could be modified to exclude ordinary regulatory action.

By addressing concerns generally in the operative provisions, this approach eliminates some of the burden on the investment screening agency to take account of every concern on a case-by-case basis. It also avoids the problem of an "all-or-nothing" approach. Thus, some investments may be admitted, but with only limited rights under an agreement.

This approach places a heavy burden on the negotiators of an agreement to consider the potential ramifications of each type of investment and to incorporate language in the agreement during negotiations to protect the host country's ability to execute its development policy.

- **Option 5: adopting a hybrid approach.** One other option is to adopt a hybrid mixture of, for example, broad and narrow definitions or asset-based and transaction-based definitions in relation to the different purposes of an investment agreement. Thus, while some countries may wish to define "investment" to include not every kind of asset, but only the specific categories included in a list, those same countries may wish to define "investment" more broadly in an agreement that regulates foreign investment, such as an agreement on transfer pricing. Generally speaking also, the liberalization of investment flows is one of the aspects of investment agreements that has most concerned many developing countries. One option in this respect is to use a broad asset-based definition for the purpose of protecting investments, and a narrower asset-based or transaction-based definition for cross-border investment liberalization agreements.

B. Investor

The definitional options in this area are, perhaps, less difficult to describe. In essence, the central issue is the choice of links with one or more contracting parties whereby natural and legal persons become integrated into the scheme of an investment agreement.

Natural persons. Usually a nationality link is sufficient as long as the contracting party's internal law recognizes the individual to be a national. There do not appear to be significant development

implications stemming from this matter. Where a natural person possesses dual or multiple nationality, then an effective link criterion could be inserted into the clause. Most bilateral treaties do not follow this option. On the other hand, the insertion of other connecting factors may ensure that an effective link can be proved on the facts. Examples include residence or domicile in the country of nationality. The main development implication of such a variation is to ensure that only persons with a significant involvement in the economy and society of the home country could claim the protection of an investment agreement in the host country. "Free-riding" on the basis of the nationality provisions of an agreement is minimized.

Legal persons. Two issues need to be addressed: first the range of legal persons covered and, secondly, the links between the legal person and a contracting party to an investment agreement. As to the first issue, one option is to have all legal persons covered. This gives maximum flexibility to investors as to the choice of the legal vehicle through which to invest in a host country. The development implications of such a "free choice of means" would centre on whether the regulatory objectives of internal law can be achieved regardless of the legal form that an investor adopts. That, in turn, depends on the nature and context of internal laws and regulations. The other option is to narrow the range of legal persons covered. This might be done where the host country has a strict regime as to the legal form that a foreign investment is permitted to take.

As to the second issue, a strict linkage based on nationality may be adopted. Such a linkage is very common in investment agreements but may be difficult to apply in practice, as was discussed in relation to the definition of "transnational corporation" or "multinational enterprise". Alternatively, a wider provision could concentrate not on the formal nationality of the legal person but its effective nationality as exemplified by the nationality of the controlling interest. Such a formulation would be favoured by investors, especially as it would ensure that foreign affiliates incorporated in a host country can benefit from an agreement. However, these may in any case be protected as "investments of the investor". As with natural persons, the major problem to be borne in mind is not to adopt a linkage provision that would permit legal persons from non-contracting states to benefit from the legal protection of the agreement on a "free rider" basis.

C. Summary

The development implications of a broad definition of "investment" in an investment agreement are substantial. Although developmental concerns can be addressed in part by narrowing the definition of "investment", that is not necessarily the only approach in every case. Depending upon the nature of the operative provisions of an agreement and the purpose(s) of the parties in concluding the agreement, these developmental concerns in particular cases may be addressed alternatively through reservations of the right to exclude investments or by limiting the applicability of specific operative provisions. It is important to remember in this context that the ultimate effect of an investment agreement results from the interaction of the definition provisions with the operative provisions. There should be sufficient flexibility in the definition to ensure the achievement of developmental objectives.

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