Foreign Direct Investment Protection in the United States and Russia

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# Table of Content

**Foreword** .................................................................................................................................................. 1
**Introduction** ............................................................................................................................................... 3

**Chapter 1 – Foreign Direct Investment (FDI)** ......................................................................................... 7
A. FDI Definition ........................................................................................................................................... 7
B. FDI Protection Sources ......................................................................................................................... 8
C. FDI Protection Mechanism .................................................................................................................. 11
D. Historical Background of FDI ............................................................................................................. 11
E. FDI Benefits and Disadvantages ......................................................................................................... 18
F. FDI Outlook ........................................................................................................................................... 20

**Chapter 2 – Model BITs of US and Russia** .......................................................................................... 23
A. Background ........................................................................................................................................... 23
B. What is a (Model) BIT? ....................................................................................................................... 24
C. Model BIT Structure .......................................................................................................................... 25

**Chapter 2.1 – Model BIT of the United States (US)** ............................................................................ 27
A. Introduction ........................................................................................................................................... 27
B. Evolution of the Objectives of the US BIT Program ......................................................................... 28
C. Modern US Investment Policy .......................................................................................................... 37
D. Core Protection Provisions .................................................................................................................. 41
E. Conclusion ........................................................................................................................................... 63
F. A Final Thought ................................................................................................................................... 64

**Chapter 2.2 – Model BIT of the Russian Federation (Russia)** .......................................................... 66
A. Introduction .......................................................................................................................................... 66
B. Evolution of the Objectives of the Russian BIT Program ................................................................... 66
C. Modern Russian Investment Policy .................................................................................................... 69
D. Core Protection Provisions .................................................................................................................. 71
E. Conclusion ........................................................................................................................................... 84

**Comparison of Model BITs** .................................................................................................................. 86

**Chapter 2.3 – Russia-US BIT of 1992** .................................................................................................. 89
A. History ................................................................................................................................................... 89
B. Treaty Provisions .................................................................................................................................. 90
C. Ratification Failure .............................................................................................................................. 91
D. Outlook ................................................................................................................................................ 92

**Chapter 3 – Legal Investment Regime in the US and Russia** ............................................................. 94

**Chapter 3.1 – Legal Investment Regime in the Russian Federation** .................................................. 96
A. Background .......................................................................................................................................... 96
B. Legal Foreign Investment Framework ............................................................................................... 99
   1. General Framework .......................................................................................................................... 99
   2. Specific Legislative Acts .................................................................................................................. 100
C. Investment Environment .................................................................................................................... 104
D. Conclusion .......................................................................................................................................... 111

**Chapter 3.2 – Legal Investment Regime in the United States** ............................................................ 113
A. Background .......................................................................................................................................... 113
B. Legal Foreign Investment Framework ............................................................................................... 116
   1. General Framework .......................................................................................................................... 116
   2. Specific Legislative Acts .................................................................................................................. 117
C. Investment Environment .................................................................................................................... 122
D. Conclusion .......................................................................................................................................... 126

**Final Conclusion** .................................................................................................................................. 127
**Bibliography** .......................................................................................................................................... 135
Foreword

Five years of studies at Universiteit Gent have allowed me to discover an eclectic array of legal subjects. Nevertheless, not many of them have actually succeeded in stirring my curiosity. Hence, until last year, I sought for a subject that could grab my full attention and frankly challenge me.

As I like to take initiative, I decided to take the matter into my own hands by questing for summer internships in diverse legal fields. My applications resulted in internships at the Raad van State, the European Union’s Judicial Cooperation Unit (EUROJUST), the International Human Rights Law Institute (IHRLI) of DePaul University, the Embassy of the Kingdom of Belgium and a number of law firms.

It was during one of my law firm internships that I came across the area of international investment law. My curiosity was immediately triggered and I whole-heartedly decided that I wanted to immerse myself into this fascinating field. As such, I have chosen to work on the topic of “Foreign Direct Investment Protection in the US and Russia”, and I am very grateful that my supervisor and mentor, Professor Diederik Bruloot, kindly let me breach this subject and supported me along the way.

Considering that the practice of international investment law is fairly new and is still in active development, there is less information available on it in comparison with more traditional legal fields. Despite this additional challenge, I planned to obtain the necessary materials and fervently researched for sources wherever and whenever I could.

As a result, in order to acquire the necessary information for my thesis, I took up relevant courses and research classes during my exchange to the Law School of University of Miami (UM). Because of this exchange, I got access to all the prominent American legal databases, which proved very helpful on the subject of US investment protection. During the same exchange I also had the opportunity to discuss my research with UM professors such as Jan Paulsson and John Rooney. Furthermore, I received particularly helpful responses from the Columbia Center on Sustainable Investment (CCSI) and the Moscow Institute of World Economy and International Relations (IWEIR) and other international investment institutions, to the dozen of emails I had written to them. Moreover, the two international authorities on FDI matters in the US and Russia, respectively Professor Kenneth J. Vandevelde and Professor Alexei Kuznetsov, have provided me with indispensable insights on some of my key research questions. I want to thank them both for taking the time to respond to my questions.

In addition, I was able to employ my knowledge of the Russian language and I met with the Political Adviser and Economic Attaché of the Russian Embassy in Belgium, who have clarified some of my
thoughts on the subject of Russian investment protection. Lastly, my friends who practice law in Russia, Belarus, Belgium, Liberia, Singapore and the US have sent me books, articles and other valuable information. A special thank you goes out to Douglass Hansen for his eloquent revisions and erudite commentaries on my work.

When I initially selected this subject for my thesis, I knew very little on this topic. The only thing I did know was that I had finally found a subject that had truly sparked my interest. Now, after thoroughly being challenged by in-depth readings, critical source examinations and comprehensive analyses, I have learned tremendously about a completely new topic and my thirst for a captivating legal subject has been quenched for now.

Thus, hereby I proudly present to you – in one single work – the result of insights gathered from all corners of the world. I truly hope that this work can contribute to the legal literature and scientific debate on this booming subject.
Introduction

It is impossible to neglect the powerful force that foreign direct investment (FDI) plays in the world economy. Nowadays, foreign investment is one of the major catalysts for global economic growth, as the expansion of globalization and advances in information technology and communication systems have turned the whole world into one big market for many businesses.

Foreign direct investment has experienced an explosive growth over the past decade and has come to play a great role in the internationalization of both major corporations and small and medium enterprises (SMEs), as for the latter, FDI represents an opportunity to become more actively involved in international business activities. At the same time, FDI is an important source of capital inflow for developing countries: their economic growth and overall development level depends to a large extent on these foreign investments.¹

In 2015, global FDI increased by 36% to a historical US$ 1.7 trillion, and it is projected to gain steam over the coming years, to an estimated US$ 1.85 trillion by the end of 2016.²

This intensifying importance of FDI is not only reflected by its financial numbers, but it is also proven by the 3,312 concluded bilateral and multilateral investment treaties³, the wide array of ongoing investment arbitrations and an increasing amount of arbitral awards, the worldwide government negotiations on promotion and protection of foreign investments, the intense academic debates on treatment standards, and the palpable effects that FDI has on domestic economies, especially when FDI decreases due to international (geo)political tensions, which intensifies economic challenges. The expanding prominence of international investments is furthermore on a day-to-day basis reflected in altering domestic FDI legislation and evolving government policies, newly drafted and revised model bilateral investment treaties, and rising media and civil society attention to public policy matters that are affected by FDI.

³ These 3,312 IIAs are divided into two types: bilateral investment treaties (2,952) and other IIAs (360). UNCTAD International Investment Agreements Navigator, www.investmentpolicyhub.unctad.org/IIA. Last accessed on 11 May 2016.
As a vital element in the ongoing globalization process, with a progressive effect on the development of international trade and enhancement of economic growth, FDI entails numerous advantages. For the recipient state, FDI increases employment levels, imports new ideas and innovations, generates technological advancement, transfers expertise and knowledge, facilitates access to R&D, and boosts a nation’s living standards. Further, FDI contributes to the overall development and prosperity in a state, and creates a trustworthy image of the country’s investment environment for prospective investors.

As for the foreign investor, FDI provides businesses with new markets and marketing channels, cheaper production facilities and special financial incentives – all of which yield an increase in business profits.

In such a way, FDI is a win-win situation for both nations and their investors, which in addition can be generated quickly and easily, by signing an investment agreement. International investment agreements (IIAs) aim to boost investment in a country’s economy by enticing investors from abroad.

In the past, it was common that for companies to make foreign investments without regard to the existence of terms of relevant investment treaties, and only later, in a second stage, when a problem or a dispute had arisen, to pay attention to the existence and terms of relevant investment treaties.

However, these days, with the massive expansion of FDI, investors are more aware of the potential risks when investing their private capital in another country and subsequently assess all the risks before making the actual investment. These investors want to be sure that their investment will not be lost or impaired, and that the host state’s attitude and legal protection will stay favorable and protective towards their investment.

Therefore, countries that wish to attract foreign capital must create a stable, secure and satisfactory investment climate for foreign investors. These investors ask for legal certainty and diminution of perceived risks that are complementary with investing abroad. In order to respond to these demands, countries provide today various legal guarantees and remedies, such as national treatment and compensation upon expropriation, both in their national legislation and in the diverse IIAs which they conclude with other states.

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In this study, I will compare how the United States and the Russian Federation cope with this task, the means through which they provide legal security for FDI, and to what extent this protection reaches. The choice of these countries in particular – the United States of America and the Russian Federation – is motivated by the fact that the US and Russia are two eminent nations with very different policies on trade and investment, especially when taking into account their political and historical background. When the first foreign investments started to circulate, Russia was focused on protecting its domestic market, while the US was opening its economy to the whole world. Therefore, it is interesting to track the evolution of the investment policies of these two nations - two historical antipodes - and to see to what extent Russia is still protective when it comes to FDI and if the US investment policy has become over the course of the years more restrictive.

The differences between the two states are expected to be profound when comparing the existing FDI protection in Russia to the one in the US. While the US is once again the top destination for FDI in the world,\textsuperscript{7} inflow of foreign investments has nearly ceased in Russia, mainly due to the recent geopolitical tensions in Ukraine.\textsuperscript{8}

In Belgium, little research has been conducted on FDI protection to date. Hence, this thesis attempts to offer a first step in the analysis of this booming area. The main objective of this study will be the examination of the FDI protection that is granted to alien investors by the United States and Russia, in order to evaluate which country endows foreign investors with the best legal protection. The core protection standards that a country offers are encompassed in its model bilateral investment treaty. Therefore we shall conduct this study on the basis of the Model BITs of both countries and the existing bilateral treaty between the US and Russia themselves, together with the respective domestic legal systems in which foreign investments primarily operate. However, even though this is a legal study in the first place, the influence of FDI reflects itself not only in legal practice. The issue of the protection of foreign investments is also directly related to economic, political and social factors, and hence the impact of those extra-legal factors will be examined accordingly.

The thesis is structured into three parts. Chapter 1 will explain the different aspects of foreign direct investment and what FDI protection exactly encompasses. Chapter 2 will examine in its first part the Model BIT of the United States, while the second part will conduct an analogous analysis of the Model


\textsuperscript{8} Ibid.
BIT of the Russian Federation. The chapter will conclude with a comparison on the level of protection that is offered by both model texts. Additionally, it will also make interesting observations on the Russia-US BIT, which has been signed but not ratified, before continuing with the next section. Chapter 3 will discuss the domestic legislative framework regarding investments in the Russian Federation, and then correspondingly elaborate on the legislative investment regime of the United States. Finally, the thesis will end with a comprehensive comparison of both legal systems and conclude by setting out which system offers the most attractive level of FDI protection to foreign investors and their investments.
Chapter 1 – Foreign Direct Investment (FDI)

Before analyzing the level of protection that the United States and Russia offer to foreign investments, it is crucial to define the concept of foreign direct investment.

A. FDI Definition

Foreign direct investment (FDI) is an investment made by a commercial business entity based in one country, into a business entity in another country. The objective of FDI is to establish ownership or control over the other business, and to exert a significant degree of influence over management of that other business. As such, the investing company can make its cross-border investment in a number of ways, for example by setting up a new subsidiary or associate company, building new facilities, acquiring shares in a local firm, participating in a joint venture, or through a merger or an acquisition of an unrelated enterprise.

The Organization for Economic Co-operation and Development (OECD), the international authority in global economic growth and world trade, has set forth the generally accepted requirements for an investment to qualify as FDI, namely that the investor’s control or ownership of the other business must exceed a threshold of 10%. That means that the foreign investor must own 10% or more of the voting stock or ordinary shares of the other company in the host state, which is considered to imply “lasting interest” on the company in the foreign economy.

Foreign direct investments are distinguished from indirect/passive investments, such as portfolio investments, wherein entities invest in public stocks and bonds listed on a nation’s stock exchange. In those cases the element of “control” is absent, as businesses making direct investments typically have a significantly greater degree of influence or control over the company they investment in.

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10 E.g. the United States defines direct investment as “the ownership of at least 10% of the voting securities of an incorporated business enterprise or the equivalent interest in an unincorporated business enterprise.” 15 C.F.R. § 806.15(a)[1].
12 Supra note 11.
13 Supra note 9.
Further, there are 3 different types of foreign direct investment, namely (1) horizontal FDI, which arises when an enterprise duplicates its home country activities at the same value chain stage in a host country; (2) platform FDI, which occurs when a company invests in a host country for the purpose of exporting to a third country; and (3) vertical FDI, which takes place when a firm moves upstream or downstream in the value chain through FDI.\textsuperscript{14}

Lastly, countries can experience inward and outward FDI flows: inward FDI flows occur when a country is the recipient or the destination of FDI, and outward FDI flows occur when a country is the source of FDI and private capital is flowing out of its economy. In that scenario, the first state serves as “host state” to the foreign investor, and the second state is his “home state.”\textsuperscript{15}

This dissertation focuses on inward FDI. One of the questions this dissertation seeks to address is which of these two states – two of the most important in the world, with quite contrasting economic evolutions – is better suited for FDI by providing greater protections, principally through its domestic laws and bilateral investment treaties. An example of this is whether an investor from India will be more likely to build a factory in the United States or Russia, on the ground that one of these two states will better protect his investment. Hence, this study is centered on and limited to inward FDI protection. The ways by which a nation promotes outward FDI of its citizens will be only lightly covered.

\section*{B. FDI Protection Sources}

Since the end of World War II, governments around the world have actively implemented programs to “resurrect “and develop their nations, in particular in the social, political and economic areas, in order to make them an interesting and attractive hub for foreign investors with private capital. This process has been facilitated by the evolution of a global network of investment treaties among sovereign states.\textsuperscript{16} These investment treaties are often referred to as International Investment Agreements (IIAs). An IIA is defined by Jeswald W. Salacuse as \textit{“an instrument of international law by which states (1) make commitments to other states with respect to the treatment they will accord to investors and investments from other states and (2) agree to some mechanism for enforcement of those commitments, with the fundamental purpose to protect and promote investment.”}\textsuperscript{17}

\textsuperscript{15} Host state is thus the state in which the investor has his legal home, which can be, for example, citizenship of a state, incorporation or majority ownership.
\textsuperscript{17} \textit{Ibid}, 1.
As such, these treaties and agreements provide the investors with protection in the host state, since they form a strong incentive for host states to honor their made promises and respect their obligations under international law. If a host state would violate the rights safeguarded by the treaty, that state would breach a legally binding contract with the investor’s home state. As many IIAs provide for dispute resolution by means of arbitration, the home state or the investor himself can go to an arbitral tribunal in order to obtain an award against the host state and receive significant damages for that governmental impairment.

International investment agreements generally comprise three categories of agreements: (1) bilateral investment treaties (BITs), which are concluded between two countries regarding the reciprocal promotion and protection of investments in each other’s territory, which form the majority of the IIAs; (2) investment provisions in other bilateral economic agreements, such as investment chapters in Free Trade Agreements (FTAs) which replicate obligations commonly found in BITs; and (3) multilateral investment agreements, which set forth rules concerning foreign investments, such as the North American Free Trade Agreement (NAFTA), the European Energy Charter Treaty (ECT), the ASEAN Agreement for the Promotion and Protection of Investments and Latin America’s Mercosur Investment Protocol.

All of these agreements are sources of international investment law. International investment law is a specialized area of international economic law, which in its turn is a specialized area of international law. The main source of international investment law is treaty law, which encompasses thousands of BITs, and various sectoral, regional and multilateral agreements with provisions and chapters on the reciprocal protection of investments.

In this dissertation, only BITs will be discussed as they are the dominant source of investment protection offered by host states to incoming foreign investors. It is important to keep in mind that while BITs offer protection to private investors by imposing obligations on state governments, the treaties themselves are concluded between two sovereign states. Hence, BITs govern state-to-state relations primarily, with secondary application to individuals.

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19 As part of international investment law, BITs are subject to international law rules on interpretation, applicability, disputes and withdrawal if the parties to the BIT did not agree on these matters explicitly in the agreement.
20 According to latest UNCTAD Statistics there are 2,951 BITs in the world, while there are only 360 other IIAs in existence. See [http://investmentpolicyhub.unctad.org/IIA](http://investmentpolicyhub.unctad.org/IIA). Last accessed on 10 May 2016.
21 Of note, bilateral investment treaties are anomalous in international law because they grant specific rights to individuals. Other than the European Court of Justice (ECJ), the European Court of Human Rights (ECHR) and some of the United Nations bodies, individuals have no standing to apply international law themselves. Thus
Of note, BITs were traditionally the result of negotiations between a developed and a developing state. The former generally wanted to guarantee the protection of its citizens’ investments in the developing state, while the latter wanted to attract capital from abroad in order to enhance the overall socio-economic development of its nation. As discussed in the next chapter, the last twenty years have also seen the emergence of reverse FDI into developed states by investors from developing states, and BITs are also increasingly used to regulate investment between developing states themselves.

The United Nations Conference on Trade and Development (UNCTAD) reported that as of May 2016, the total number of negotiated BITs in the world was 2,951 BITs, of which 2,319 are in force. Commentators Stefan Amarasinha and Juliane Kokott have labeled the map of contemporary BITs a “spaghetti bowl” in international law, while Salacuse describes it as the “treatification” of international investment law.

**Figure I. The “spaghetti bowl”**

*Source: UNCTAD*
C. FDI Protection Mechanism

As mentioned before, FDI falls within the wide-ranging field of international law, and international law is based on the doctrine of state sovereignty. Technically, no state is obliged to admit foreign investors and their capital on its territory, as a state can regulate its own economic affairs as it chooses.\footnote{R. Dolzer and C. Schreuer, Principles of International Investment Law, Oxford, Oxford University Press, 2008, 7-11.} Subject to this doctrine of state sovereignty, FDI activity can be divided in two main areas, even though both are intertwined, namely standard-setting and dispute resolution.

As a result, sovereign state promotes and protects private interests of national and foreign investors through the establishment of protection standards, namely domestic laws and international investment treaties, and the provision of dispute settlement mechanisms, e.g. international investment arbitration.\footnote{F. Beveridge, The treatment and taxation of foreign investment under international law, Manchester, Manchester University Press, 2000, 5-8.} Because of their sovereign autonomy, state governments possess wide discretion to admit or exclude FDI into their territory, and to freely determine the amount of protection they are willing to offer to a foreign investor.

Consequently, besides subjecting foreign businesses to domestic legislation and regulations, like tax tariffs, or antitrust and labor laws, a state can impose additional requirements or restrictions upon foreign investors – for example financial thresholds, sector restraints or performance requirements. It can also provide foreign investors with extra security and protection measures\footnote{Ibid, 10-34.} – like national treatment, fair and equitable treatment, and full protection and security – all which will be discussed in the next chapters.

The FDI protection that a country offers depends on its domestic legal system, the bilateral and multilateral investment treaties its government has ratified, and the available facilities for the settlement of investment disputes, which usually includes recourse to international investment arbitration. The latter two protect the alien investor against diverse injurious acts and omissions by the host state; if no investment treaties existed, the alien investor would be compelled to rely solely on the host state’s domestic legal system, which may be biased, unstable and unfavorable towards foreigners. This would entail a big risk for the alien investor, which he would need to consider as one of the decisive factors when concluding on where to invest.

D. Historical Background of FDI


States have protected the private property of their nationals abroad long before the first BIT was signed at the end of the 20th century. The practice of bilateral agreements dates from the 17th century, when the precursors of the current BITs and other IIAs emerged. These Treaties of Peace and Friendship and Treaties of Friendship, Commerce and Navigation (FCN treaties) formed the foundation for international diplomatic relationships for centuries.

FCN treaties were concluded well into the 20th century, with the last one being agreed to in 1966. These treaties aimed at facilitating trade and creating a stable diplomatic and economic relationship between contracting parties. However, they did not stop at commercial commitments, but covered in a single document a wide range of issues, including human rights, immigration and shipping, military matters, inheritance and taxation. According to commentator John Coyle, they served as a “medium par excellence through which nations have sought in a general settlement to secure reciprocal respect for their normal interests abroad.”

In addition, FCN treaties were regarded by some as indispensable for the recognition of a nation as a sovereign state, as by signing a treaty, the contracting state party implicitly grants its economic and political support to the other state. This reasoning applies today to the motives of some states for concluding BITs, as some developing states seek recognition and economic success through such investment agreements.

FCN treaties went out of use fifty years ago, as nations started to enter into more single-issue agreements with fellow states. Modern multilateral and bilateral agreements are concluded on each

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30 For example, the Treaty of Peace and Friendship between the Great Britain and Spain of 1667, or the Treaty of Peace and Friendship between the United States of America and the Bey and Subjects of Tripoli of Barbary of 1796, http://avalon.law.yale.edu/18th_century/bar1796t.asp.

31 The first FCN treaty was concluded in 1778 between the US and France. The US used the FCN treaties as a strategic tool to establish worldwide alliances, and hence concluded them in large numbers. See A. Foster, “Some Aspects of the Commercial Treaty Program of the United States – Past and Present”, 11 Law and Contemporary Problems, 1946, 647-662.


34 Nevertheless, the features of the FCN treaties would not be accepted by states these days. They functioned as instruments for spreading power of the major players and tying smaller, less powerful states as allies. For example, they allowed an unlimited right of entry and establishment of businesses, usually through a one-way flow from the developed into the developing state. As roles have shifted today, similar provisions have been severely limited. J. F. Coyle, “The Treaty of Friendship, Commerce and Navigation in the Modern Era”, Colum. J. Transnat’l L, 2013, 306.

35 As it was the case with the United States after its independence in the 18th century. V. G. Setser, “Treaties to Aid American Business Abroad”, 40 Foreign Commerce Weekly, 1950, 18.
of the topics that were previously found in a single, multi-issue FCN document. In other words, while FCNs sought to regulate all aspects of the relationship between two states, modern treaties between states treat only single or narrowly grouped issues. For example, the General Agreement on Tariffs and Trade (GATT) covers trade issues, while international human rights treaties such as the International Covenant on Civil and Political Rights (ICCPR) comprises diverse human rights issues, and the Double Taxation Treaties (DTT) address tax relations.

Similarly, BITs deal specifically with foreign direct investments and nothing else. According to Muthucumaraswamy Sornarajah, “the experience that was gained with these [FCN] treaties shaped the structure and the content of the future bilateral investment treaties.”

When the early FCN treaties were ratified, the main fear of foreign investors was the expropriation of their private property by the host state. Subsequently, as one of the first developments in the field of FDI protection – due to a historical disagreement discussed later – an extensive network of protections against uncompensated expropriation had been established. Three important events occurred: the Latin American idea, the Soviet escalation and the post-colonial New International Economic Order (NIEO) challenge.

a. The Latin American Idea

The story begins with the 19th century Argentine scholar Carlos Calvo, who promoted in 1863 the principle that foreign investments must be subordinated to pure national treatment by the host country. He argued that governments should treat foreign investors in a manner equivalent to the way they treat their own citizens in the host state, regardless what level of protection that entails. Hence, the home state of the investor should not interfere in host states’ economic policies and treatment of investments, as it is equal to that of its own citizens. Moreover, Calvo was of the opinion that as home states may not interfere in another state’s treatment of its nationals, the foreign

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37 General Agreement on Tariffs and Trade, 30 October 1947, 55 U.N.T.S. 188.
investors should be limited to the host state’s domestic courts when seeking remedies against host state’s illegal or discriminatory actions.

**b. Soviet Escalation**

The practical elaboration of Calvo’s ideas began after 1918, when the Bolshevik leaders of the Russian Revolution proclaimed their communist ideas about property. Before the Russian Revolution, private property was widely protected in diverse constitutions, just as the national treatment standard was the norm in bilateral investment treaties. The success of the Bolsheviks put this universal foreign investment protection to an end. Firstly, the Soviet Union ceased acknowledging the right to property of their own citizens. Next, its Constitution denied the right to property to foreigners as well. Consequently, all protection foreign investors enjoyed vanished in an eye blink and their private property was nationalized without any compensation, as the new Soviet government refused to pay compensation for the seized property.

The abolishment of private property by Lenin, combined with Calvo’s doctrine, led to the embodiment of the fear of all investors – namely, that their investments were no longer safe.

The Soviet Union used Calvo’s principle to defend its takings, and in return, this tactic was adopted by the Mexican government during their expropriations in 1938. The country – in fact the whole Latin American region where the Calvo doctrine originated from – embraced Russia’s justification of national treatment for expropriations of foreign property. This development divided the global opinion on the level of protection to foreign investors under international law, in particular whether it is the national treatment or are there certain minimum standards to which the host states must adhere.

A milestone in this debate was the emergence of the “Hull Formula”. After Mexico nationalized farmland belonging to American nationals living in Mexico in 1938, the US Secretary of State, Cordon Hull, engaged in a dialogue with the former Mexican Foreign Minister, Eduardo Hay. Hull wrote a diplomatic note on the failure of the Mexican government to compensate the property belonging to US citizens. Although he did agree with Mexico’s right to expropriate property of national and foreign

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45 Konstitutiya RSFSR (1918), Art. 1, Chapter 2, §3.
46 These governmental actions had resulted in a massive protest from the Western nations, whose nationals were affected by the seizures, and a lack of recognition of the new Soviet government by the major world powers. Consequently, this deteriorated any possible economic growth of a nation whose economy was in ruin after the Russian Revolution. R. Leal-Arcas, *International Trade and Investment Law: Multilateral, Regional and Bilateral Governance*, Cheltenham, Edward Elgar, 2011, 62-65.
citizens, he insisted that compensation was compulsory and that it must be “prompt, adequate and effective.”

Thus the so-called “Hull Formula” emerged and is still implemented in many bilateral and multilateral treaties regarding international investments. It encapsulates a minimum standard to which a host state to FDI must adhere. Still, among Latin American countries this formula stays controversial as they have historically supported the Calvo doctrine, and thus are of the opinion that it should be left to the host state to decide the amount of compensation, if any, in expropriation cases.48

c. The Post-Colonial NIEO Challenge

Discussions on Hull’s minimum standard versus Calvo’s national treatment standard continued for a several decades. The debate became especially intensive in the early post-World War II years of decolonization, when a clear discrepancy emerged wherein the right to compensation for expropriations was defended by the commercially strong European states and the United States, while rejected by the newly independent states in Africa.49

Once freed from the chains of colonialism, the newly independent states sought recognition in the international community and started to develop their own nations. Nationalism became the new driving force.50 These countries fought not only for an end of political and economic dominance by the former colonialist powers, but also for the creation of a world order wherein they could develop their own economies, enjoy their sovereignty, conduct trade on their own terms and enjoy free access to the international market.

In order to provide a forum for new developing countries to discuss issues related to economic development, UNCTAD was established in 1964, as a permanent intergovernmental body of the United Nations.51 In the ‘70s and ‘80s, UNCTAD’s main objective was the promotion of this NIEO, which strived


49 For an extensive overview of the development of international economic policies from the 1940s to 1970s, see C. Lipson, Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries, Berkeley, University of California Press, 1985, 85-96 and 97-103.

50 Supra note 47.

51 UNCTAD is the principal organ of the United Nations General Assembly dealing with trade, investment, and development issues, and has 194 member states. UNCTAD’s principal goal is to “offer direct technical assistance to developing countries and countries with economies in transition, help them to build the capacities they need to become equitably integrated into the global economy and improve the well-being of their populations”, http://unctad.org/en/Pages/AboutUs.aspx.
to ensure fairness in global trade and greater participation of developing nations in the world's economy.\textsuperscript{52}

The NIEO proclaimed that developing nations must have the power to regulate and control the activities of multinational corporations operating within their national borders, as they were now sovereign states. Where they deemed it necessary, these countries maintained that they must be able to nationalize foreign property on conditions favorable to them. Hence, it was the “adequate” aspect of compensation that this movement rejected. The new independent governments, often of low-income and economically developing countries, challenged their ex-colonial masters in Europe and investors from the United States over the amount of compensation due to foreign investors. This was a logical move, as the NIEO governments could ill afford to pay the full market price for the seized property; however, they were motivated differently by stating that they relied on the principle of a nation’s permanent sovereignty over its natural resources.

The NIEO nations expropriated foreign businesses without compensation, since they rejected the “adequate” compensation standard and consequently acted according to the self-proclaimed “appropriate compensation for the situation of post-colonial governments” standard.\textsuperscript{53} Nonetheless, by the ’80s – while still opposing Hull’s “adequate” standard, but now only vocally and not in practice – the NIEO states began to sign BITs in great numbers, in hope – and especially in need – of foreign direct investments.\textsuperscript{54}

\textbf{d. BIT Emergence}

Parallel with these events of the late 20\textsuperscript{th} century, the BITs emerged. In the beginning, when the first were BITs, countries were still negotiating and concluding FCN treaties. However, soon BITs gained the upper hand and countries exclusively adopted bilateral and multilateral investment agreements. This does not impede that many FCN treaties which are still in force today.\textsuperscript{55}

The first BIT was signed in 1959 between Germany and Pakistan.\textsuperscript{56} After losing World War II, Germany was in an acute need of FDI. In addition, it predicted the failure of the international community to

\textsuperscript{52} UNCTAD did not succeed in implementing this New International Economic Order. Consequently, social, political and economic inequalities between industrialized and developing countries kept on growing.


\textsuperscript{55} More than 40 of these treaties remain in force today and are available at http://www.americanlaw.com/treatylist.html.

\textsuperscript{56} Treaty between the Federal Republic of Germany and Pakistan for the Promotion and Protection of
conclude a multilateral international investment agreement with universally accepted protection standards. As a result, Germany became a pioneer in the conclusion of BITs: the government initiated two-pronged negotiations with other nations, with the aim to establish reciprocal investment treaties. Over the years, German prediction was proven correct, as until present there is no universal investment treaty in existence despite the many initiatives, negotiations and debates that have been conducted on the subject.\textsuperscript{57} Indeed, nations continue to conclude BITs worldwide until this very day.

Despite Germany’s insight, it took the rest of the world almost two decades to concede this international failure and to initiate the development of their own national BIT programs.

Once these national BIT programs were launched, BITs rapidly gained momentum: they numbered 75 by the end of the ‘60s, rose to 167 by the end of the ‘70s and 389 by the end of the ‘80s. After this gradual growth, the number of concluded BITs experienced a sharp upswing in the ‘90s: there were 446 BITs in 1990, and just a decade later, by the year 2000, there were no less than 2,118 BITs signed.\textsuperscript{58} This is an increase of more than 470\% between 1990 and 2000.

The impetus for this explosion of BITs in the ‘90s can be explained diverse by different factors: the wave of expropriations and resulting fear among the home states of investors, the initiatives of developing NIEO countries to attract FDI, and the collapse of the centrally planned Soviet Union into different states with free market economies. Above all, even though a universal investment agreement never saw the light of day, states were not deterred from concluding regional investment protection chapters, clauses and agreements.\textsuperscript{59}

\textsuperscript{57} A OECD-led attempt to negotiate a global investment protection treaty, the Multilateral Agreement on Investment (MAI), was aborted in 1998. Draft MAI Negotiating Text and the MAI Document Database, are available on http://www.oecd.org/investment/internationalinvestmentagreements/multilateralagreementoninvestment.htm.


\textsuperscript{59} E.g. ASEAN Comprehensive Investment Agreement, the ASEAN – Australia – New Zealand Free Trade Agreement (FTA), Chapter 11 of the North Atlantic Free Trade Agreement and the recently signed Trans-Pacific Partnership (TPP) trade agreement among twelve Pacific Rim countries. The negotiations for a Transatlantic Trade and Investment Partnership (TTIP) agreement between the European Union and the United States are still ongoing.
By the end of 2010 there were 2,807 BITs worldwide and as of today, there are 2,951 BITs. After the BIT big bang between 1990 and 2000, where on average four BITs per week were concluded, the growth of BITs has markedly decreased over the past decade, falling on average to one new BIT per week. Consequently, some commentators assert that the IIA regime has lost a part of its dynamism, as they see this decrease as a signal that the BIT reach of countries is saturated. However, even though the adoption of new BITs has slowed down, BITs continue to be signed and the overall amount is, slowly but surely, growing. Besides, countries are sitting down to renegotiate their existing BITs, current model bilateral investment treaties are being thoroughly revised, and the amount of FDI arbitral awards is augmenting, which means that the “spaghetti bowl” of BITs is becoming more entangled and complex.

E. FDI Benefits and Disadvantages

a. Advantages

Foreign direct investment is a fundamental element in the globalization process and has a positive effect on the development of international trade, as it creates direct and solid long-lasting relations between economic systems across the globe.

For host countries, FDI inflow is an important source of capital that can increase countries’ economic growth and GDP. It further creates new employment opportunities, brings innovations and technological advancement to the domestic companies, provides access to new expertise, training and knowledge transfer to local population, facilitates access to R&D resources, and boosts the living standards in general. In addition, the capital influx can be channeled into improvement and development of a country’s infrastructure and other projects that enhance the overall development of a state.

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As for the foreign investor, FDI represents the possibility of new markets, lower raw materials costs, special tax incentives, access to a cheaper and/or more qualified workforce, all of which lead to an increase in a company’s profits.

Further, FDI can improve the competitive position of both the recipient host state and the investing home state on the global market, while at the same time, the domestically increased competitiveness will qualitatively ameliorate products and services offered to consumers, and this at a lower price.  

b. Disadvantages

On the other side, FDI encompasses also disadvantages to the host and home states. The most widespread criticism is that FDI steers the host state towards a decline of its sovereignty and regulatory space. Furthermore, some states lowering social standards and enacting lax regulations in order to attract more FDI, which can have a destructive environmental impact and weaken employee protection against socio-economic exploitation.  

The restraint on the states’ capacity to regulate their economic activities because of IIAs is a widely discussed adverse effect of such agreements. By signing an investment agreement, a state promises to comply with the legally binding protection obligations provided therein; if it fails to respect these obligations, the treaty establishes legal mechanisms that penalize the nonconforming state through dispute settlement proceedings, which can lead to substantial monetary damages being awarded against the state. The criticism is that, because states are anxious about such investment claims and no state wishes to be forced to pay compensations, they will mitigate this risk by, among other things, being more flexible and indulgent with private foreign corporations, which in their turn will increase their influence on host governments, and by barely utilizing their regulatory space regarding environmental protection and labor rights. As such, the preservation of sufficient autonomy to pursue national policy objectives – in an unrestricted and unbiased way – is considered fundamental for a sovereign state.


68 However, this sovereignty issue was more relevant during the period of the one-sided BITs of last century than in today’s treaties. In addition, there is a lot of attention devoted to safeguarding a government’s regulatory space in diverse arbitral awards, academic literature and the changing attitude of the modern BITs and their model texts.

69 Supra note 62.


71 Supra note 62.
Not only will a state be deterred from regulating in favor of environment and labor rights, even worse, it may also relax its regulatory standards in these areas in order to attract additional foreign capital. As such, lobby groups and NGOs are tremendously worried that states are creating unhealthy and dangerous working conditions for their citizens, together with “pollution havens” for multinationals, which accelerate the “race to the bottom” phenomenon.\(^{72}\)

Beyond the detrimental effects on the environment, labor rights and corporate social responsibility, another criticism of FDI is pointed at the expansion of foreign control over certain sectors, in particular the energy sector. States and individuals are concerned that this may create a dependency problem, whereby a host state becomes too dependent on foreign capital inflow and, if the foreign investor withdraws his investment to reinvest elsewhere, the host state’s economy will be significantly impaired. Similarly, with regard to job creation in the host state based on FDI, this may be only of a short-term nature and at a low pay rate. Lastly, among the potential disadvantages for the home state, it is argued by some that FDI causes job losses in the host state, replaces exports, and reduces domestic capital and investments.\(^{73}\)

**F. FDI Outlook**

The future of FDI and its increasingly dense network of treaties is fascinating. After the massive BIT explosion in mid-’90s and the subsequent proliferation of almost 3,000 separate treaties, international investment law has experienced many challenges in recent years. According to some authors, the outlook for FDI is cloudy, as the adoption of bilateral investment treaties has been declining, and states occasionally terminate their existing BITs\(^{74}\) or withdraw\(^{75}\) from the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention).\(^{76}\) Similarly, negotiations for a multilateral investment agreement have undeniably failed, which once more highlights the extent of disagreement in the international community on treatment standards for foreign investors.\(^{77}\) Furthermore, there are serious concerns

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\(^{74}\) E.g. Bolivia and Spain have terminated their BIT in 2012 and Ecuador and Finland did the same in 2010. In 2013, South Africa served a notice of termination in respect of its BIT with Spain, and more recently, Indonesia has decided to terminate its BIT with the Netherlands and Bulgaria in 2015.

\(^{75}\) Bolivia, Ecuador and Venezuela have denounced the ICSID Convention respectively in 2007, 2010 and 2012.

\(^{76}\) Convention on the Settlement of Investment Disputes between States and nationals of Other States, done at Washington, 18 March 1965, entry into force, 14 October 1966. 575 U.N.T.S. 159. ICSID is part of the World Bank Group and is an international arbitration institution for international investment dispute resolution. Many states have agreed on ICSID as a forum for investor-State dispute settlement in numerous international investment treaties, investment laws and contracts.

\(^{77}\) D. Collins, *The BRIC States and Outward Foreign Direct Investment*, Oxford, Oxford University Press, 2013,
about transparency and the complexity of newly concluded BITs. Fragmentation, regulatory competition and treaty shopping are just some of the many undesirable consequences of this “spaghetti bowl.”

Nevertheless, states are continuing to negotiate and conclude new BITS, while investors carry on their businesses away from their home states. This is best illustrated by the rise of the global investment flow by 36% in 2015, which led to an estimated US$ 1.7 trillion of FDI worldwide, which is its highest level since the financial crisis of 2008.

Another trend is the end of the traditional one-sidedness of so-called “North – South” FDI between developed and developing states. Today, the underlying dynamics of foreign capital flows have changed. A complex web of universal relations has emerged and made the long history of the North-South paradigm outdated. Developing countries are no longer solely host states to foreign investors, but have also become their home states. At the same time, developed states now also function as host states to FDI from emerging markets. Moreover, least developed countries (LDCs) have developed their own Model BITs and investors from these LDCs are investing in their neighboring countries, which are often fellow LDCs, creating so-called “South – South” FDI. In fact, one third of contemporary BITs are concluded between developing countries due to a significant amount of investments flowing from the South and the East to the West.

Through the globalization of FDI, there are rising concerns from the international community regarding environmental standards, labor laws, human rights protection, corporate responsibility and regulatory space of host states. Consequently, there is a growing global expectancy that future FDI policies should take non-economic values and pressing public policy issues into account when developing new BIT programs and FDI legislation.

136-137.
78 Supra note 24.
In order to meet the needs of the international community and keep up with the modern developments, state governments and their BIT negotiators will have to take action.\textsuperscript{84}

A first step will be to review their Model BITs and the previously concluded BITs with other nations. This is important as the majority of BITs were concluded by developed, capital-exporting countries, that forced their interests upon developing host states. Luckily, this one-sided FDI flow is changing as foreign investments now flow in both directions and there is an increasing presence of non-Western firms in the United States and Europe. Thus, gradually, governments in developed countries are becoming more reciprocal and are devoting the required attention to the protection of foreign investors.

Next, FDI in developing countries will have to become more service-focused and less extraction-focused.\textsuperscript{85} Some commentators note that this shift may, however, put competitive pressure on services-focused developed countries, as they are unable to compete successfully in the extraction sector because of high labor costs, which in its turn may lead to a protectionist response in form of restrictions on foreign ownership, refusal to recognize foreign academic and professional qualifications, and the expropriation of foreign assets.\textsuperscript{86}

Lastly, it must be remembered that new economic powers are emerging, including Brazil, China and India. This is attested by a change in the export patterns of FDI, as new multinational corporations enter the scene, including the state-owned oil corporations of China and India that are pursuing mergers with existing Western multinationals. The role of these rising economic powers has shifted from being solely importers to also being exporters of foreign capital, just as it has been traditionally the case with other developing countries.

Consequently, the original BITs and IIAs in general, which once protected investors of North America and Europe against potential harm in developing countries, can come back to haunt them as Western states have become host states to FDI from developing states.\textsuperscript{87} According to Sornarajah, this shift is perceived as a "\textit{prelude for a future assertion of sovereign control of such investments by the developed states and a selective relinquishing of the inflexible rules on investment protection that these states}

\textsuperscript{84} For example, the 2012 US Model BIT now incorporates provisions on environment (Article 12) and employment (Article 13) protection, while the investment chapter in the Canada-Peru FTA contains corporate social responsibility clauses (Article 810).

\textsuperscript{85} Russia is the perfect example of such an extraction economy. See Chapter 3.1.


\textsuperscript{87} E.g. the US-Canada-Mexico NAFTA saga.
had built up.” Thus, the rules that the developed states had written to protect the investments of their nationals will soon backfire, as these new multinational corporations from developing countries will shape the future rules of the game. As Sornarajah points out, developed countries may now have to take shelter themselves in the “sovereignty and regulatory space” arguments that the developing states of the NIEO movement have made in the past.

Chapter 2 – Model BITs of US and Russia

A. Background

Home states wanted to protect their investors abroad, while host states needed to provide the investors with legal guarantees in order to encourage the inflow of private capital; as no international framework existed that responded to both of these needs, the only way left to generate protection and promotion of FDI was through bilaterally negotiated agreements.

Today, the universe of bilateral investment treaties numbers close to 3,000. The majority of these BITs have been negotiated on the basis of a template, known as a Model BIT, but through a give-and-take process between the parties and given the specific context of each state involved, a compromise is reached that embodies the final BIT.

When the first BITs were signed by the end of the 20th century, model negotiating texts were almost exclusively drafted by industrialized countries, as they were the main capital-exporters and thus the home states of investors seeking formal protection of their investments. Hence, no such thing as a compromise existed back then, because the developing countries just accepted the Model BITs without any adjustment and as such, the industrialized nations held the upper hand in the “negotiations”. They served exclusively as host states for investments and fulfilled a capital-importer role. At the time, FDI flowed only in one direction and, accordingly, the Western world created Model BITs which imposed substantial obligations on the legal systems of the Third World states, that were supposed to provide the incoming Western investors with certain legal protection measures. As these countries did not even provide these protection measures to their own citizens, they had to completely adapt their legal

89 Just as in the past with NAFTA, with regards to the United States and Canada.
91 Supra note 57.
frameworks and judicial systems. These states were not in a position to oppose these conditions, as they needed to attract capital, liberate their economies and project an image of themselves outwards to the global market as reliable, business-worthy nations.

With the arrival of 21st century globalization, this situation has changed. Today, the former capital-importing countries are gradually exporting capital to the West and are developing their own model negotiating texts. This increasing two-way FDI flow has been stimulated by universal exchange of expertise, technological advancements and increasing interest in developing countries and their markets, but more importantly, by the failure and inability of the international community to create a single multilateral agreement on foreign direct investments. The intersection of these different factors explains the explosion of BITs by the end of the ‘90s and beginning of the ‘00s.

This dissertation assesses the Model BITs of the United States and the Russian Federation, respectively. As a BIT is a tool by which two nations protect the investments of their citizens abroad and through which they seek to attract foreign investors into their territory, the Model BIT is the best representation of the investment policy and standards of a country. In the context of FDI, it stands for the core economic values a nation upholds and the legal safeguards it is willing to grant to foreign investors, before the negotiations commence and a bilateral compromise has to be made.

**B. What is a (Model) BIT?**

A BIT primarily aims at protecting the private investment of a state’s national from detrimental treatment by the government of its contracting partner state, through guaranteeing diverse minimum standards of treatment and investment protection obligations. This boosts in its turn a country’s image of being a reliable trading partner and hence fulfills the second objective of a BIT, which is attracting FDI.

The main feature of the modern BITs is their reciprocity, as such investment safeguards ensure that investors from both contracting parties can enjoy a stable and predictable legal environment when making an investment in the other state. Thus, a final BIT is a bargain that compromises between the respective interests and policies of both nations.

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94 *Supra* note 57.
95 Even though it has been different in the past, *supra*.
BITs are typically negotiated on the basis of a Model BIT, a model negotiating text that serves as a starting point for every bilateral treaty negotiation between two nations and depicts each state’s attitude towards foreign investment, the general economic policy and the protection terms and mechanisms they present to alien investors. As such, a Model BIT outlines the regime in which the foreign investor will operate and manage his investment abroad.

The use of model BITs is an efficient and convenient way for countries to conduct BIT negotiations, reduces their transaction costs and rapidly expands their BIT network. Although the end product of the negotiations represents a compromise, the use of a Model BIT is also a means for ensuring consistency in a country’s policy and an approximate uniformity of the protections extended to their citizens’ investments in the many concluded bilateral treaties.

In addition, the practice of a state when conducting negotiations on the basis of a Model BIT is of great significance for lawyers and arbitrators when they examine a provision in a disputed treaty. Lawyers and arbitrators commonly ask themselves: what is the state’s practice when negotiating a BIT? Does it fully adhere to its Model BIT or does it allow some flexibility over some provisions? Is it the custom to significantly deviate from the Model BIT in the eventually concluded bilateral investment treaty? The answers to these questions are essential when analyzing a state’s BIT practice and interpreting a state’s obligations.

The worldwide treaty-making trend has ensured that a certain degree of homogeneity in the Model BITs has been instituted. Particularly, the homogeneity can be found among the protection standards that states offer to their contracting treaty partners. These protection standards often incorporate principles from customary international law and the investment safeguarding standards that were already in use in the Treaties of Friendship, Commerce and Navigation that states zealously concluded for over the past 200 years.

Lastly, states regularly conduct revisions of their model texts, which means that countries’ investment practices and policies are perpetually changing; this usually occurs in response to their shifting interests-in particular business relationships and their experiences from prior BIT litigation, as we shall see in the next chapters.

C. Model BIT Structure

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Even though every bilateral investment treaty is custom-made and adapted to the particular interests and concerns of both state parties, the majority of BITs have similar content provisions and follow an analogous structure. As mentioned above, many states have considered it efficient to develop model texts for future BITs they seek to conclude, and as such, these model agreements also contain a particular structure. The structure of a typical Model BIT resembles:97

**a. Preamble**

Usually, the first provisions of a Model BIT form the preamble which sets out the parties’ aims. Two fundamental objectives are typically found in here: protection and promotion of FDI between the two nations. Of note, the international law principles of treaty interpretation have to be kept in mind, as the stated goals in the preamble can broaden or limit the scope of the treaty obligations.

**b. Definitions**

The next section is most likely devoted to the definition and explanation of the key terms of the model text. Definitions are typically provided for what will be seen as an “investment”, who will be considered as an “investor” and what “national treatment” and “most-favored nation treatment” exactly mean.

**c. Scope**

The Model BIT will limit its scope to the investors and investments of contracting state parties. However, as these terms have already been well-defined in the previous section of definitions (and thus have a rather restricted reach), the application of these terms can be expanded through the scope provisions, under which an investor or an investment still will be able to benefit from the treaty’s protection, in case it would not fall under the original definition.

**d. Market access**

Some model bilateral treaties establish clauses regarding access of one party’s investment to the market of the other party, which allow a host state to admit foreign investments “in accordance with its national legislation.” The main objective of such market access provisions, is to let both parties retain the freedom to screen FDI before admitting it to their territory, and to do so only if it is in the country’s national interest.

**e. Protection standards**

This section deals with the treatment and protection owed by the host state to foreign investors and their investments. Among most popular protection standards we can find: obligations of full protection and security, non-arbitrariness, fair and equitable treatment, national treatment and most-favored

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nation treatment, free transfer of payments and expropriation only with compensation. Depending on the Model BIT, some of these standards can be found in one single clause, while in other model texts they will be divided among separate articles.

\( f. \) Dispute settlement

Almost all Model BITs will contain an arbitral procedure that must be followed in case a dispute arises between the parties to the agreement. As the parties are sovereign states, a state can bring an action against the other state, in cases where the other state did not provide sufficient protection to the foreign investment of its national or violated the BIT in any other way. Besides this option for State-State dispute settlement, Model BITs also frequently provide the possibility of an investor-State dispute settlement, wherein a private investor can bring a claim against the host state before an arbitral tribunal. Lastly, it is up to the state parties to decide on the available arbitration fora and to negotiate on the applicable rules of the arbitral proceedings.

\( g. \) Final provisions

Like any other international treaty, a Model BIT also encloses ratification requirements, the conclusion date of the treaty and the date of the entry into force of its obligations, together with procedures for amending or terminating the BIT.

\[ \text{Chapter 2.1 – Model BIT of the United States (US)} \]

\[ \text{A. Introduction} \]

The United States is one of the many countries that concludes bilateral investment treaties with other states on the basis of a model negotiating text. Such a Model BIT consists of core content and a basic structure, which establish the guiding framework for the country’s negotiations (especially with respect to the non-negotiable provisions). In addition, it expresses the current US policy on foreign investment and contains its modern objectives when concluding bilateral treaties, which have evolved tremendously over the last decades.

The most recent US Model BIT dates from 2012 and has known no less than ten predecessors. However, the fundamental provisions, and especially the ideology behind the Model BIT as it is today, go back to Chapter 11 of the North American Free Trade Agreement (NAFTA) of 1994,\(^98\) and the state’s

\[^98\] NAFTA is a trilateral trade agreement concluded between Canada, United States and Mexico that aims to establish one of the largest free trade zones in the world by eliminating most tariff and non-tariff barriers to trade and investment among the parties. Its goal is to foster economic growth and prosperity. Chapter 11 of NAFTA provides specific protections to foreign investors (for example obligation of national and most-favored
arbitration experience as a respondent in numerous claims under that chapter. These unexpected claims were the sweeping forces behind the current 2012 Model BIT.

This section will shed light on the history of the US BIT program. Second, it will discuss modern US investment policy. Lastly, it will examine the core protection provisions of the 2012 US Model BIT, which reflect the extent of protection the most recent US Model BIT offers to alien investors on US territory, and the extent of protection US investors (are expected to) receive when investing abroad. This section will close with concluding remarks.

B. Evolution of the Objectives of the US BIT Program

Since the United States concluded its first BIT in 1982, with Egypt, to the last one it ratified in 2008, with Rwanda, the United States has signed 47 BITs, of which 41 are currently in force, while negotiations for prospective BITs with countries such as China and India, are ongoing.

The US BIT program is led by the US Department of State and the Office of the US Trade Representative, with the assistance of Departments of Commerce and the Treasury. The program was conceived in 1977 under the Carter Administration, and replaced 19th and 20th century FCN treaties. Since the beginning of the bilateral investment treaty program, the Model BIT has been revised and fine-tuned regularly by the US government, so it would stay in line with United States’ evolving objectives. The first Model BIT was finalized in 1981, with successor models finalized in 1983, 1984, 1987, 1990, 1991, 1992, 1994, 1998, 2004 and 2012.

nation treatment), together with remedies in form of binding dispute resolution mechanisms. See http://www.naftanow.org/about/default_en.asp.

101 BITs with Belarus, El Salvador, Haiti, Nicaragua, Russia and Uzbekistan have been signed, but not ratified by one of the parties. See http://www.state.gov/e/eb/ld/bi/117402.htm.
105 Ibid, 2.
As suggested by the top authority in international investment law and the former BIT negotiator for the United States, Professor Kenneth J. Vandevelde, the evolution of the US bilateral treaties and the policy behind them is defined by three waves:106

- The first wave from 1980 – 1986, which is from negotiating the first US Model BIT to transmitting to the US Senate the first ten negotiated BITs with other states for ratification.
- The second wave from 1989 – 1999, which is from receiving the Senate’s support for the first BITs to the earliest claims against the US under NAFTA Chapter 11.
- The third wave from 2004 – present, which is from the enforcement of the 2004 Model BIT to the ongoing BIT negotiations, parallel to negotiations of investment chapters in free trade agreements (FTAs), which are based on the content of the 2012 Model BIT.

A survey of these various model negotiating texts and how they have changed over the past 30 years shows that the ideology behind the US BIT program has evolved. A closer look at the periodical reevaluations of the texts reveals that US objectives have changed remarkably over time.

During the first wave, the US concluded only ten BITs over the course of almost ten years and only with least developed countries (LDCs).107 After their conclusion, the BITs were forwarded to the US Senate for ratification.108 The US government sought to explore if the Senate would give its support to the initiated BIT program before putting effort in negotiating other BITs. The 1984 Model BIT was the primary Model for the first wave of negotiated BITs and, as formulated by Jose Alvarez, another US former BIT negotiator, it set the “gold standard” for BITs.109 According to Alvarez, at the time he was negotiating with the prospective US BIT partners, the one and only objective – without any underlying political objectives – was to guarantee fair and equitable treatment of investors within a stable legal

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108 Regarding the procedure for entering into bilateral treaties, before the official negotiations on the conclusion of a potential BIT with another state take off, the US usually shares its Model BIT first with the prospective partner state. Then it organizes extensive dialogues in order to explore if the negotiations would lead to a fruitful outcome. If the answer is affirmative, then the official negotiations commence, and once these come to an end, the finally concluded BIT still needs US Congressional approval. This entails that, as the US classifies its BITs as “treaties” under Article II of the US Constitution, two-thirds of the US Senate must give its advice and consent to the BIT before it is ratified and enters into force.

framework, wherein the United States had three primary goals: (1) payment of prompt, adequate, and effective compensation for expropriated property; (2) provision of the better national or most-favored nation (MFN) treatment; and (3) investor-State arbitration for dispute settlement. This objective was necessitated by the 1938 Mexican expropriation of US investments. As the United States was afraid of hostile and discriminatory treatment of US investments abroad, it desired to protect them in a world of Calvo doctrine – supporting, socialist and developing states. As a result, not only did the United States aspire to spread the “prompt, adequate and effective compensation” principle around the world, it also advocated for the full “gold standard” of investment protection in every negotiation it conducted in order to facilitate a fair and transparent global environment for American capital. The establishment of such legal protection is what the 1984 Model BIT and the subsequent first wave BITs – exclusively – were all about.

Contrary to this positive evaluation of the central aim of the first BIT wave, Alvarez points out that “the treaty’s reference to ‘reciprocal’ investment flows were something of a fraud,” as the US concluded BITs only with LDCs such as Bangladesh, Haiti and the then Zaire. Thus, generally speaking, there was only a one-way flow of foreign direct investment from the US to the least developed countries during the first wave. Alvarez points out that “the regulatory burden of [the 1984 Model] treaty fell almost entirely on our BIT partners. It was the Grenadas and Bangladeshes of the world that had to reform their laws to be sure that they could satisfy the US BITs standards.”110 This means that the partner states of the United States were the ones who had to reform their domestic regulatory frameworks. It were these LDC partner states that had to make sure that, among other things, they established property rights and that a protection mechanism against investment infringement by local authorities was in place. Hence, it was prerequisite for states to establish an adequate legal framework when entering a BIT with the United States and to show “minimal commitment” to the US market-oriented principles.111

As the United States drafted the 1984 Model BIT that was the basis for the negotiations with those LDCs, the United States did not worry about adapting its national laws and practices in order to meet the protection obligations in the ratified BITs, as it was not likely that many investors from those nations would enter the US market with big capital investments, and as it was even less likely that they would submit a claim against the United States for violating the BIT. Not only did the United States conclude bilateral treaties completely on the basis of the Model BIT it drafted itself and consequently

imposed upon the LDC state, it also believed that its laws were offered more protections to foreign investors than the laws of other countries, and thus it was purely hypothetical that it would breach the BIT itself. Thus, the first wave represented not only of a one-way FDI flow, but it was also a one-way exchange of non-negotiable US terms, rather than a true negotiation between equal sovereign partners.

Alvarez concluded in 1992 that “United States’ BIT partners turn to the US BIT with the equivalent of an IMF gun pointed at their heads. For many, a BIT relationship is hardly a voluntary, un-coerced transaction.” Hence, the US was focused on restraining the host states from action that would be conflicting with the interests of the US investors.

Having seen that the results of this 1982-86 experiment were positive and that the Senate had given its consent, the US government picked up its BIT negotiations in 1989, which symbolizes the beginning of the second wave in the US BIT program.

The key objective of the 1984 US Model BIT did not last and evolved over time due to changing geopolitical circumstances. One of the major events that occurred at the end of the century and characterizes the second wave of BITs for the largest part is the dissolution of the Soviet Union. A process which commenced in 1989 and effectively took place in 1991, and which at the same time represented the triumph of the United States in its ideological battle with the Soviet Union. For the United States, the fall of the Soviet Union increased prospective FDI exchanges with a dozen newly formed states and, as such, the number of potential US BIT partners grew substantially. As Vandevelde points out, the conclusion of BITs with those emerging states had not only an economic aim, but also a higher, underlying political aim. By entering into a BIT with post-Soviet states, both countries made a symbolic statement to the outside world, a statement which reflected that the new state

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embraced a free market economy and was not only open for, but also actively seeking private investment from abroad.

The freshly formed states in Eastern Europe vocally supported FDI, and as such the United States – once again – did not have to compromise its principles when negotiating BITs. Moreover, it anticipated that over the course of time these states would embrace and enact the core principles of the US BIT when establishing the rule of law in their states, drafting national investment codes and developing domestic market-oriented frameworks. Even though the new nations did not, as yet, have stable regimes or protective, reliable legal systems, the United States still endorsed their sovereignty and deemed them trustworthy to conclude reciprocal treaties. It even assisted them in their transition from centrally planned to free market economies. For example, Section 306 of the Support for East European Democracy Act of 1989 advised President George H. W. Bush to conclude BITs with Poland and Hungary in order to create a more stable and reliable legal regime for investments by US investors.119

Subsequently, in addition to the original, exclusive goal of protecting US investors abroad, the United States started promoting its foreign policy and legal standards in its new BIT partner states.120 As stated by the former Assistant Secretary of State Eugene McAllister, during the Russia-United States BIT negotiations in 1992: “The BITs help advance US values and ideas. They do so by promoting US investment, spreading US legal concepts and lending support to economic reforms and reformers in newly emerging democracies. The BITs are a means of establishing a common economic and commercial language and rules with countries struggling to move from centrally planned economies to market economies. One of the most striking results of our BIT negotiations with first the Soviet Union, then Russia, was the education process. They learned from our negotiations and applied these lessons not just in the treaty, but also in their domestic laws.”121 BITs therefore helped as emerging states did not have any familiarity with a free market system or forming a favorable business environment for foreign investors.

In total, during its second BIT wave from 1990 to 1998, the United States concluded twenty BITs with the former Soviet states.122 This was the result of its efforts to bolster a free market economy in

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121 4 August 1992 hearings in US Senate before the United States Senate Committee on Foreign Relations. Available at https://babel.hathitrust.org/cgi/pt?id=pur1.32754074685102;view=1up;seq=11;size=75.
transition economies, as a means for increasing FDI flows, together with spreading US values and legal standards abroad.

While BITs provided stabilization and transformation assistance to those newly founded foreign states, they are sometimes seen as representing the “politicization” of BITs: the use of BITs not only for the international protection of US investments, but also for the transference of US foreign policy goals and its national legal principles. Even though this development was best observable in relation to Eastern European countries, it was definitely not the only place where such politically-motivated aims occurred during the second BIT wave.

Simultaneously, on the other side of the Atlantic, the United States concluded the NAFTA with Canada and Mexico in 1994. When the United States drafted the NAFTA Chapter 11 on investments, it inserted its former Model BITs, thereby importing its previously concluded BITs and the policies behind them as the foundation for this trilateral investment chapter. The first time that the United States had to appear as defendant in investor-State arbitration under the NAFTA, however, it quickly realized that the situation had changed and its earlier non-negotiable assumptions, overconfident attitude and self-interested policies could not gain ground under the new circumstances.

The first NAFTA dispute that involved the United States came in 1998 when a Canadian investor asserted that he had been discriminated against by a US court on the basis of his nationality. However, unlike United States’ earlier contracting parties, Canada was not a least developed country, and when NAFTA was signed Canada was one of the largest sources of inward FDI in the United States. As Canadians now had a large pool of daunting potential claims against the United States, only the outcomes of initiated disputes would be able to confirm, or counter, the presumption of the strength of the US legal system and its compliance with BIT obligations it had created itself.

Quite paradoxically, the United States’ protective measures eventually backfired. While the original goal of NAFTA was to impose investment protection measures for US investors in Mexico, the treaty’s

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125 Loewen Group, Inc. and Raymond L. Loewen v. United States of America, ICSID Case No. ARB(AF)/98/3. Available at http://www.italaw.com/cases/632#sthash.zNnMOoKT.dpuf.
126 For example, the Methanex Corp v United States, a case where California’s rights to protect its ground water was challenged as a breach of the broad fair and equitable treatment guarantee.
adverse effect led to its use as a key source for entirely unexpected claims by Mexican investors against
the United States.\textsuperscript{127} For reasons such as this, the world-renowned FDI expert Muthucumaraswamy
Sornarajah has described NAFTA as a “Pandora’s box” for investment disputes against developed
states.\textsuperscript{128}

Consequently, the United States abruptly stopped negotiating new BITs, put ongoing negotiations on
hold and focused on reevaluating its self-imposed BIT obligations and the entire US investment policy
and objectives. Even though the US government presented a strong and protective investment
environment for alien investors, the country was still exposed to robust investment claims based on
treaties based on its own Model BIT. This anxiety precipitated the revision of the 1998 Model BIT in
1999, and led to the fundamentally different 2004 Model BIT.

It was not only the United States that had generally negative experience with NAFTA’s investment
chapter and the litigation deriving from it.\textsuperscript{129} At the same time, this chapter faced criticism from various
places, principally with regard to the shrunken legislative sovereignty of the signatory countries and
the absence of transparency in the arbitral proceedings.\textsuperscript{130} In particular, it was broadly contended that
the articles that permit the foreign investor to bring a direct claim against a state and which
consequently lead to the condemnation of the state result in significant damages,\textsuperscript{131} and restrain states
from regulating in the public interest. Thus, the prospect of an extremely costly lawsuit and/or
unfavorable award was a significant consideration for the governments when regulating. In addition,

\textsuperscript{127} For example, the United States and Canada revised their petroleum contracts on the ground that they had
become injurious to state interests and the US had eventually legislation that put a control on inward FDI which
caused national security concerns. M. Sornarajah, \textit{The International Law on Foreign Investment}, Cambridge,
\textsuperscript{128} \textit{Ibid}, 25.
\textsuperscript{129} Chapter 11 of NAFTA has been subject to many controversy, especially with respect to its provisions
surrounding expropriation and investor-State dispute settlement mechanism, with \textit{Methanex v United States}
and \textit{Metalclad v Mexico} being the most famous cases. In addition, opponents of the NAFTA assert that the
Chapter 11 provisions establish additional rights for big investing enterprises, with the result of creating
loopholes for them in the rule of law, together with giving in on public interest. See S. Singh and S. Sharma,
“Investor-State Dispute Settlement Mechanism: The Quest for a Workable Roadmap”, \textit{Merkourios -
\textsuperscript{130} A.K. Anderson, “Individual Rights and Investor Protections in a Trade Regime: NAFTA and CAFTA”, \textit{63
\textsuperscript{131} J. Byrne, “NAFTA Dispute Resolution: Implementing True Rule Based Diplomacy through Direct Access”, \textit{35
if a state had to pay damages to investors, they would result in higher tax rates for the state’s citizens, as can be illustrated by the under NAFTA resulting Metalclad and Methanex cases.\textsuperscript{132}

Another criticism directed towards NAFTA Chapter 11 is that it provides foreign investors more rights than it does to a nations’ own investors, as the treaty allows alien investors to bring claims against the governments of Canada, US and Mexico, whereas such rights are not given to domestic investors due to each state’s sovereign immunity.\textsuperscript{134}

A final criticism of NAFTA is the absence of transparency. Under NAFTA Chapter 11, the disputing parties must commence the arbitral proceedings either through ICSID or UNCITRAL Rules. However, neither set of rules allows for an arbitral decision or awards to be published without the parties’ explicit consent.\textsuperscript{135} As such, this lack of transparency forms another source of concern for litigation where public interests are disputed.\textsuperscript{136} Therefore, it has been widely advocated that cases, for example those involving public safety and the health of citizens, must allow affected citizens and NGOs to participate in the arbitral process. As a result, in modern BITs – especially those by the United States and Canada – these demands have been met.\textsuperscript{137}

As a result, even though the US has never been condemned to damages and has prevailed in all arbitrations that led to an award,\textsuperscript{138} its investor-State arbitration experience under NAFTA Chapter 11 has largely colored its current mindset towards protection of foreign investments. It has made the United States more cautious when drafting model BITs and negotiating BITs with other states, and it reflects not only from the perspective of a capital-exporting state, with a one-way FDI flow, but at the same time, it puts itself in the shoes of a capital-importing state.

\textsuperscript{132} In the case of Metalclad v Mexico, the government of Mexico was held liable to pay damages of US$ 15.6 million, a load which in the end was carried by the Mexican taxpayers. Metalclad Corporation v. United Mexican States (2001) ICSID Case No ARB(AF)/97/1, 40 ILM 36.

\textsuperscript{133} Methanex Corp. v United States (2005), UNCITRAL Case, Final Award of the Tribunal on Jurisdiction and Merits, 44 ILM 1345. This case highlights this controversy which allegedly leads to the state governments paying damages, in order to be able to regulate and enact environmental laws, if those laws reduce the anticipated profits of foreign investors. See W. T. Waren “Paying to Regulate: A Guide to Methanex v. United States & NAFTA Investor Rights”, 31 ELR 10986, 2001.

\textsuperscript{134} Supra note 130, 1067.

\textsuperscript{135} Article 48(4) ICSID Arbitration Rules and Article 34(5) UNCITRAL Arbitration Rules.

\textsuperscript{136} Supra note 130, 1080.

\textsuperscript{137} See further in the article-by-article discussion of the 2012 US Model BIT.

At present, the United States negotiates BITs on a substantially different model agreement, with the following 2004 Model BIT being the inception of the third wave in the US BIT program.

Whereas the first wave was exclusively about legal protection of US investors, and the second wave had a political statement and the dissemination of US legal standards in the transition nations as focus, the third wave was fixed on global trade. The United States recognized that more and more foreign investors were coming overseas to invest in its country and that those investors were more assertive and aware of their rights due to precedents established by infamous NAFTA litigation. Yet, even though the US government undeniably wanted to keep attracting alien investors and never stopped seeing FDI as a vital component for its economic growth, it had to remodel and reinforce its shield against foreign investment claims. These considerations resulted in the 2004 Model BIT.

The US saw the overly broad and open-ended investment protection obligations of previous BITs as the source of a great portion of NAFTA arbitration. Therefore, in the course of the last decade, the United States became much more careful and alert with regard to the expansion of FDI protection to foreign investors, and the spirit of the original one-way investment flow and one-way BIT imposition vanished completely. These days, not only the protection of US capital is the epicenter of the country’s policy, but the US government also devotes significant attention to the – now existing – reciprocal aspects in the BIT negotiations and the FDI flows.

This increased awareness towards broad protection guarantees to foreign investments on US territory, as well as the extinct assurance that the domestic US laws and practices are sufficient and cannot conflict with US BITs, loudly resonate in the 2004 and 2012 US Model BITs. In those Model BITs, the US government focused on minimizing its losses and mitigating its risks. It tried to balance between preserving its core protection standards from the 1984 BIT program, while ensuring that these guarantees were not overly broad and open to use against itself.

This strategy is reflected in the narrowed scope of particular definitions and substantive protections, including limiting the offered minimum standard of treatment and fair and equitable treatment, the elimination of several clauses, e.g. the umbrella clause, and the implementation of new articles that

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139 See Preamble and Articles 12 and 13 in 2012 Model BIT.

140 The “umbrella clause” is a provision that states can include in their BITs, which has as effect the provision of additional protection for foreign investors. Commonly, BITs cover only disputes relating to breaches of “obligations under this agreement”, i.e. only for claims of BIT violations. With the umbrella clause, investors can enjoy a wider protection, as “any dispute relating to investments” is now also included in the bilateral treaty protection. For history, litigation and different formulations of the umbrella clauses, see Y. Small,
address environmental and labor rights.\textsuperscript{141} Nowadays, the host states to FDI can finally make use of their sovereign right to regulate in the public interest without being penalized for it.

As a result of these additional provisions, the 2004 Model BIT was twice as long as the original model texts and signifies a substantial leap in the US BIT ideology: it changes from an overly open-ended and self-centered approach, towards one that not only reveals a careful and self-preserving attitude, yet one that is actually reciprocal.

The 2012 Model BIT is the most recent extension of this evolution, and was only modestly modified compared to its 2004 predecessor: it incorporates most of the text of the 2004 model agreement and reaffirms its policy goals, while its changes pale in comparison to the massive, almost revolutionary, modifications that the 2004 Model brought along. Even though the complete revision had begun in 2009 and took three full years to complete, the reexamination resulted in a carefully and meticulously adjusted model agreement. This insubstantial readjustment of the 2004 Model BIT makes the current text even more comprehensive and polished. It clarifies indistinct provisions, gives precision to several procedural proceedings, adds more transparency to future BITs, elaborates on the dispute settlement mechanism, emphasizes protections related to labor and environment, and especially – inspired by the unpleasant NAFTA experience – delicately tries to eliminate prospective litigation. All of these changes will be discussed under the core protection provisions in the 2012 Model BIT below.

The third wave’s focus on global trade and reciprocity is best illustrated by US President Barack Obama, who said: “That’s my commitment to you. Because we are confident that if you invest in any of the communities that are represented here, what you will find is not only outstanding workers, and not just outstanding infrastructure, and not just an extraordinary market, and not just cheap energy, but what you will find is that the American people like doing business and they respect business, and they’re looking forward to working with you to make sure that your companies succeed, and that the faith that you place in those communities is ultimately going to result in outstanding results for your company.”\textsuperscript{142}

C. Modern US Investment Policy


When reading through the 2012 US Model BIT and the commentaries thereon, it is important to keep in mind the general US economic agenda and investment policy the government, although more cautiously due to its experience with NAFTA. The main aims of the current US BIT program are stated in the preamble to the 2012 Model BIT. It describes the fundamental policy on foreign investments and the US objectives when its government signs a bilateral treaty with another state. The preamble, however, does not impose any binding legal obligations on the state parties. It rather serves as a source for interpretation of substantive BIT provisions in case a dispute arises. Nevertheless, as the commentators Caplan and Sharpe emphasize, when interpreting a BIT provision, the interpretation must always start with the specific language of the provision itself.\textsuperscript{143}

The preamble reads as follows:

\textit{The Government of the United States of America and the Government of [Country] (hereinafter the “Parties”);}

\begin{quote}
Desiring to promote greater economic cooperation between them with respect to investment by nationals and enterprises of one Party in the territory of the other Party;
Recognizing that agreement on the treatment to be accorded such investment will stimulate the flow of private capital and the economic development of the Parties;
Agreeing that a stable framework for investment will maximize effective utilization of economic resources and improve living standards;
Recognizing the importance of providing effective means of asserting claims and enforcing rights with respect to investment under national law as well as through international arbitration;
Desiring to achieve these objectives in a manner consistent with the protection of health, safety, and the environment, and the promotion of internationally recognized labor rights;
Having resolved to conclude a Treaty concerning the encouragement and reciprocal protection of investment;
\end{quote}

As we can deduct from this preamble, the United States puts great emphasize on the promotion and protection of foreign investment in its country – inward FDI – and investment by its citizens abroad – outward FDI.\textsuperscript{144}

As expressed by President Barack Obama: “I want more American products being sold in your countries, and I want your companies investing more here in the United States of America. I’m here because I want your companies to know – I want companies around the world to know – that I believe there is


\textsuperscript{144} “Investment is not only a domestic issue. Our businesses invest in order to export to foreign markets and there are substantial cross-border investment flows. The President is committed to opening up foreign markets to American goods, a step that would increase the return to making investments in the United States. Trade also has been shown to increase innovation by increasing competition and also through learning by exporting.” Statement by the Chairman of Council of Economic Advisers, Jason Furman on 30 September 2015, “Business Investment in the United States: Facts, Explanations, Puzzles, and Policies”, available at https://www.whitehouse.gov/sites/default/files/page/files/20150930_business_investment_in_the_united_states.pdf.
no better place in the world to do business than the United States of America.” And why is this so? “This is because we have a strong and open economy, the world’s most productive workforce, a unique culture of innovation and entrepreneurship, remarkable colleges and universities, and a business environment marked by transparency, protection of intellectual property, and the rule of law.”

According to President Obama, “investments by foreign-domiciled companies and investors create well-paid jobs, contribute to economic growth, boost productivity, and support American communities” and are therefore of vital importance to an economy.

Resultant from such statements, specific investment-promotion initiatives have been developed to stimulate both inward and outward FDI, such as the establishment of the SelectUSA Investment Summit, the reform of the L-1B workers visa category for employees of international companies and improvement to its intellectual property protection regime.

According to the latest World Bank’s Doing Business report of June 2015, the United States offers to foreign investors an open, transparent and non-discriminatory investment climate, which positions it 7th out of 189 economies for ease of doing business. The World Bank states that “the best performers

147 Ibid.
148 SelectUSA is the first government program to attract foreign investment and increase employment in the US. Since its establishment in 2011, SelectUSA has facilitated more than US$ 20 billion of investments in the US, generated numerous jobs and endorsed the economic growth. For more information, see http://selectusa.commerce.gov/.
149 L-1B visa category is a non-immigrant visa that allows international companies, with offices in both the United States and abroad, to temporarily deploy workers with specialized knowledge to the US, when launching or conducting operations in the US. With the recent initiative by the Obama Administration in order to spur the American economy, U.S. Citizenship and Immigration Services will increase clarity around the adjudication of this visa, which will allow foreign companies to obtain this visa in a faster and simpler way. See U.S. Citizenship and Immigration Services (USCIS) at https://www.uscis.gov/working-united-states/temporary-workers/l-1b-intracompany-transferee-specialized-knowledge.
150 “Investments further benefit from the world’s best intellectual property protection regime. Government fees for obtaining a U.S. patent are among the lowest in the industrialized world. Appropriate trademark protections protect companies’ investments in brand and reputation. The U.S. Patent and Trademark Office bolsters those protections by performing “relative grounds examination” of trademark applications, ensuring that potential trademarks are not likely to be confused with currently active, registered trademarks. This up-front vetting of a brand or mark guards against potentially costly trademark disputes in the future.” Department of Commerce and the President’s Council of Economic Advisers, Foreign Direct Investment in the United States Report, October 2013, available at https://www.whitehouse.gov/sites/default/files/2013fdi_report_-_final_for_web.pdf.
151 With only Singapore, New Zealand, Republic of Korea, Hong Kong and UK ahead of it. For a complete comparison across 189 economies—from Afghanistan to Zimbabwe, see
are not those with little regulation but those with good rules that allow efficient and transparent functioning of businesses and markets while protecting the public interest.”

These policies result in the United States being the world’s largest recipient of FDI. With an estimated US$ 384 billion in inflows in 2015, the United States is the number one FDI destination in the world.

Furthermore, another aspect of the US policy that is quite progressive and innovative compared to the majority of the world’s Model BITs, is the attention it gives to environmental protection and the protection of labor rights. From its experience as respondent in several NAFTA disputes, the US government now seeks to maintain a fair balance between the rights accorded to foreign investors operating in the United States, and its own sovereign rights to regulate health, labor and environmental matters.

By realizing all these policy aspects through its most novel 2012 Model BIT, the United States sets an example to countries in all corners of the world and profiles itself as a forward-looking nation, which not only prioritizes its own economic interests, but also puts the protection of human rights, amelioration of health and living standards, and the preservation of the environment on its agenda.

As affirmed by a joint statement issued by the US Department of State and the Office of the United States Trade Representative, in 2012: “The 2012 U.S. Model BIT text will help ensure that U.S. companies benefit from a level playing field in foreign markets, providing effective mechanisms for enforcing the international obligations of our economic partners, and creating stronger labor and environmental protections. The 2012 Model BIT also supports our strategic international commitment to a robust economic agenda. It will play a critical role in ensuring that American firms can rely on strong legal protections when competing for the 95 percent of the world’s consumers who live outside the United States, as well as in promoting good governance, the rule of law, and transparency around

http://www.doingbusiness.org/rankings.


the world. BiTs such as those based on the U.S. Model, will improve investment climates, promote market-based economic reform, and strengthen the rule of law.”

Nevertheless, the reactions to the newest Model BIT have been markedly divided. Opponents claimed that it has barely changed from the 2004 version and that it does not satisfactorily protect domestic public interests. In fact, even the proponents had stated that they were disappointed that the new model text did not go far enough to address the concerns that labor unions and public interest groups have raised regularly for many years. According to them, during the review process, many of their proposals were simply overlooked. Overall, they concluded that the model BIT “made some progress but fell well short of expectations.”

D. Core Protection Provisions

The 42-page 2012 US Model BIT is the most detailed BIT yet drafted, and consists of 37 articles and two annexes. After the preamble, Article 1 contains the definitions specific for the US Model BIT and Article 2 precises the general scope and coverage of the prospective bilateral treaty. Articles 3 through 13 govern the principal substantive obligations of the parties, Articles 14 through 21 create the exceptions and qualifications to the substantive obligations, and Article 22 develops the provisions on the duration of the future BITs. Lastly there is a whole section (Articles 23 through 36) that discusses the process for resolving disputes that may arise between a foreign investor and the host state, which are called investor-State disputes. Finally, Article 37 provides a mechanism for resolving inter-State disputes regarding the interpretation or application of the bilateral treaty.

The core principles of the US BIT program ensure all investments made in the United States with the following six fundamental benefits: (1) the better of national treatment or most-favored nation (MFN) treatment from the very establishment of an investment; (2) protection from expropriation and payment of prompt, adequate and effective compensation; (3) freedom of transferability of means and funds; (4) limitation of performance requirements; (5) submission of disputes for settlement directly to international arbitration; and (6) non-rigidness on nationality of top managerial staff in the

157 Statement released by the Emergency Committee for American Trade (ECAT) on 20 April 2012.
159 Ibid, 5.
investing enterprise. It is worth mentioning that there are two other traditional protection norms, namely fair and equitable treatment, and full protection and security.

**Figure II. Six core BIT principles**

![Diagram of Six core BIT principles]

*Source: US Department of State*\(^{160}\)

All six core BIT principles, together with other important standards of protection, will be discussed now, followed by exceptions and qualifications to these substantive provisions, and rules on dispute settlement on investor-State and State-State levels.

The formal name for the most recent US Model BIT is:

**2012 U.S. Model Bilateral Investment Treaty**

*TREATY BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF [Country] CONCERNING THE ENCOURAGEMENT AND RECIPROCAL PROTECTION OF INVESTMENT*

The first substantive, and thus legally binding, core FDI protection principles, can be found in the interrelated Articles 3 and 4 of the Model BIT, which respectively contain the national treatment and the most-favored nation (MFN) treatment protections.

a. Article 3: National Treatment and Article 4: Most-Favored-Nation (MFN) Treatment

Article 3: National Treatment

1. Each Party shall accord to investors of the other Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory.
2. Each Party shall accord to covered investments treatment no less favorable than that it accords, in like circumstances, to investments in its territory of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
3. The treatment to be accorded by a Party under paragraphs 1 and 2 means, with respect to a regional level of government, treatment no less favorable than the treatment accorded, in like circumstances, by that regional level of government to natural persons resident in and enterprises constituted under the laws of other regional levels of government of the Party of which it forms a part, and to their respective investments.

Article 4: Most-Favored-Nation (MFN) Treatment

1. Each Party shall accord to investors of the other Party treatment no less favorable than that it accords, in like circumstances, to investors of any non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory.
2. Each Party shall accord to covered investments treatment no less favorable than that it accords, in like circumstances, to investments in its territory of investors of any non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

These two articles provide key non-discrimination responsibilities, which are interconnected, regarding the treatment of an investor and its investment in a host state. They oblige each state party to accord the investors, and their investments, a treatment that is no less favorable than that accorded, in like circumstances, to the party’s own citizens-investors and their investments (national treatment), and to investors of other nations and their investments (MFN treatment). As was already stated in one of its first Model BITs, the main goal of US investment regime behind these two provisions, is “to get the best possible treatment for US investors in the host country and to assure this treatment in a treaty obligation.”\(^{161}\)

It is also worth mentioning that the preceding US model texts additionally required that each party must accord the more favorable treatment, whether national or MFN.\(^{162}\) However, this requirement has been eliminated from the latest 2012 Model BIT, as it is now viewed as unnecessary since the investor must be in any case allowed to invoke the better of the two treatments, without an explicit written treaty permission to do so.

\(^{161}\) 1993 USG Responses to US Senate, 23.

\(^{162}\) See e.g. 1994 Model BIT, Art. 2
Further, unlike provisions on compensation in event of expropriation and the obligation to provide fair and equitable treatment, the national and MFN treatment requirements do not constitute customary international law. These obligations are binding on the contracting states only due to the states’ own consent and commitment to the BIT in question.

Lastly, Articles 3 and 4 form relative standards of treatment instead, thus making the treatment owed by the host state not predetermined, but dependent on the treatment that the host state accords to its own and other states’ investors.

**Article 3 Specifications**

This provision in the 2012 Model BIT embodies a longstanding concept of the US BIT regime. The goal of this protection guarantee is to prevent the host state from providing a competitive advantage to domestic investors on the basis of their citizenship, and hence encourage nationality-based discrimination. As such, this investment barrier will be broken and it will allow foreign investors to function at an equally competitive level as the domestic investors. The national treatment clause ensures that foreign investors are treated fairly, in a non-discriminatory manner, while at the same it providing a warranty for economic efficiency.

Article 3 protects foreign investors throughout the entire lifecycle of their investment, which means that the investment is protected during the “establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investment.” This is unique to the BIT practice of the United States, as it is one of the few Model BITs that likewise applies to the establishment phase. This phase takes place before an actual investment is made on a country’s territory, namely when the investor is seeking to make or is in the process of making an investment. In this sense, the US Model BIT “extends its object and purpose to the general liberalization of markets for foreign investments.” This provision attests of the liberal approach to FDI that the United States takes, as it accords national treatment from the very entry and establishment of the alien investment. Nonetheless, pursuant to Article 14 of the 2012 Model BIT, it is possible for a contracting state to insert negotiated exceptions to its Article 3 obligation. This will be discussed further below.

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Article 4 Specifications

Article 4 requires each party to accord treatment no less favorable than it accords, in like circumstances, to investors of third, non-party states and the investments they make on a party’s territory. Like Article 3, the temporal scope of this obligation is determined in the article: it applies to the complete lifecycle of an investment, from the establishment-phase until the very disposition of the investment-phase. This implies that Article 4 is only valid with respect to treatment regarding the lifecycle of an investment. Therefore, no additional protections can fall under a MFN clause, as its realm remains limited to the lifecycle of an investment, and for example does not extend to the dispute settlement of an investment. Consequently, in the event a dispute settlement and a discussion concerning the applicable resolution mechanisms occurs, an investor cannot rely on the most-favored nation treatment from the host state.169

Lastly, just as in the national treatment obligation and pursuant to Article 14 on non-conforming measures, a party to the bilateral treaty can implement exceptions to this MFN treatment obligation, provided that the contracting state agrees with them.170

b. Article 5: Minimum Standard of Treatment

1. Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.
2. For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights. The obligation in paragraph 1 to provide:
   (a) “fair and equitable treatment” includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world; and
   (b) “full protection and security” requires each Party to provide the level of police protection required under customary international law.
3. A determination that there has been a breach of another provision of this Treaty, or of a separate international agreement, does not establish that there has been a breach of this Article.
4. Notwithstanding Article 14 [Non-Conforming Measures][5][b] [subsidies and grants], each Party shall accord to investors of the other Party, and to covered investments, non-discriminatory treatment with respect to measures it adopts or maintains relating to losses suffered by investments in its territory owing to armed conflict or civil strife.
5. Notwithstanding paragraph 4, if an investor of a Party, in the situations referred to in paragraph 4, suffers a loss in the territory of the other Party resulting from:
   (a) requisitioning of its covered investment or part thereof by the latter’s forces or authorities; or
   (b) destruction of its covered investment or part thereof by the latter’s forces or authorities, which was not required by the necessity of the situation,

170 For example, the US has made use of this option in its latest BITs with Rwanda and Uruguay in 2008. See Annexes I, II and III to these BITs on the website of the Office of the US Trade Representative, https://ustr.gov/trade-agreements/bilateral-investment-treaties/bit-documents.
the latter Party shall provide the investor restitution, compensation, or both, as appropriate, for such loss. Any compensation shall be prompt, adequate, and effective in accordance with Article 6 [Expropriation and Compensation](2) through (4), mutatis mutandis.

6. Paragraph 4 does not apply to existing measures relating to subsidies or grants that would be inconsistent with Article 3 [National Treatment] but for Article 14 [Non-Conforming Measures](5)(b) [subsidies and grants].

This is the third core protection provision for foreign investments in a party’s territory. Article 5 obligates parties to treat alien investments in accordance with customary international law, including fair and equitable treatment and full protection and security, overarchingly called the “minimum standard of treatment” of foreign investors and their investments.

The United States recognizes in its 2012 Model BIT Article 5(1) the minimum standard of treatment as a norm that is part of customary international law, which protects aliens by granting them a minimum set of principles that states must live up to when coming into contact with foreign investments, irrespective of their domestic legislation. Although customary international law and its key principles may alternate over time, they exist separately and independently from BITs or other IIAs.171

Contrasting to the two above-mentioned core principles of national treatment and most-favored nation treatment, both of which are relative standards, the minimum standard of treatment represents an absolute standard for nations to respect. Thus, regardless of the treatment and legal protection a host state offers to its own citizens, the contracting parties to the bilateral agreement must obey the treatment that the absolute standard outlines.

Further, Article 5(2) clarifies that fair and equitable treatment and full protection and security form by themselves the minimum standard of treatment. It adds that these two concepts do not require treatment in addition to or beyond that which is required by the respective standard and do not create any additional substantive rights.

More precisely, Article 5(2)(a) specifies that the obligation to provide fair and equitable treatment includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world. Such denials of justice and thus breaches of customary international law, can occur in two ways according to the United States, namely through a procedural denial of justice – e.g. a foreigner might

171 This is being challenged by some authors. E.g. P. Dumberry, “Are BITs Representing the ‘New’ Customary International Law in International Investment Law?”, 28 (4) Penn State International Law Review, 2010, 675-701.
be wrongly denied access to a court – and a substantive denial of justice – e.g. a foreigner was subject to a manifestly unjust decision.\textsuperscript{172}

Meanwhile, Article 5(2)(b) specifies that the full protection and security obligation requires each party to provide the level of police protection required under customary international law. Vandevelde, a former US BIT negotiator, points out that the US BIT negotiators usually interpreted this requirement as \textit{“the obligation of each state to supervise actions by a state’s public authorities as well as private persons and groups, in relationship with foreign investors and their property, and the possible damage and losses which can result therefrom.”}\textsuperscript{173}

Next, Article 5(3) provides that the observation that there has been a breach of another provision of the eventually concluded BIT, does not mean that there has been a breach of this Article.

The next three paragraphs, (4), (5) and (6) are all interrelated and address armed conflicts and civil strife. The first provision of Article 5(4) clarifies that, in spite of exception in Article 14(5)(b), each state must accord to foreign investors and their investments a non-discriminatory treatment with respect to measures it adopts, or maintains, relating to losses suffered by investments in its territory owing to armed conflict or civil disturbance. As a consequence, it establishes a rule prohibiting discrimination when a country chooses to reimburse its own investors or those from another country. In connection to this paragraph, Article 5(6) further makes clear that a state does not have to pay foreign investors any existing subsidies or grants that it is was already paying to its own or other foreign investors. Lastly, Article 5(5) deals with the situation in which a foreign investor’s property has been seized or destroyed by the contracting state’s authorities or forces acting beyond military necessity. In that case, the violating state must provide the foreign investor restitution or prompt, adequate, and effective compensation for its loss. Contrary to paragraph (4), Article 5(5) creates an absolute restitution or compensation obligation, regardless of whether the party arranges for remuneration to its own or other investors.

c. Article 6: Expropriation and Compensation

1. Neither Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization (“expropriation”), except:
   \begin{itemize}
   \item[(a)] for a public purpose;
   \item[(b)] in a non-discriminatory manner;
   \end{itemize}
\textsuperscript{174}

(c) on payment of prompt, adequate, and effective compensation; and
(d) in accordance with due process of law and Article 5 [Minimum Standard of Treatment](1) through (3).

2. The compensation referred to in paragraph 1(c) shall:
   (a) be paid without delay;
   (b) be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place (“the date of expropriation”);
   (c) not reflect any change in value occurring because the intended expropriation had become known earlier; and
   (d) be fully realizable and freely transferable.

3. If the fair market value is denominated in a freely usable currency, the compensation referred to in paragraph 1(c) shall be no less than the fair market value on the date of expropriation, plus interest at a commercially reasonable rate for that currency, accrued from the date of expropriation until the date of payment.

4. If the fair market value is denominated in a currency that is not freely usable, the compensation referred to in paragraph 1(c) – converted into the currency of payment at the market rate of exchange prevailing on the date of payment – shall be no less than:
   (a) the fair market value on the date of expropriation, converted into a freely usable currency at the market rate of exchange prevailing on that date, plus
   (b) interest, at a commercially reasonable rate for that freely usable currency, accrued from the date of expropriation until the date of payment.

5. This Article does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights in accordance with the TRIPS Agreement, or to the revocation, limitation, or creation of intellectual property rights, to the extent that such issuance, revocation, limitation, or creation is consistent with the TRIPS Agreement.

Expropriation or nationalization is the legal or illegal governmental taking of property that requires the payment of compensation. Expropriation is a component of customary international law, and represents a uniform practice in which states around the world engage from a sense of legal obligation.

Article 6 of the 2012 US Model BIT confirms the early position of the United States\footnote{Which was firstly articulated by the United States Secretary of State Cordell Hull, in response to Mexico’s nationalization of American petroleum companies. This formed the conception of the “Hull Formula” in 1938, which required that any form of expropriation strictly be accompanied by compensation that is prompt, adequate and effective. OECD, “Indirect Expropriation” and the “Right to Regulate” in International Investment Law”, OECD Working Papers on International Investment, OECD Publishing, 2004, https://www.oecd.org/daf/inv/investment-policy/WP-2004_4.pdf.} that private property in a foreign jurisdiction may not be expropriated directly or indirectly (Article 6(1)), with the exception of a public purpose (Article 6(1)(a)) and in a non-discriminatory manner\footnote{Meaning that a state party may not arbitrarily target foreign investors and their investments on the basis of nationality, without there being a reasonable and just relation to a legitimate host state goal. See C. Brown, Commentaries on Selected Model Investment Treaties, Oxford, Oxford University Press, 2013, 792.} (Article 6(1)(b)), on payment of prompt, adequate and effective compensation (Article 6(1)(c)). These requirements accord with the due process of law and the minimum standard of treatment provisions in Article 5 (Article 6(1)(d)).

At a basic level, according to Article 6(1), expropriation can be divided into direct and indirect expropriation. The two types of expropriation distinguish themselves one from another by the
existence of a formal transfer of title of the investor’s property. In case of direct expropriation, the foreign private property is being seized through a formal state measure that expressly withdraws the legal title of ownership over an investment, while in case of indirect expropriation, states take measures that result in the substantial deprivation for the foreign investor of the financial value of its investment in the host state. The former gives the alien investor a specific action from the government and a point in time from which he can assess the host state’s liability. On the contrary, the latter is less identifiable, does not have a clear definition and cannot be pinpointed on a clear single action by the state. However, there is a thin line between what an indirect expropriation and legitimate governmental regulation, as not all governmental interference will lead to a compensable appropriation. Hence, states engage in non-compensable expropriation when they enact regulations and legislation that are within the police power of states. This is because international law acknowledges that the national government must still have the margin to regulate, which includes the right to expropriate foreign direct investments as part of a nation’s police power, where feasibly no compensation or less than full compensation may be due. Such an exercise of police powers allows a state to protect essential public interests from certain types of harms. International law recognizes two broad categories of police power where appropriations by the host state justify non-compensation. These are the protection of public order and morality, and the protection of human health and the environment. In addition, state taxation is another well-known form of non-compensable nationalization. Thus such actions, in exercise of a host state’s police powers, are permitted even if they have a negative effect on FDI.

The risk for the alien investor that state regulatory actions can sometimes transcend its police powers and rise to the level of indirect expropriation, translates itself in the fact that he will not be

176 This occurs either on an individual basis, for example a government takes over a factory, depriving the investor of all ownership and control, or this can happen as part of a wider scale nationalization program where an entire industry sector (e.g., water, electricity) is being nationalized.

177 The former US Model BITs mentioned “measures tantamount to expropriation or nationalization”. But due to various misinterpretations of this wording (some thought that this created a third category of expropriations next to direct and indirect expropriation), this phrase was removed. See K. J. Vandevelde, US International Investments Agreements: Policy and Practice, Oxford, Oxford University Press, 2009, 497.

178 Indirect expropriation can happen by different means, for example through regulatory intrusion such as the revocation of a license or through a series of different actions over a longer period. Hence, commentators have diversely described and divided indirect expropriation into disguised, creeping and consequential expropriation. See J.Barratt and P. Roche, “Expropriation - Investment protection and mitigating the risks”, Norton Rose Fulbright, September 2010, http://www.nortonrosefulbright.com/knowledge/publications/30459/expropriation-investment-protection-and-mitigating-the-risks.


remunerated (at all or with a certain amount) for the occurred expropriation. Therefore, the rule of protection against expropriation is complimentary with compensation, as compensation is the very essence of this protection. The first two questions that arise when assessing the due compensation is how much the injured investor should be compensated and how the compensation should occur? Article 6(2) of the US Model BIT describes this in (a) – (d). According to paragraph (2), the compensation must be “prompt”, which means that the investor must be granted immediate compensation without any delay; “adequate”, which entails that the deprived property must be compensated by an amount equivalent to its fair market value immediately before the expropriation occurred, without diminishment in its value that materialized because the appropriation had become known earlier and deflated its value; and lastly “effective”, which describes a payment method that is fully realizable and freely transferrable, and a payment that occurs in a freely usable currency.181 This is the deprivation according to the so-called “Hull Formula”, which over the course of the years has been adopted by a significant number of BITs worldwide.

Article 6(3) further commands that the compensation referred to in paragraph 1(c) will be no less than the “fair market value” on the date of expropriation, which is the “truest measure of an asset’s full equivalence.”182 This means that the compensation amount according to the fair market value standard must be calculated as the price a willing buyer would pay a willing seller in an arm’s-length transaction that takes place in an open market.183 For example, for an operating enterprise, the fair market value consists of it going concern value.184 Article 6(4) further elaborates on paragraph (3) regarding fair market value, and adds that the expropriating host state cannot transmit the exchange risk of the received compensation into a freely usable currency to the investor.

The last paragraph of Article 6 is new to the US BIT program. Article 6(5) ensures that this expropriation article is not applicable to the issuance of compulsory licenses granted in relation to intellectual property rights in accordance with the TRIPS Agreement, or to the revocation, limitation, or creation of intellectual property rights to the extent that such issuance, revocation, limitation, or creation is consistent with the TRIPS Agreement. Consequently, the issuance of compulsory licenses by a host state is not considered as an expropriation if it conforms with the requirements of Article 6(5).

184 Supra note 182.
Lastly, to stay in line with and compared to the previously mentioned core protection standards, the 2012 US Model BIT does not permit a contracting state to make any exceptions under Article 14 to this expropriation or nationalization provision.

d. Article 7: Transfers

Article 7 establishes the obligation upon a contracting state to permit all transfers relating to an investment (such as profits, dividends, royalties, interests, etc.) to be made freely, in a usable currency, and without delay into and out of its territory. This reflects the strong US policy in favor of free transfers, as the United States views restrictions on capital flows as a source of negative consequences. As Vandeveld reckons, these restrictions weaken investor confidence and reduce inflows of FDI, cause significant administrative costs, artificially reduce the pressure for countries to conduct needed economic reforms and increase the risk to the domestic economy in a time of crisis.\textsuperscript{185} Therefore, through Article 7, US Model BIT strives to eliminate these negative consequences and embodies the free transfer of capital and investment profit.

Notwithstanding Article 7, a party may prevent such a transfer through the equitable, non-discriminatory, and good faith application of its laws relating to fields such as, but not limited to, bankruptcy, insolvency, criminal or penal offenses, and compliance with orders or judgments in judicial or administrative proceedings.

Lastly, a state party is not permitted to make any exceptions under Article 14 to this obligation.

e. Article 8: Performance Requirements

This article deals with a state party’s ability to inflict performance requirements on foreign investors. Performance requirements are measures that a host state implements to restrict or condition an investor’s establishing or functioning within the host state’s borders.\textsuperscript{186} According to UNCTAD, the aim of performance requirements is to influence the location and character of investment, and in particular, its costs and benefits.\textsuperscript{187}


Performance requirements can take diverse forms, of which the most widespread are local content requirements, technology transfer obligations and minimum export quotas. Each of these has a distortive consequence, despite the good intentions of the host state. For that reason, as another US core policy principle, and in order to avert adverse consequences as much as possible, Article 8 of the 2012 US Model BIT prohibits the host state from requiring that a foreign investor adopts inefficient and trade distorting practices as a condition for the establishment, acquisition, expansion, management, conduct, operation, or sale or other disposition of an investment.

This provision contains an elaborate enumeration of barred performance requirements, limiting the circumstances in which such requirements can be imposed. For example, neither party can impose or enforce by law or regulation, or condition the receipt of an advantage, the export of a given percentage of goods or services; require a given level of domestic content; purchase, use, or accord a preference to goods produced in its territory; transfer a particular technology, a production process, or other proprietary knowledge to a person in its territory.

Further, Article 8(3) commands various clarifications and exceptions to the prohibitions in the previous two paragraphs. Article 8(3)(a) carves out certain performance requirements, namely the conditioning of the receipt of an advantage, on requirements to locate production, supply a service, train or employ workers, construct or expand particular facilities, or carry out research and development in a party’s territory. In addition, Article 8(3)(b) provides an exception that a party can offer advantages in exchange for a commitment by an investor to comply with any of certain performance requirements when the requirement is imposed by a court, administrative tribunal, or competition authority to remedy a practice determined after judicial or administrative process to be anticompetitive under the party’s competition laws.

Article 8(3)(c) also provides an exception to requirements where they have the legitimate goal of protecting human health or the environment, and are necessary to secure compliance with laws and regulations that are not inconsistent with the BIT, provided that such measures are not applied in an arbitrary or unjustifiable manner, or constitute a masked restriction on international trade. Thus, this exception tries to balance the rights of investors with the sovereign regulatory power and obligations

188 Article 8(1) 2012 US Model BIT.
189 Article 8(2) 2012 US Model BIT.
of the host state. Lastly, a party to a BIT is allowed to attach negotiated exceptions to Article 8(3)’s obligations, as provided in Article 14 of the Model BIT.

Article 8 is the last core principle that can be found in the 2012 US Model BIT. It is followed by protection provisions that, although not as fundamental as the previous articles, are nevertheless discussed as they belong to the broader FDI protection spectrum of the US BIT program.

**f. Article 9: Senior Management and Board of Directors**

Under Article 9, the investor has the right to appoint and engage the managerial personnel of its choosing, irrespective of the personnel’s nationality. The essence of this protective requirement is that the investor retains the indispensable personnel flexibility and is not limited in his or her choice of staff when filling senior management positions.

**g. Article 10: Publication of Laws and Decisions Respecting Investment and Article 11: Transparency**

Although not directly affecting the core of FDI protection, two other important provisions are contained in Articles 10 and 11.190

Pursuant to Article 10, each state party is obliged to ensure that its laws, regulations, procedures, and administrative rulings of general application, and adjudicatory decisions respecting any matter covered by the BIT, are promptly published or otherwise made publicly available. This rule’s principal aim is the promotion of transparency of a host state’s legal domestic framework governing investments by nationals and aliens.

Articles 10 and 11 of the Model BIT work cohesively to expand the host state’s transparency obligations. Article 11 requires the governments of each party state to regularly consult and communicate with each other in order to improve their transparency practices. While Article 10 addresses the publication of laws and regulations, Article 11 requests that each party notify the other and provide reasonable occasions for input and comments from interested persons when changes to those regulations are proposed. As specified in the US Government’s Fact Sheet on the 2012 Model BIT: “The Model BIT bolsters the Parties’ obligations to publish proposed regulations, explain their purposes and rationales, and address substantive comments provided by stakeholders (among other

190 In addition, both articles are non-exceptionable under Article 14 of US Model BIT.
Further, there are specific rules for the publication of proposed and finally adopted regulations respecting any matter covered by the ultimately signed BIT with the United States. In subsequent paragraphs, responsibilities are imposed on the both parties concerning the prompt provision of information requested by the other party, impartiality and legality in administrative proceedings, and review and appeal by independent tribunals.

h. Article 12: Investment and Environment and Article 13: Investment and Labor

The last two substantive provisions of the 2012 US Model BIT focus on the international community’s growing awareness of environment and labor protections in financial and economic agreements. Civil society organizations, trade unions and NGOs increasingly agitate for these rights to be addressed and protected in economic instruments (e.g. BITs) and commercial deals, especially due to public concerns that nations are weakening their environmental laws and regulations, or offering specific waivers to big enterprises, in pursuit of more FDI inflows. As previously mentioned, the United States has a strong history of protecting foreign investments, and thus the Obama Administration has elaborated on these global concerns in the United States’ most recent Model BIT. This progressive approach sets an example to other nations for their Model BITs, while discouraging and condemning the ongoing “race to the bottom” at the expense of the environment and human rights. It is important to remember that these two provisions arose in response to NAFTA disputes, including prominently the Methanex and Metalclad cases, which raised concern in civil society over the outcome of arbitration cases.

Article 12 is relatively detailed in this respect, and addressed the balance that states must reach between attracting additional investment activity and protecting the human life and the environment. The article explicitly declares in paragraph (1) that states acknowledge that their respective environmental laws and policies, and multilateral environmental agreements to which they are both

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192 For example, Article 11(3)(b) prescribes a period of 60 days before the date public comments are due, to publish the proposed regulation in the official journal of national circulation.
194 Not only for the outcome, but also for the process of the arbitration of such disputes. Infra at Article 29.
party, play an important role in protecting the environment. This statement of recognition is new to the 2012 Model BIT. The statement in paragraph (2), was already included in the 2004 Model BIT.\textsuperscript{195} Article 12(2) obligates the parties to recognize that it is inappropriate to attract investment by weakening or reducing domestic environmental laws. Accordingly, each state is forbidden to waive or otherwise derogate from its environmental laws, or fail to effectively enforce those laws, as an encouragement for investment in its territory.\textsuperscript{196} The difference between the 2012 BIT provision on the environment and the one from 2004 is that now the obligation has been strengthened and obligates states to adhere to these commitments.

However, the 2012 Model BIT narrows the scope of Article 12(3), and the model text allows the parties to retain the right to exercise discretion with respect to regulatory, investigatory, and prosecutorial matters. Thus a party is in compliance with paragraph (2) where a course of action (or inaction) reflects a reasonable exercise of such discretion.

The primary purpose of the complete Article 12 is the protection of the environment and therefore Article 12(4) provides a non-exhaustive list of methods by which a government can regulate the environmental protection.\textsuperscript{197}

Lastly, Article 12(5) adds that nothing in a BIT concluded with the United States will be construed to prevent a state from adopting, maintaining, or enforcing any measure that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concern.

Article 13 is the last article that contains a substantive provision, and follows a structure that is comparable to the structure of Article 12. The Model BIT seeks to balance attracting foreign investments and protecting labor rights of the host state’s citizens. Article 13(1) begins with a statement that the parties reaffirm their respective obligations as members of the International Labor Organization (ILO) and their commitments under the ILO Declaration on Fundamental Principles and Rights at Work and its Follow-Up. As with Article 12 on environmental protection, a principal purpose


\textsuperscript{196} Article 12(2) 2012 US Model BIT.

\textsuperscript{197} These include: (a) prevention, abatement, or control of the release, discharge, or emission of pollutants or environmental contaminants; (b) control of environmentally hazardous or toxic chemicals, substances, materials, and wastes, and the dissemination of information related thereto; and (c) protection or conservation of wild flora or fauna, including endangered species, their habitat, and specially protected natural areas, in a party’s territory.
of the US BIT policy is to avoid and discourage the race to the bottom with regard to the protection of labor rights. This is expressed in Article 13(2), which obligates the parties not to waive or otherwise loosen their labor laws, or fail to effectively enforce those laws to encourage additional investment in its territory.¹⁹⁸

After this last substantive obligation in the 2012 US Model BIT, exceptions and qualifications for all the above mentioned substantive obligations (Article 3 through 13) follow in Article 14 through 21. As is often mentioned, Article 14 is the most used exception of all the substantive provisions. It creates a framework under which states can discuss and insert carve-outs to the application of a large part of substantive provisions. Thus, the recent US BIT may contain all substantive provisions from the Model BIT, except for those that are expressly excluded from application through negotiations based on Article 14.

Articles 15 through 21 discuss: the scope of Article 3 on national treatment regarding the required special formalities (Article 15); the non-derogation rule (Article 16);¹⁹⁹ the permitted circumstances for denying benefits to a foreign investor (Article 17); the measures that a state may consider necessary for the protection of its own security²⁰⁰ or the maintenance of international peace and security (Article 18); the disclosure of confidential information (Article 19); the application of non-discriminatory measures relating to financial services and policy of a state (Article 20); and the absence of taxation measures, as they usually fall outside the reach of a BIT and are separately addressed in double taxation treaties (Article 21).

After the exceptions and qualifications articles, Article 22 of the Model BIT provides for the time period that the BIT will be in force and how a party may terminate it,²⁰¹ before going over to the investor-State dispute settlement provisions (Article 23-36).

¹⁹⁸ Just as in Article 12, this provision has been strengthened in comparison to its predecessor in the 2004 Model BIT.
¹⁹⁹ Non-derogation is a longstanding US practice and ensures that a concluded US BIT will not deprive an investor of any more favorable treatment than which he is entitled under any of the following: a state’s national legal regime, administrative practices or procedures, or administrative or adjudicatory decisions, the international legal obligations of a state, or any other obligations assumed by a party, including those contained in an investment authorization or an investment agreement. See C. Brown, Commentaries on Selected Model Investment Treaties, Oxford, Oxford University Press, 2013, 811.
²⁰¹ The BIT remains in force for a period of ten years and continues to be in force thereafter, unless terminated by a party at the end of the initial ten-year period or at any time thereafter, by giving one year’s written notice to the other party.
i. Articles 23-36: Investor-State Dispute Settlement

Provisions on dispute settlement are crucial to BITs, as they offer the most protection to a foreign investor where he has no recourse to the host state’s judicial system or, as in most of the cases, the foreign investor fears that he would not have receive a fair trial in a domestic court. The importance of dispute settlement provisions is also reinforced by the fact that no less than 14 articles of 37 articles in the 2012 Model BIT are devoted to dispute settlement.

The dispute settlement mechanism for international investments borrowed its key components from commercial arbitration. It has become an established international practice in bilateral investment agreements that contracting states and their investors take recourse to international investment arbitration in the event of an investment dispute rather having to litigate against a state before its own courts. The main advantage of international investment arbitration is that it facilitates a stable and secure dispute settlement mechanism, with a neutral legal environment that offers impartial and competent decision making, and depoliticizes disputes.202

There are two types of investment arbitration options provided in the US Model BIT: investor-State and State-State arbitration. In the event of investor-State arbitration, the foreign investor whose investment is allegedly impaired in the host state or who is allegedly mistreated by the host government has the option to bring an investment claim directly against the host state before an international arbitral tribunal, and this despite the international principle of state immunity. In the case of State-State arbitration, the home state of the investor has the right to bring an action against the host state of the investment. In the first scenario, the investor is the claimant while the host state is the respondent, while in the second scenario the home state is the claimant and the host state is the respondent.

These fourteen articles in the 2012 US Model BIT govern arbitration proceedings in great detail. Its provisions range from the submission of a claim to arbitration and the selection of arbitrators, to the substantive and procedural aspects of the arbitration. Article 24 establishes main terms and margins under which a claimant can submit his claim. BITs, NAFTA, the Energy Charter Treaty and other IIAs commonly offer investors more than one arbitration method.

Next to the types of actions that an investor may bring and the time slots within which he is obliged to do that, Article 24 determines the initial procedures according to which he can file a claim and the

applicable procedural rules. In particular, according to Article 24(3), a claimant may submit an investment claim (a) under the ICSID Rules of Procedure for Arbitration Proceedings, provided that both states are ICSID Contracting Parties; (b) under the ICSID Additional Facility Rules, provided that either one of the disputing parties is an ICSID Contracting Party; (c) under the UNCITRAL Arbitration Rules; or (d) if the claimant and respondent consent to arbitration by any other institution or under any other arbitration rules. Thus, the claimant is expressly authorized to choose the applicable procedural rules from the four above options. In addition, under a US BIT, an investor-claimant is not compelled to exhaust local remedies before initiating international investment arbitration.

Article 25 of the 2012 Model BIT provides that if a state signs a BIT with the US it consents to the submission of future investment claims to arbitration in accordance with the terms of the BIT. This article represents one of the fundamental principles of and requirements to arbitration in general. The consent of the disputing parties is crucial in order to commence arbitral proceedings, and Article 25 fulfills this requirement, as it represents the pre-consent of each party to investor-State arbitration. Since the signatories to a BIT are states, and in the case of investor-State arbitration the claimant in the arbitral proceedings will be an investor, the latter consents to arbitration from his side by submitting a claim under Article 24(3) of the US Model BIT. In doing so, the investor-claimant agrees to subject his action against the host state-respondent in accordance with the procedural rules set out in the 2012 US Model BIT. Thus, the host state’s consent and the investor’s submission of the action shape the indispensable agreement to arbitrate.

204 For an investor to start arbitration under the International Centre for Settlement of Investment Disputes (ICSID) Convention against a state, that state must be a party to that Convention. Membership of ICSID, however, is not sufficient for a state to be sued under the ICSID Convention. ICSID’s jurisdiction over investor-State disputes rests on the notion of “consent”, which is the general cornerstone of international dispute settlement involving states. Thus, in addition to ICSID membership, consent to arbitration under the ICSID Convention is required for a case to be taken up by the ICSID. This consent is in this case given by the signing of the BIT by both states, as the relevant provision in a BIT represents a unilateral offer of consent, which can be accepted by the other disputing party, namely a foreign investor, by filing a request for arbitration under the ICSID Convention. Once the disputing parties have consented to arbitration under the ICSID Convention, neither one can unilaterally withdraw its consent. The vast majority of the BITs include such an option for ICSID arbitration. The Centre provides facilities for arbitration of international investment disputes. The importance of ICSID derives from the fact that, unlike other international arbitral awards, ICSID awards do not require domestic enforcement procedures in accordance with the New York Convention and, therefore, cannot be refused enforcement by the state. An ICSID award is equivalent to “a final judgment of a court of that state” (ICSID Convention, Article 54(1)(2)), and therefore is directly executable. See L. Reed, J. Paulsson and N. Blackaby, Guide to ICSID Arbitration (2nd ed.), Kluwer Law International, 2010; P. Bernardini, “ICSID versus non-ICSID Investment Treaty Arbitration” in Liber Amicorum Bernardo Cremades, 2011, available at http://www.arbitration-icca.org/media/4/30213278230103/media012970223709030bernardini_icsid-vs-non-icsid-investent.pdf.
205 Supra note 203.
Article 28(1) of the 2012 Model BIT also requires the disputing parties to agree on the place of the arbitration under the applicable arbitral rules under Article 24(3). If the disputing parties fail to agree on the arbitral seat, Article 28(1) stipulates that, by default, the arbitral tribunal has to choose an arbitral seat within a state that is party to the New York Convention of 1958. The principal purpose of this rule is to ensure the maximum enforceability of the eventual arbitral award, since currently 156 states are parties to the New York Convention.207

In order to support transparency of the dispute settlement, Article 28(3) of the Model BIT contains an option for the arbitral tribunal to accept and reflect on amicus curiae submissions, completely at its own discretion.208 Further, Article 28(8) permits a tribunal to order interim measures of protection to preserve the rights of a disputing party, or to ensure that the tribunal’s jurisdiction is made fully effective. This includes an order to preserve evidence in the possession or control of a disputing party or to protect the tribunal’s jurisdiction.

Article 28(9) permits the arbitral tribunal to moot its “draft award”, if requested to do so by a disputing party. The paragraph asserts that a tribunal, before issuing a decision or award on liability, must transmit its proposed decision or award to the disputing parties, in response to which the disputing parties receive 60 days to submit their written comments concerning any aspect of the proposed decision or award. After the 60-day comment period, the arbitral tribunal has 45 days to consider the comments and issue its decision or award. The circulation of draft awards provision is novel and according to commentator Mark Kantor, it “allow[s] the tribunals to correct any errors or inconsistencies before issuing their final awards, while at the same time curtailing possible claims by the losing parties, regarding the lack of a fair opportunity to be heard on all relevant issues.”210 In addition, this review process allows BIT parties to express their joint views on the interpretation of the BIT,211 which facilitates dispute settlement. When a party is warned of its loss in advance through a

207 Last accessed on 10 May 2016.
208 The issue of amicus curiae submissions first arose under Chapter 11 of the NAFTA in the context of Methanex and UPS cases. Non-governmental organizations from the United States and Canada petitioned to intervene in those two cases, citing the tribunal’s authority to “conduct the arbitration in such manner as it considers appropriate”, even though the NAFTA does not contain an explicit provision on such amicus submissions. The tribunal agreed to permit NGO submissions in the both cases. See Methanex Corp v United States and United Parcel Service of America, Inc. v. Government of Canada, Award on the Merits, 24 May 2007.
209 Some think that had NAFTA included a review option like this, some controversies regarding the legal reasoning of the tribunal might have been avoided, in particular in the Metalclad Corporation v. The United Mexican States case. See C. Brown, Commentaries on Selected Model Investment Treaties, Oxford, Oxford University Press, 2013, 836.
draft award, it may seek to settle or withdraw the case before it is condemned to significant damages, its loss is spread among its shareholders and is known by its current and prospective clients.

Another progressive provision in the 2012 US Model BIT is Article 28(10), which establishes an appellate mechanism for reviewing awards rendered by investor-State dispute settlement arbitral tribunals. The US Congress mandated an appellate mechanism in 2002, declaring it to be a principal negotiating objective for investment chapters and treaties.\textsuperscript{212} Consistent with this objective, the 2012 Model BIT states that in the event that such a body or a similar mechanism is developed in the future, the state parties will consider whether the rendered arbitral awards should be subject to that appellate mechanism. To date, however, no appellate mechanism for investor-State arbitration has been created.

International arbitration has often been utilized by private parties as a mechanism to safeguard the confidentiality of proceedings. Over the past twenty years investors have increasingly made use of international arbitration provisions in BITs and other IIAs to bring claims against sovereign states, which has raised questions over transparency obligations of public bodies.\textsuperscript{213} While both types of arbitration use the same procedural rules, there are inherent differences between investor-State arbitrations and arbitrations between two private entities, with the latter being based on the confidential character of private commercial arbitration. As a result, investor-state arbitrations habitually lack transparency in their proceedings and provide no opportunity for public participation or even knowledge, for example through third party submissions and access to hearings.

This development in international law has resulted in issues of public importance being resolved in a “closed door” system, without any public awareness or participation. This fundamentally conflicts with the state’s fundamental obligation to act in a transparent way and its citizens’ corresponding right to have a say in public interest issues. As OECD notes: “Investment arbitral awards may have a significant impact on the state’s future conduct, the national budget and the welfare of the people, so the public interest in investment disputes is understandable.”\textsuperscript{214} Consequently, public interest groups have advocated for more transparency and greater involvement in arbitral proceedings in order to augment


\textsuperscript{213} Treaty-based investor-state arbitration is a rather recent phenomenon, as the first investor-State arbitration under a BIT was only submitted in 1987 and decided in 1990. \textit{Asian Agricultural Products Ltd v Sri Lanka}, ICSID Case No ARB/87/3.

the legitimacy of arbitral awards, in particular those that address important domestic policies related to environment and health protection, social welfare, labor rights and the use of natural resources.

As a response to NGO advocacy, some states, led by the United States and Canada due to their negative experience in defending NAFTA Chapter 11 cases, have implemented provisions in their new Model BITs that are devoted to enhancing transparency in the different phases of the arbitration process. The US State Department has even described transparency as one of the “expanded core principles” of the 2004 Model BIT.

By promoting in its BIT regime and general foreign investment policy an “open door” system, with the needed respect for confidentiality of proceedings, the United States sets an example in its Model BIT to other states. As IISD observes: “Notably, many of the texts requiring the greatest openness are those to which the United States and Canada are party—two countries that have each been respondents in a relatively high number of disputes [under the NAFTA] and are therefore familiar with having to confront and address these issues of public interest and transparency in investor-state dispute settlement. Their continued commitments to transparency through the various stages of dispute settlement proceedings are evidence that parties and tribunals are able to provide for such transparency (1) without imposing a burden on or unduly delaying the proceedings, or exacerbating the disputes and (2) while ensuring the protection of claimants’ and respondents’ confidential and privileged information.”

215 “It was with the first cases under the investment chapter (Chapter 11) of the North American Free Trade Agreement (NAFTA) in the mid-to-late 1990s that it became clear that the typically confidential nature of private arbitrations was not appropriate for investor-state disputes of public interest. In 2001, as a step toward increasing the [controversial alleged lack of] transparency of NAFTA investor-state arbitrations, the parties to that agreement issued an interpretative note specifying that nothing in Chapter 11 itself precluded a NAFTA party from providing public access to documents submitted to or issued by Chapter 11 tribunals. The interpretative note also set forth the NAFTA parties’ agreement to make such documents available to the public in a timely manner, subject to certain exceptions, including for the protection of confidential business information and where disclosure would be prohibited under applicable arbitral rules. In bilateral investment treaties and free trade agreements concluded by the NAFTA parties subsequently, the countries have gone even further to ensure openness of investor-state dispute settlement by including provisions on transparency directly in the treaties (as opposed to interpretative notes).” See S. Singh and S. Sharma, “Investor-State Dispute Settlement Mechanism: The Quest for a Workable Roadmap”, Merkourios - International and European Law: General Issue 2013 - Vol. 29/76, 2013, 88-101.

216 Such provisions are usually incorporated to amend, clarify or complete the applicable arbitration rules, e.g. the ICSID or UNCITRAL arbitration rules.


This has been a cornerstone of the US policy for many years now, and thus transparency requirements are incorporated in multiple provisions in the 2012 US Model BIT. The all-embracing Article 29 is most relevant, in this regard. Article 29 comprehensively ensures that transparency obligations are binding on the disputing parties. The two chief transparency requirements that are established in the first two paragraphs are (1) making available to the public the key documents in the proceedings, such as the parties’ written submissions and the decisions of the tribunal; and (2) conducting hearings that are open to the public. Parallel to these crucial openness requirements, Article 29 also requires the arbitral tribunal to safeguard “protected information” from disclosure to the public. Elaborated procedures are provided on how to protect such submitted information from disclosure in Article 29(4).

Lastly, Article 34 outlines the phases for an arbitral tribunal to issue a final award in a dispute. In line with customary international law, an arbitral tribunal can make an award against a respondent state demanding full reparation. However, an arbitral tribunal may award only of (a) monetary damages with applicable interest; and/or (b) restitution of property. Article 34 further specifies that a tribunal may also award costs and attorney’s fees, but may not award punitive damages. Further, each party is responsible for the enforcement of an award in its territory, meaning that a state is assumed to have created and developed laws and set up institutions requisite to enforce an award. Finally, Article 34 orders each party to abide by and comply with a rendered award without delay. In case a party fails to do this, a tribunal will be established under Article 37 (State-State Dispute Settlement).

j. Article 37: State-State Dispute Settlement

Article 37 is the last article of the 2012 US Model BIT. It establishes a compulsory recourse to State-State arbitration and outlines the applicable arbitral procedures in the event the parties did not resolve their dispute over the interpretation or application of the BIT. Hence, an unsettled dispute must be submitted to State-State arbitration for a binding decision or award on the request of either party, in accordance with applicable rules of international law. It further precises that in the absence of an agreement by the parties, UNCITRAL Arbitration Rules apply, except as modified by the parties or the applicable BIT. Although several claims have been filed against the United States under the investor-
State arbitration provisions of Article 24 through 36, at the time of this writing, only one claim has been submitted under Article 37 for State-State arbitration.²²⁴

The Model BIT ends with:

IN WITNESS WHEREOF, the respective plenipotentiaries have signed this Treaty.
DONE in duplicate at [city] this [number] day of [month, year], in the English and [foreign] languages, each text being equally authentic.

FOR THE GOVERNMENT OF
OF THE UNITED STATES OF AMERICA: FOR THE GOVERNMENT OF

E. Conclusion

The 2012 US Model BIT reveals a strong, thought-through, comprehensive drafting template for conclusion of bilateral investment treaties that is adapted to past experience, progressive and truly protective of investor rights. It lays the foundations not only for its own BIT negotiations, but also for the global BIT network, as many BITs between other countries are closely modeled on the US Model BIT.²²⁵ Hence, in the current global BIT proliferation, the US Model BIT sets a high standard for nations across the world to emulate in the development of their own model agreements.

It is worth noting that the US Model BIT upholds the deep-rooted US economic agenda which is favorable to both inward and outward FDI. As stated by the US Department of State: “The U.S. BIT program provides several key economic benefits, from protection of investment interests overseas, to promotion of market-oriented policies and exports. The BIT program’s basic aims are to: protect investment abroad; encourage the adoption of market-oriented domestic policies that treat private investment in an open, transparent, and non-discriminatory way; and support the development of international law standards consistent with these objectives.”²²⁶ These basic aims consequently mirror the robust US government policy on FDI.

This high-standard Model BIT helps foster, promote and support FDI into and out of the United States, which results in hundreds of millions of inward and outward FDI. Over the decades, these financial inflows and outflows have turned the United States into the world leader in FDI and has nurtured it to grow into the world’s major economic power.

²²⁴ The State-State arbitration between the United States and Ecuador, subsequent to an investor-State arbitration in the Chevron case pursuant to the US-Ecuador BIT, a legal saga which has finally been decided on January 20, 2016. Chevron Corporation and Texaco Petroleum Corporation v. The Republic of Ecuador, UNCITRAL, PCA Case No. 2009-23. See http://www.italaw.com/cases/257#sthash.L7HiUW2t.dpuf.
Likewise, it is worth emphasizing that with its latest Model BIT, the United States portrays itself as a progressive and forward-thinking nation, not only in offering considerable protection to alien investors, but also in balancing public interests and concerns, such as environmental and labor rights, with the state’s sovereign right to regulate and pursue a specific public policy objective.\(^{227}\) To summarize this Model BIT in one sentence: “The 2012 US Model BIT has secured its place on the leading edge of the next generation of model investment agreements.”\(^{228}\)

**F. A Final Thought**

Nonetheless, it is interesting to note that since the 2012 Model BIT was enacted,\(^{229}\) not a single new BIT has been signed or ratified by the US government. The last BIT that was signed came in 2008 with Rwanda and was concluded on the basis of the 2004 Model.

The question that automatically arises is: why is this so? Is it because the BIT negotiations with different nations have been stalled by other US government priorities, like concern with international peace and security? Or, even though it might seem unlikely, is it because the United States lacks resources and capacity to conclude new BITs? Or is concluding a BIT just a timely, lengthy and very technical process?\(^{230}\) Or is it because the United States is more prudent now in concluding new BITs because of its negative experiences as a respondent in NAFTA arbitrations? Or else are the requirements of the revised 2012 Model BIT just too demanding for most nations, and they are not willing or able to comply with the obligations? Or is the US BIT program saturated by now with 47 BITs in existence?

A very interesting and valuable insight on these questions has been provided by Professor Vandevelde. In response to my email with these considerations, he responded the following:

“I do not believe that the explanation for the lack of new BITs is the claims brought against the United States. In response to those claims, the United States did revise its Model BIT. But I believe that the United States is willing to conclude that new model with any country that is able to meet the obligations


\(^{229}\) To clarify, revisions of the Model BIT do not require Congressional action, while negotiated BITs do require advice and consent of two thirds of the Senate.

\(^{230}\) For example, regarding the US-China negotiations, before the negotiations on substantial matters had even started, the two sides had already nine rounds of talks on technical issues behind them. For a current update on the US-China talks, see http://thediplomat.com/2016/03/are-china-and-the-us-close-to-sealing-an-investment-treaty/. As for the US-India negotiations, they have not yet been commenced, as the two parties are still in the phase of technical discussions, see http://articles.economictimes.indiatimes.com/2014-04-25/news/49406239_1_bilateral-investment-treaty-india-nancy-powell-non-tariff-barriers.
imposed by that model. I also believe that the United States has the resources to negotiate more BITs. If a country with which the United States wanted a BIT appeared eager to conclude one, I believe that the United States would have the capacity to do so. The explanation lies in part in what you observed - - that there are already 47 BITs in existence."²³¹

Professor Vandevelde continued with an elaboration on some recent cases and developments in which the United States is involved: “First, the United States has concluded a number of free trade agreements with investment chapters. If the United States has concluded with a country an FTA with an investment chapter, then it has no need to negotiate a BIT with that country. The United States now has FTAs with 20 countries in force, most of these signed since 2000. A few of those FTAs are with countries where the United States already had a BIT in force. But counting the FTAs, the United States has signed an investment agreement (either a BIT or an FTA) with more than 60 countries.

Second, the numbers that I just gave you do not include the very recently concluded Transpacific Partnership. There are 5 countries that have signed the TPP with which the United States does not have a BIT or FTA in force. So, the brings the number of treaties with investment commitments signed by the United States up to about 70. In addition, the United States is negotiating the Transatlantic Trade and Investment Partnership with the European Union. I believe that there are 28 countries in the EU. If that negotiation is successful, then we will have signed an FTA or BIT with about 100 countries.

Finally, the United States has been involved for several years in a BIT negotiation with China. It has conducted less extensive discussions with a few other countries in recent years. So, we are still negotiating BITs, but our BIT is more demanding than the BITs of most countries and not every country is willing to agree to the obligations in our BITs.

As this indicates, while the number of BITs has not increased for several years, the number of FTAs has been increasing steadily and these have investment chapters that contain the same protections as a BIT.

In short, I believe that there is a lot more activity than you realize, but the activity is occurring mainly with respect to the FTAs at the moment, that we do have some BIT negotiations occurring.”²³²

²³¹ D.d. April 21, 2016.
²³² supra
Chapter 2.2 – Model BIT of the Russian Federation (Russia)

A. Introduction

While Russia is an established political and military power, it should not be forgotten that the country only recently transitioned from a centrally planned economy to a market-oriented one. Thus, it is still on its way to fully embracing and comprehensively enacting the liberal market principles that protect and promote FDI.

This section follows a parallel structure of the discussion of the 2012 US Model BIT. It begins with an analysis of the history of the Russian BIT program, continues with an investigation of Russia’s modern view on foreign investments, both inward and outward FDI, provides an overview of the core protection provision of the most recent Model BIT, and concludes with final observations.

B. Evolution of the Objectives of the Russian BIT Program

The Department of Trade Negotiations in the Ministry of Economic Development is responsible for conducting BIT negotiating and signing treaty with other states. All Russian BIT negotiations are based on the Russian Model BIT. Once the text of the BIT text is finalized, it is submitted to both chambers of the Russian Parliament (called the “Duma”). Both chambers of the Duma must then pass a bill approving the BIT, after which the President of the Russian Federation signs the bill into law and the treaty is ratified.233

After the dissolution of the Soviet Union in 1991, the Russian Federation – as an emerging state and a transition economy – actively negotiated and concluded BITs with states in all corners of the world. Remarkably, the first BIT treaty was concluded in 1989,234 while the Soviet Union – Russia’s predecessor state – was still formally a communist state. In 1989 and 1990 alone, the Soviet Union entered into thirteen BITs as part of its perestroika reforms. After the Soviet Union disintegrated in 1991, the Russian Federation inherited all these BITs as its successor state.

As Russia is one of the world’s powers, with massive natural resources and a large consumer market, the country consequently has a vast array of concluded bilateral treaties. As of today, Russia has 78 BITs, of which 58 are in force,235 and the Department of Trade Negotiations is actively negotiating new

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234 With Finland, on the basis of a 1987 USSR Model BIT.
The latest Russian BIT to enter into force was with Uzbekistan in 2014, while another was signed with Morocco in March 2016 and is awaiting ratification. In order to attract investments from abroad, Russian concluded its first BIT in 1989 with Finland. Over the following years, it concluded BITs with developed countries in North-America and Europe, and since 2000 it has concluded agreements with developing markets, including transitioning post-Soviet states, emerging Asian nations and most recently African countries. This diverse mixture of Russian BIT partners, positions the country as a growing player in both capital-import and capital-export. However, Russia is still an economy in transition, and one commentators describe it as a “capital importing developing country and a capital exporting developed country.”

The first Russian Model BIT was developed and enacted in 1992. Unlike the ten Model BIT revisions in the United States, Russia has revised its Model BIT only once, in 2001. However, the 2001 model agreement was significantly amended in 2002, as the 2001 Model BIT did not include obligations of fair and equitable treatment, national treatment and most-favored nation treatment. Just as NAFTA resulted in litigation against the United States that greatly influenced its US BIT objectives, the Energy Charter Treaty led to litigation and caused Russia to reassess its BIT program. In 1994, Russia became a signatory state to the ECT, a regional international agreement which aims to: (1) promote long-term international cooperation in the energy field with respect to investments, trade and efficiency; (2) reciprocally protect foreign investments made in the energy sector; and (3) compensate investors in case of expropriation.

236 The two most recently signed treaties are the one with Iran in December 2015 and with Morocco in March 2016. The treaties with Latvia and Bosnia and Herzegovina are ready to be signed, while there are still ongoing negotiations with Australia, Azerbaijan, Israel, Malaysia, Mexico, Myanmar, Nicaragua, Peru, Saudi Arabia and Tunisia. The BITs with Belgium, Luxemburg and Romania are currently being renegotiated. As for the future, Russia is interested in concluding BITs with Brazil, Chile, Ghana, Iceland, Oman, and the United Arab Emirates.


238 See the statement of 18 July 2016 by the Russian Ministry of Foreign Affairs, on the occasion of the meeting between Russian Minister of Foreign Affairs, Mr. Sergey Lavrov, and the Chairperson of the African Union Commission, Ms. Nkosazana Dlamini-Zuma: “...they will discuss ways to invigorate Russia-Africa trade, economic and investment cooperation and attract Russian businesses to major infrastructure projects, primarily in the framework of Agenda 2063 and the New Partnership for Africa’s Development (NEPAD).” http://www.mid.ru/en/web/guest/kommentarii/-/asset_publisher/2MrVt3CZw5sw/content/id/2241790.


240 Originally, the Energy Charter Treaty was based on integrating the energy sectors of the ex-Soviet Union at the end of the Cold War into the European and world markets. The treaty has been signed by 52 countries all around the world (the United States not included), the European Union and Euratom. See for a full list of the members, signatories and observers http://www.energycharter.org/who-we-are/members-observers/.
While Russia signed the ECT, it never ratified it. Nevertheless, Article 45(1) of the ECT provides for the “provisional application” of the Treaty to states that have not ratified it. Article 45(1) states: “Each signatory agrees to apply this Treaty provisionally pending its entry into force for such signatory in accordance with Article 44, to the extent that such provisional application is not inconsistent with its constitution, laws or regulations.”

On the basis of Article 45(1), the Permanent Court of Arbitration held in the notorious Yukos case that the ECT provisionally did apply to Russia, much to the country’s disapproval. Consequently, in 2009, former Prime Minister Vladimir Putin declared that Russia did not intend to become a contracting state party to the ECT and that it would no longer provisionally apply its provisions. The international community reacted negatively to Russia’s withdrawal.

241 Former majority shareholders and management of - the now bankrupt - Yukos Oil Corporation filed several international arbitral claims in 2005, seeking compensation for expropriation of their investment by the Russian government. GML Ltd., the former owner of 60 percent of Yukos, filed the lawsuit under the Energy Charter Treaty before a tribunal at the Permanent Court of Arbitration (PCA) in The Hague, under the rules of the UNCITRAL Rules. The Court handled the following three cases: Hulley Enterprises Limited (Cyprus) v. The Russian Federation; Yukos Universal Limited (Isle of Man) v. The Russian Federation; and Veteran Petroleum Limited (Cyprus) v. The Russian Federation. The PCA rendered three identical interim awards in 2009 which stated that, based on Article 45(1), the ECT provisionally applied to Russia as it was a signature to the Treaty. Consequently, Russia challenged this and the final award rendered against Russia by the PCA on July 18, 2014 amounted to US$ 50 billion, as the court unanimously found that an expropriation had taken place. According to the decision, Russia had until January 2015 to pay. In addition, if the state did not pay, the claimants were permitted to freeze and confiscate sovereign commercial assets of the Russian Federation by obtaining court orders that allow such seizure of state assets, and this in all 156 state parties to the New York Convention, as Russia is a party itself to the Convention. Russia refused to pay damages and let the deadline pass. Therefore, the prevailing parties were obliged to seek such court orders, with success in France, Germany and Belgium. At the same time, Russian entities harmed by these actions went to court to appeal the freezing and confiscation of their assets. On 20 April 2016, The Hague District Court annulled the 2014 award of the PCA, ruling that it had no jurisdiction as provisional application of the ECT arbitration clause violated Russian domestic law. Now that the PCA award is reversed, the Russian Federation is no longer obliged to pay compensation to former Yukos shareholders.

Yukos Universal Limited (Isle of Man) v. The Russian Federation, UNCITRAL, PCA Case No. AA 227. See http://www.italaw.com/cases/1175, and De Rechtspraak press release of 20 April 2016 at https://www.rechtspraak.nl/Organisatie-en-contact/Organisatie/Rechtbanken/Rechtbank-Den-Haag/Nieuws/Paginas/Arbitration-awards-on-multi-billion-claims-against-Russia-quashed.aspx: “The court concluded that the option of arbitration under Article 26 ECT for disputes such as the ones in these proceedings are contrary to written Russian law. The court’s examination of Russian legislation resulted in the finding that a legal provision is required for subjecting the Russian state to arbitration in such disputes; one which requires the approval (ratification) of the Russian parliament. Such provision does not exist, neither in a general sense nor in a specific sense for this case, as the Russian legislature has not ratified the ECT. This means that the arbitral clause of Article 26 ECT does not apply through the provisional application of the treaty. The court finds that the arbitrators did not have jurisdiction to take cognizance of this case and were therefore wrong to declare themselves competent.” For the complete judgement of the Hague District Court, see http://deeplink.rechtspraak.nl/uitspraak?id=ECLI:NL:RBDHA:2016:4230.

242 On 20 August 2009, Russia officially terminated the provisional application of the ECT. See http://www.energycharter.org/who-we-are/members-observers/countries/russian-federation/.

Despite Russia’s withdrawal, the Yukos affair did not stop here, as Article 45(3)(b) of the ECT provides that: “In the event that a signatory terminates provisional application under subparagraph (a), the obligation of the signatory under paragraph (1) to apply Parts III and V with respect to any Investments made in its Area during such provisional application by Investors of other signatories shall nevertheless remain in effect with respect to those Investments for twenty years following the effective date of termination.” Hence, notwithstanding the termination of provisional application by Russia, Article 45(3)(b) clause requires Russia to comply with ECT’s investment promotion and protection obligations (Part III) and arbitration provisions (Part V) through 2029.244

C. Modern Russian Investment Policy

Just as in the case of the United States, the preamble of the 2001 Russian Model BIT reflects the modern investment policy of the Russian Federation best. The preamble reads:

The Government of the Russian Federation and the Government of the ..., hereinafter referred to as the Contracting Parties, intending to create favorable conditions for making of investments by investors of one Contracting Party, in the territory of the other Contracting Party, recognizing that the promotion and reciprocal protection of investments on the basis of the present Agreement shall stimulate the flow of capital and contribute to the development of the mutually beneficial trade and economic, scientific and technical cooperation, have agreed as follows,

Even though the preamble is not binding and can be viewed as rather concise, Russia’s BIT objectives and policies are crystal clear: the Russian BIT program emphasizes the promotion of agreements and reciprocal protections. By creating a favorable environment for investors, Russia aims to stimulate private capital inflow with the ultimate intent of increasing development of trade, together with economic, scientific and technical cooperation between the contracting nations.

Thus, the primary aim of the Russian Federation is the improvement and expansion of trade relationships with its treaty partners. Unlike the US Model BIT, the Russian Model BIT does not mention the protection of health, environmental and labor laws, improvement of living standards, or human rights. Nonetheless, even though the United States mentions these considerations in its preamble, the core of its Model BIT remains the “promotion and protection of foreign investments”, just as asserted in Russia’s Model BIT. As some commentators explain, this brevity and restrictiveness of the Russian Model BIT’s purpose is typical for first generation BITs. First generation BITs do not generally reflect

the country’s experiences and negative consequences with investment treaty arbitration, as the United States did under NAFTA’s Chapter 11. As Russia was never exposed to these issues before the Model BIT’s adoption in 2001, the preamble was considered satisfactory.245

The need to expand the Model BIT may be building, however, as the 2014 events in Ukraine prompted a steep increase in arbitration filings under the Russia-Ukraine BIT.246 Only the outcomes of these arbitrations will reveal whether Russia determines that it needs to reexamine its fifteen-year-old Model BIT. There is precedent for this: after the 2006 Yukos affair under the ECT,247 Russia completely withdrawing from the Treaty on 30 July 2009. It is perfectly plausible that Russia will react in the same way with regard to the Russia-Ukraine BIT in response to increasing numbers of arbitration cases arising out of the conflict in the Ukraine. Additionally, in the event of an unfavorable outcome from these and perhaps other future BIT disputes, it is conceivable that the government will revise its 2001 Model BIT completely, and may even terminate those BITs in force.

Nevertheless, at present Russia remains committed to its BIT program. In March 2016, during the Meeting of the Government Commission on Monitoring Foreign Investment, Russian Prime Minister Dmitry Medvedev reaffirmed the focal point of the Russian Model BIT preamble as follows:

“Despite the sanctions and the difficulties of business transactions, we are determined to develop investment cooperation. Our economy remains open. Now that the political situation is effectively dictating its terms to foreign business, we are especially attentive and respectful with regard to the foreign companies that continue to work in our country or are coming to our country with investment. We are willing to provide a comfortable environment for them to incentivize them to implement large projects in Russia. The Government should continue to pursue a very thorough approach when considering applications from foreign companies that are willing to invest in Russian strategic enterprises.

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245 The preamble can be utilized in interpreting the subsequent substantive provisions of the BIT, according to Article 31 of the Vienna Convention on the Law of Treaties of 1969. When looking back, such preambles that are in favor of the weaker party, the foreign investor, were usually used by the arbitral tribunals to interpret and clarify the vague substantive provisions in the favor of the foreign investor. See A. Newcombe and L. Paradell, Law and Practice of Investment Treaties: Standards of Treatment, Kluwer Law International, 2009, 113-116.

246 E.g. a claim filed on 6 January 2016 based on the Russia-Ukraine BIT, Aeroport Belbek LLC and Mr. Igor Valerievich Kolomoisky v. The Russian Federation, UNCITRAL, and another on filed on 30 March 2016, based on the same BIT, PJSC CB PrivatBank and Finance Company Finilon LLC v. The Russian Federation.

247 Yukos Universal Limited (Isle of Man) v. The Russian Federation, UNCITRAL, PCA Case No. AA 227.
This economic interaction is beneficial for all parties. As a result, Russian companies get the essential financial resources, modern technology, newest managerial solutions and innovative products while our foreign colleagues strengthen their positions in the Russian market.248

This statement may have come in response to the latest UNCTAD data on FDI inflows into Russia. While the global FDI increased by 36% in 2015, Russia recorded a 92% decline in FDI last year, falling to just $2 billion.249

This poor FDI inflow is mainly due to the 2014 geopolitical conflict in Ukraine, which led to the United States, Canada and the European Union imposing diplomatic and economic sanctions on Russia, as well as Russian economic countermeasures. As these sanctions and countersanctions have seriously affected Russia’s business relations with the European Union, its number one trading partner,250 the Russian government has turned its focus to supporting and strengthening its alliances with other regions, like Asia and Latin America.

As such, by negotiating more bilateral treaties with countries such as Morocco, by doing business with China, and by establishing its own economic alliances like the Eurasian Economic Union with Belarus and Kazakhstan, Russia is trying to overcome the tough times its economy is going through.

As Putin has stated in latest state of nation speech in 2015:

“We have reached the next level of cooperation within the Eurasian Economic Union by creating a common space, with free movement of capital, goods and labor. We have reached a basic agreement on combining Eurasian integration with the Chinese Silk Road Economic Belt. A free trade zone with Vietnam was established. Next year, we will host the Russia-ASEAN summit in Sochi, and I am sure we will be able to work out a mutually beneficial agenda for cooperation.”251

D. Core Protection Provisions

The formal name for the 2001 Russian Model BIT is:

248 This was a regular meeting scheduled with the purpose of announcing the approval of two major transactions: the acquisition by Indian ONGC Videsh Limited Company of 15% of the shares in Vankorneft, and the acquisition by Swiss Molumin AG Company of 75% of the shares in Geotechnology. See for full speech http://government.ru/en/news/22289/.


250 Russia’s main capital importer and trading partner was the EU. While for the EU, Russia was its third largest trading partner, behind the US and China. See R. Leal-Arcas, International Trade and Investment Law: Multilateral, Regional and Bilateral Governance, Cheltenham, Edward Elgar, 2011, 129.

In contrast to the extensive US Model BIT, which includes 37 articles over 42 pages, the Russian Model BIT consists of “only” eight pages and twelve articles. Its length is not unique, however, especially in comparison with European Model BITs, which are all brief and concise.

An interesting observation is that the 2001 Russian Model BIT is only available in the Russian language; there is no official English translation to it. Interestingly, many Russian BITs declare that the English version prevails in case of inconsistencies between the texts.

Just as in the US Model BIT, the core protection provisions of the Russian Model BIT are discussed below. Article 1 contains definitions and Article 2 restates the intent from the preamble to create a favorable environment for foreign investors in Russia, and to promote and protect investments. In addition, Article 2 specifies that each contracting state must maintain complete discretion regarding the admission of foreign investments on its territory, implying that pre-entry screening of FDI will be conducted according to the domestic laws and regulations of the host state. Thus, the Russian Model BIT does not provide for a right of establishment and therefore belongs to the group of “post-establishment” Model BITs.

The first core protection provision is found in Article 3.

**a. Article 3: Treatment of Investors**

1. Each Contracting Party shall ensure in its territory fair and equitable treatment of investments of investors of the other Contracting Party related to management and disposal of investments.
2. The treatment referred to in paragraph 1 of this Article shall be at least as favorable as that granted to investments of its own investors or to investors of a third state whichever is more favorable according to the investor.
3. Each Contracting Party reserves the right to apply and introduce exemptions from national treatment of foreign investors and their investments including reinvestments.
4. The treatment granted in accordance with paragraph 2 of this Article shall not apply to benefits that the Contracting Party is providing or will provide in the future:
   - In connection with the participation in a free trade area, customs or economic union;
   - On the basis of agreements for the avoidance of double taxation, or other arrangements on taxation issues;

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252 Unofficial translation: “Model agreement between the Government of the Russian Federation and ... (name of the foreign government) on the promotion and protection of investments”.


254 See the website of Garant, the official Russian legal database with Russian legislation and case law, for the full 2001 Russian Model BIT (only available in Russian): http://ivo.garant.ru/#/document/12123282/paragraph/9242:5.

255 E.g. Article 2 and 2.1 respectively in the Russia-Netherlands BIT and Russia-China BIT.
By virtue of agreements between the Russian Federation and those states, which had earlier formed part of the Union of Soviet Socialist Republics.

5. Without prejudice to the provisions of Articles 4, 5 and 8 of this Agreement, the Contracting Parties shall accord the treatment no more favorable than the treatment granted by each Contracting Party in accordance with the Agreement establishing the World Trade Organization (the WTO Agreement), including the obligation of the General Agreement on Trade in Services (GATS), as well as in accordance with any other multilateral arrangement that will involve both Contracting Parties and will concern the treatment of investments.

Article 3 therefore provides for fair and equitable treatment, the national treatment and the most-favored nation treatment. Unlike most BITs, it does not mention full protection and security of the investor and his investment.

The fair and equitable treatment guarantee in the first paragraph is an autonomous and unqualified standard, as it does not reference principles of international law or to the minimum standard of treatment under customary international law. This implies that an arbitral tribunal will interpret Article 3 based on the normal meaning of the words “fair and equitable” in the context of the BIT, and thus will not require that a certain element of the fair and equitable treatment (as protection of transparency, due process or legitimate expectations) is to be found in customary international law.

Article 3(1) obliges a state to treat an investment fair and equitable only with regard to “management and disposal of investments.” This is a remarkable limitation, as most Model BITs of other states strive for fair and equitable treatment to be granted to all aspects of investment, which normally includes conduct, operation, possession, use and enjoyment, above management and disposal of investments. By limiting applicable activities under Article 3(1) to the management and disposal of the investment, the Russian Model BIT restricts the obligation to protect, seeing as the harmful activities taken by the government are rather situated in the operation and enjoyment of an investment.

In addition, Article 3(2) provides for national and most-favored nation treatment, depending which one of the two is the more favorable one from the perspective of the alien investor. According to Newcombe and Paradell, even though it is not mentioned in Article 3(2), this requirement includes both de jure and de facto discrimination against the investor, together with a compulsory comparison of investments in like circumstances. Furthermore, because of the limitation in its textual formulation – “the treatment referred to in paragraph 1 of this Article” – the second paragraph on

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national and most-favored nation treatment is likewise limited to the management and disposal of the foreign investment.

The core standard of national treatment is also impaired by the reservation in Article 3(3), which identifies permissible deviations from its obligations under the BIT, for example on the grounds of national security or protection of the environment. Therefore, under the Russian Model BIT, a host state is free in the implementation of exemptions to the national treatment standard. This is the most dubious protection offered by the Russian Model BIT, as this clause enables a nation to considerably derogate from the national treatment of a foreign investor. In short, Article 3(3) renders a core protective obligation of BITs extremely difficult to enforce, to the extent that it is possible to question whether Article 3(3) grants any protection at all to investors.

Consequently, crucial principles of BITs are significantly restricted by of Article 3 of the Russian Model BIT. The limited protections in Article 3 mark a general trend in the 2001 Russian Model BIT; while it contains the fundamental principles and substantive obligations contained in most countries’ Model BITs, careful analysis reveals that the scope of these substantive obligations are actually limited by other provisions.

Nevertheless, despite these peculiarities, the majority of the BITs concluded by Russia contain more favorable formulations of these core provisions than provided in the 2001 Russian Model BIT. Similarly, the permissible derogations from these guarantees are limited, when compared to the model text. During the negotiations, which obviously differ from one bilateral treaty to another, the scope of these obligations are usually altered to provide broader protections to foreign investors and in order to bring Russian BITs in line with those of most countries.

Another exception is contained in Article 3(4), which concerns the benefits that a contracting state provides or will provide in the future to other states under international agreements. This exception is therefore only applicable to the most-favorable nation treatment in Article 3, even though it does not

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260 E.g. the most-favored nation provision in Article 2 in Berschader v Russia case, wherein this treatment applies to all aspects of a treatment of a foreign investment (Vladimir Berschader and Moïse Berschader v. The Russian Federation, SCC Case No. 080/2004), and Russian BITs with Indonesia, Qatar and Venezuela that extend the fair and equitable treatment obligation to the “possession, use and disposal of investments” and thus do not apply only to “management and disposal of investments” from the 2001 Model text. Another example is the Russia-Thailand BIT wherein a contracting state can insert exceptions to the national treatment only “for the purpose of national security and public order” (Article 3(3)), while under the BIT with Japan, it is only possible “for measures that are really necessary for the reason of national security” (paragraph 5(1) of the Protocol to the Russia-Japan BIT).
By including such an exemption, foreign investors are unable to invoke the MFN standard in order to enjoy these particular (current and future) benefits. Even though it seems as though the list of the international treaties and agreements in question is exhaustive, it is also open-ended as it comprises many free trade agreements, economic and customs union agreements, double taxation treaties, and regional economic integration agreements with former USSR states, for example the Eurasian Economic Union (EAEU or EEU) of 2015\textsuperscript{262} and the Union State of 2000.\textsuperscript{263}

\textbf{b. Article 4: Expropriation}

1. \textit{Investments of investors of one Contracting Party made in the territory of the other Contracting Party shall not be subject to measures of forced dispossession having an effect equivalent to expropriation or nationalization, except when such measures are carried out in the public interest, in accordance with the procedure established by the legislation of this Contracting Party, are not discriminatory and are accompanied by prompt, adequate and effective compensation.}

2. \textit{The compensation shall correspond to the market value of the expropriated investments calculated as of the date when the actual or impending expropriation has become officially known. The compensation shall be paid without delay in a freely convertible currency and be freely transferable from the territory of one Contracting Party to the territory of the other Contracting Party. From the moment of expropriation until the moment of payment of compensation, interest shall be paid on the amount of compensation, set at a commercial rate established on a market basis, but no lower than the six-month US dollar LIBOR rate.}

This Article conforms fully to the widely used expropriation clauses in other counties’ Model BITs, both in its formulation and content. Article 4 covers direct and indirect expropriation, identifies the prerequisites for an expropriation to be legal, sets out the basics for evaluating compensation, establishes for the valuation date for this calculation, and provides for the payment of interest until the date on which compensation has been effectively paid.

The expropriation is thus lawful only if the following four conditions are satisfied, namely: (1) the expropriation has been made “in the public interest”, thus for a public purpose that the state has the authority to determine;\textsuperscript{264} (2) it has been conducted “in accordance with the procedure established by the legislation,” which is the domestic law and practices of the nationalizing state, and not the international due process requirements; (3) it was “not discriminatory” regarding the race, religion, culture, ethnicity or nationality\textsuperscript{265} of the foreign investor; and (4) the expropriation was “accompanied


\textsuperscript{262} The member states of the EEU are the Republic of Armenia, the Republic of Belarus, the Republic of Kazakhstan, the Kyrgyz Republic and the Russian Federation. For more information, see http://www.eaeunion.org/?lang=en#about.

\textsuperscript{263} The member states of the Union State consist of the Russian Federation and the Republic of Belarus. For more information, see http://www.soyuz.by/.

\textsuperscript{264} Usually states have a broad margin of appreciation, although in the end it is for the arbitral tribunal to determine whether an action is in the public interest.

by payment of prompt, adequate and effective compensation,” which is the widely accepted Hull Formula. Where a contracting state does not satisfy all of these conditions, the expropriation is illegal. Article 4(2) stipulates the compensation due to a foreign investor who has been divested of his private investment. It obliges the host state to: (1) pay an amount corresponding to the “market value” of the taken investment; 266 (2) align the valuation date with the date on which the expropriation became officially known; (3) pay the compensation without delay (i.e. within a reasonable amount of time); 267 (4) ensure that the investor is compensated in a freely convertible currency; (5) guarantee that the compensation is freely transferable between the two parties, a clause that is further detailed in Article 6; and (6) pay interest on the compensation from the date of the expropriation to the date of full payment, with the minimum interest rate set at the six-month US dollar LIBOR rate. 268

It bears remembering that this provision applies to the situation where the host state lawfully expropriated from the investor. In cases of unlawful expropriation, due compensation cannot be on terms less favorable to the investor than what was available on the free market. In fact, it is permissible for an arbitral tribunal to award compensation to an investor for the illegitimate expropriation of his investment that is higher than its market value. 269 Finally, the host state may be forced to pay the foreign investor for non-pecuniary damages, for example for moral harm or incidental expenses. 270

c. Article 5: Compensation for Losses

Investors of one Contracting Party whose investments suffer losses in the territory of the other Contracting Party as a result of war, civil disturbance, or other similar circumstances shall be accorded treatment, as regards restitution, indemnification, compensation or other types of settlement, which the latter Contracting Party accords to investors of a third State or its own investors, whichever is more favorable, as regards any measures it takes in relation to such losses.


268 “The 6 month US Dollar LIBOR interest rate is the average interest rate at which a selection of banks in London are prepared to lend to one another in American dollars with a maturity of 6 months.” See http://www.global-rates.com/interest-rates/libor/american-dollar/usd-libor-interest-rate-6-months.aspx.

269 E.g. ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary, ICSID Case No. ARB/03/16, paragraph 497, wherein the date of the award was considered by the tribunal as the valuation date of the payable compensation, which consequently produced a higher compensation for the investor.

Article 5 of the 2001 Russian Model BIT corresponds to similar provision in other states’ BITs. This Article provides for the payment of compensation to a foreign investor in the event of war, civil disturbance or similar circumstances, including revolutions, revolts, riots and other armed conflicts in the host state of the foreign investment. It is noteworthy that the host government need not have caused these conditions; they may be triggered by the host state’s nationals or by non-state actors. However, Article 5 does not clarify in which cases the financially injured investor should be reimbursed, what process is to be employed or how much he is entitled to. The Model BIT merely states that the investor is entitled to the better treatment than national or third state treatment when compensation is paid in one of the above-mentioned circumstances. Therefore, this is a relative protection obligation, which contrasts with the standard obligation to provide “reasonable/adequate” compensation, which is contained in other BITs.

**d. Article 6: Transfer of Payments**

1. Each Contracting Party shall guarantee to investors of the other Contracting Party, upon fulfilment by them of all tax obligations, a free transfer abroad of payments related to their investments, and in particular:

   a. Returns;  
   b. Funds in repayment of loans and credits recognized by both Contracting Parties as investments, as well as accrued interest;  
   c. Proceeds from full or partial liquidation or sale of investments;  
   d. Compensation pursuant to Articles 4 and 5 of this Agreement;  
   e. Wages and other remunerations received by investor and natural personas of the other Contracting Party authorized to work in connection with investments in the territory of the first Contracting Party.

2. Transfers of payments shall be effected without delay in a freely convertible currency at the rate of exchange applicable on the date of transfer pursuant to the exchange legislation of the Contracting Party in whose territory the investments were made.

This Articles guarantees a foreign investor’s freedom to transfer funds related to his investment, whether to his home state or to any other country.

This right is conditioned, however, on the investor’s prior fulfillment of his tax obligations, which can be a hindrance to the transfer of payments. This is particularly the case where a state abuses its legislative power over domestic taxation towards foreign investors. This kind of exploitation of a state’s taxation powers and the unfounded use of tax claims or fines form a perpetual danger to investors. On

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272 E.g. UK Model BIT, Article 4(2) “Nationals or companies of one Contracting Party who in any of the situations referred to in that paragraph suffer losses in the territory of the other Contracting Party resulting from (a) requisitioning of their property by its forces or authorities, or (b) destruction of their property by its forces or authorities, which was not caused in combat action or was not required by the necessity of the situation, shall be accorded restitution or adequate compensation.”
273 Article 1(c) of the 2001 Model BIT “Returns means the amounts yielded from investments and include in particular profits, dividends, interest, licence remunerations and other fees.”
the other hand, the majority of BITs by other countries usually contain not just one, but many diverse exemptions to this transfer of payments guarantee. The goal is to make sure that the investor adheres to his legal obligations, for instance in matters such as insolvency, securities trade, criminal offences and execution of court orders, before transferring profits, dividends and other returns abroad. In this aspect, the Russian Model BIT is more beneficial to foreign investors than are other BITs.

It is not clear from Article 6(1) if the list of “payments related to their investments” is illustrative or exhaustive. Commentator Ripinsky notes, however, that the paragraph speaks of “payments related to investments” in general, and that the list is not preceded by the words “in particular”. Accordingly, Ripinsky concludes that Article 6(1) is illustrative and therefore that other categories may also apply.²⁷⁴ Despite the fact that the Russian Model BIT appears quite comprehensive and contains all of the principles and substantive obligations found in other states’ Model BITs, it also contains additional, somewhat discrete, but important limitations to the core protective obligations. It is unclear, therefore, whether the Russian government intended for Article 6 to be illustrative, with other not explicitly mentioned categories, rather than exhaustive, or if this was done in error.

Article 6(2) additionally specifies how the freedom of transfer obligation should be executed: (1) without delay (i.e. within a reasonable amount of time depending on “the customary practices in this area and on specific circumstances of the case”);²⁷⁵ (2) in a freely convertible currency;²⁷⁶ and (3) at the rate of exchange applicable on the date of transfer. With respect to the final category, the payment will be determined by the market exchange rate, even though it is supposed to be determined by the exchange legislation of the host state.²⁷⁷

As previously discussed, the Russian Model BIT is relatively short as it contains only twelve articles. Having provided all the core protection standards with respect to the treatment of a foreign investor by a host state, there are six articles left. Two of the six are concerned with substantial protections. The remaining four address issues related to consultations between the parties on questions of interpretation and application of the BIT, the treaty’s entry into force date, the fifteen-year duration of the agreement, the mechanism for terminating it, the amendment process, the procedures to follow

²⁷⁵ Ibid.
²⁷⁶ The Russian ruble is considered a freely convertible currency just as e.g. the Euro, Pound Sterling, Swiss Franc and the Norwegian Kroner. See A. Zwass, Money, Banking, & Credit in the Soviet Union & Eastern Europe, Vienna, Springer, 2016, 233.
in all these cases, and so on. The remaining two substantial articles, Articles 8 and 9, deal with investor-State and State-State dispute settlement, respectively.

e. **Article 8: Settlement of Disputes between a Contracting Party and an Investor of the Other Contracting Party**

1. **Disputes between one Contracting Party and an investor of the other Contracting Party arising in connection with an investment in the territory of the first Contracting Party, including disputes relating to the amount, conditions and procedure of payment of a compensation pursuant to Articles 4 and 5 of this Agreement, or to the procedure of transfer of payments set in Article 6 of this Agreement, shall be settled in so far as possible by way of negotiations.**

2. **If a dispute cannot be settled by way of negotiations during a period of six months from the date of the request for negotiations by any disputing party, it shall be submitted at the choice of an investor for consideration to:**
   a. A competent court or arbitrazh court of the Contracting Party in whose territory the investments were made, or
   b. An ad hoc arbitration tribunal in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL), or
   c. To the International Centre for Settlement of Investment Disputes (ICSID)\(^\text{278}\), created pursuant to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States signed at Washington on 18 March 1965, for settlement of a dispute according to provisions of this Convention (provided that it has entered into force for both Contracting Parties), or its Additional Facility Rules (in case that the Convention has not entered into force for either or both of the Contracting Parties).

3. **An arbitral award shall be final and binding upon both parties to the dispute. Each Contracting Party shall enforce such an award in accordance with its legislation.**

Article 8 provides for an investor-State dispute settlement mechanism, one of the two arbitration forms available under the Model BIT. This mechanism is only available to the parties after they have made every effort to come to an agreement by way of preliminary negotiations over a period of six months preceding the arbitration claim.

It should be noted that Article 8 concerns all disputes “arising in connection with an investment,” which means that a party must not necessarily assert that the contracting state has violated the BIT, which deviates from common BIT practice. As a result, the spectrum of disputes that can be counted under investor-State arbitration is quite broad, and in this regard the Russian investor-State clause in Article 8 empowers the foreign investor to submit a dispute to international investment arbitration where the issue in dispute is governed by the host state’s national law, or customary international law. The only pre-requisite for the application of Article 8 is that it is “related to an investment.”\(^\text{279}\)

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\(^{278}\) The ICSID is an agency of the World Bank and was established in 1965, “recognizing the value of foreign direct investment as an aid to development, but also the dangers of investing in politically volatile countries. It grants a degree of security to investors located in regions lacking political or legal stability by providing a means of legal redress for commercial damage caused by the regulatory and administrative actions of host state governments” D. Collins, *The BRIC States and Outward Foreign Direct Investment*, Oxford, Oxford University Press, 2013, 16.

Once the six-month negotiation period has elapsed, an investor may bring the dispute before one of three adjudicatory bodies: a court or arbitration tribunal\(^{280}\) of the host state, an ad hoc tribunal in accordance with the UNCITRAL Arbitration Rules, or the ICSID in accordance with the ICSID Convention or its Additional Facility Rules.

As mentioned above, one of the cornerstones of international arbitration is the parties’ entirely voluntary consent to participate in arbitration. According to the language of Article 8, which entitles the parties to initiate arbitration proceedings, their consent is granted upon signing the given BIT; thus, once a party files an investment claim under investor-State arbitration, the arbitral process formally commences without requiring separate consent from the host state despite its usual sovereign immunity. Moreover, the Model BIT does not require that parties exhaust local remedies first.

Russia has signed,\(^ {281}\) but not ratified, the ICSID Convention. Thus, in any case it cannot conduct arbitral proceedings according to the ICSID Convention, and its only option for arbitration falls under the Additional Facility Rules. These Additional Facility Rules allow Russian entities to bring claims against ICSID Member States and vice versa. Proceedings under the Additional Facility Rules can be initiated if “arbitration or conciliation of investment disputes between a state and a foreign national, one of which is not an ICSID Member State or a national of an ICSID Member State.”\(^ {282}\) Although Article 8 seems to suggest the opposite, it is only possible for a dispute to be processed under the Additional Facility Rules if at least one party is member to the Convention. Therefore, it is impossible to initiate proceedings under ICSID Additional Facility Rules where both parties are non-member states.\(^ {283}\)

To date, not a single case has been brought against Russia under the ICSID Additional Facility Rules against Russia, and no Russian investor has relied on the Rules to commence arbitration against

\(^{280}\) There is sometimes confusion about the nature and function of the Russian arbitrazh courts. An “arbitrazh court” in Russia hears most commercial disputes and many other cases involving business entities, even those which are against the state of the RF itself. They are not arbitration tribunals as we know them, and they do not conduct arbitration. Arbitrazh courts are courts in the general sense of the word, operate according to federal laws, and are staffed by full-time judges who are paid and approved by the state. See U.S.-Russia Business Development Committee, *Handbook on Commercial Dispute Resolution in the Russian Federation: A Guide for Businesses on Navigating the Russian Legal System for Resolution of Business Disputes*, 2002, 9-13.


\(^{282}\) Article 2 of the ICSID Additional Facility Rules.

\(^{283}\) In addition to the fact that the dispute has to exist between a state and a foreign national, only one of which is not an ICSID Member State or a national of an ICSID Member State, and that the parties have given their consent in writing to international arbitration, it is compulsory that the dispute is of a legal nature and directly arising out of an investment. (Article 25: Jurisdiction of the Centre of the ICSID Additional Facility Rules).
another state.\textsuperscript{284} So far, all claims have been disputed under the UNCITRAL Rules or the Arbitration Rules of the Stockholm Chamber of Commerce (SCC).

Article 8(3) provides that arbitral awards from one of these three adjudicating bodies are final and binding.\textsuperscript{285} This prevents a party from resubmitting the dispute to another tribunal for a new decision and prohibits a state party’s national courts from revising it as well. As a result, without the need of first obtaining an exequatur, a condemned contracting party must automatically enforce such an award in accordance with its national legislation, and may not delay by resorting to additional procedures in domestic courts. This last obligation can create a stumbling block for the winning party, as the national procedures for the enforcement of an international arbitral award have a varied flexibility range among all countries in the world, depending on where the award has effect.

From the past, Russia has not been the easiest or most cooperative state and often fails to recognize and enforce arbitral awards. Consequently, commentators have repeatedly questioned its commitment to the arbitration process.\textsuperscript{286} This poses an especial problem, as all the arbitration cases involving Russia, have been conducted under the UNCITRAL Rules or the SCC Arbitration Rules. A notorious example is the \textit{Sedelmayer v Russian Federation} case,\textsuperscript{287} where a German investor won an arbitration case against under the SCC Arbitration Rules on the basis of the 1989 USSR-Germany BIT. The investor was awarded damages in the amount of US$ 2.35 million, plus interest, for his expropriated investment. Despite the award, the Russian government did not compensate him for his loss. It took thirteen years from the date of the award in 1998, with filings before various jurisdictions, before the last court decision taken by the Swedish Supreme Court in 2011.\textsuperscript{288} Eventually, he was awarded the assets of Russian governmental officials in different European countries as compensation for the allocated damages.\textsuperscript{289} This case is believed to be the only one that has ever resulted in a successfully enforced arbitral award against Russia.\textsuperscript{290} Mr. Sedelmayer stated at the end of his saga in

\textsuperscript{285} Article 52(4) of the ICSID Additional Facility Rules.
\textsuperscript{287} Mr. Franz Sedelmayer \textit{v. The Russian Federation}, SCC Case, Arbitration Award of 7 July 1998. It constitutes the first international arbitration award against Russia.
\textsuperscript{288} For all the 26 court orders and decisions that were issued between the original arbitration award from 1998 and the last judgement by the Swedish Supreme Court in 2011, see http://www.italaw.com/cases/982. See also the Ministry of Foreign Affairs of the Russian Federation press release of 7 July 2011 http://archive.mid.ru//brp_4.nsf/0/DD2145A87B572045C32578C6005B2CED.
\textsuperscript{289} \textit{Supra} note 286.
\textsuperscript{290} R. Rothkopf and F. Albert, “Russia Turns Its Back on the ECT: A New Era for Investment Arbitration”, 81
2011: "Russia is making a very serious mistake as she puts her international image in jeopardy. Because of some two million euros, which kicked the whole thing off, the Russian authorities are putting pressure on the government of Sweden to demonstrate their power. They want to show this power to the Russian population and to many of those, who lost their property in Russia. As a matter of fact, Russia’s reaction shows that the country is not safe for those claimants who try to retrieve what they lost as a result of corruption or illegal withdrawal of property." He further added that: “Investors and foreign entrepreneurs are carefully watching the process of how Russia wants or does not want to abide by its obligations. The majority of entrepreneurs - those who can’t deal with speculations with foreigners in the first place - will stay away from the Russian investment market.”

To conclude, unlike the majority of BITs, the Russian Model BIT of 2001 does not present any details on further aspects of the arbitration proceedings, such as the conduct of the arbitration, the selection of arbitrators, review of objections, third-party indemnification, interim measures of protection, transparency of arbitral proceedings, governing law, claims consolidation, or amicus curiae submissions.

f. Article 9: Settlement of Disputes between the Contracting Parties

1. Disputes between the Contracting Parties concerning the interpretation or application of this Agreement shall be settled by way of negotiations. If a dispute cannot be settled in such a way within six months from the beginning of the negotiations, it shall be submitted upon the request of either Contracting Party to an arbitral tribunal.

2. An arbitral tribunal shall be constituted for each individual case. To this effect each Contracting Party shall appoint one member of the arbitral tribunal within two months of the receipt of a request for arbitration. Those two members shall then select a national of a third State who, on the approval of the two Contracting Parties, shall be appointed as the Chairman of the arbitral tribunal within a month from the date of the appointment of the other two members.

3. If within the time-limits specified in paragraph 2 of this Article the necessary appointments have not been made, either Contracting Party may, in the absence of any other agreement, request the President of the International Court of Justice (ICJ) to make such appointments. If the President of the ICJ is the national of the State of either Contracting Party or is otherwise unable to discharge the said function, the Vice-President of the ICJ shall be requested to make the necessary appointments. If the Vice-President of the ICJ is also a national of the State of either Contracting Party or is otherwise unable to discharge the said function, the member of the ICJ who is not a national of the State of either Contracting Party next in seniority shall be requested to make the necessary appointments.

4. The arbitral tribunal shall render the award by a majority of votes. Such award shall be final and binding upon the Contracting Parties. Each Contracting Party shall bear the costs of activities of its own member of the court and of its representation in the arbitration proceedings; the costs related to the activities of the Chairman of the arbitral tribunal and other costs shall be borne in equal parts by the Contracting Parties. The tribunal may, however, in its award direct that a higher portion of costs shall be borne by one of the Contracting Parties and such award shall be binding on both Contracting Parties. The arbitral tribunal shall establish its own procedure independently.


Article 9 of the Russian Model BIT concerns the other form of arbitration available to prospective disputing parties, which in this case will be the contracting home and host state. State-State arbitration is likewise only accessible after the conclusion of mandatory six-month efforts by the parties to come to a settlement by way of negotiations.

In contrast to the above-discussed investor-State arbitration, the State-State dispute resolution mechanism is not very common or widespread among nations. Even though Article 9 is longer than Article 8 on investor-State arbitration – in particular because it provides the basic components of the arbitral procedure, which Article 8 does not provide – it is still relatively brief and concise, as the details are left to the applicable rules of arbitration and further independent elaboration by the tribunal. However, this is typical in the world of investment arbitration and thus most State-State arbitration clauses in BITs are even shorter than the Russian investor-State arbitration clause. The disputes than can be settled through State-State arbitration must concern “the interpretation or application” of the BIT in question. It follows that, according to its *ratione materiae*, the scope of this provision is narrower when compared to the scope in Article 8, which applies to “all disputes arising in connection with an investment”, which is also broader than the majority of other BITs.

As this is a State-State dispute resolution instrument, the prevailing party need not seek recognition and enforcement of the award. In summary, the provision in the 2001 Russian Model BIT on the State-State dispute settlement mechanism does not contain any peculiarities and is fully aligned to global practices when dealing with arbitration proceedings between two sovereign states.

The 2001 Russian Model BIT closes with:

Совершено в __________ “___”_________ 200__ года в двух экземплярах, каждый на русском и __________ язык(ах), причем оба текста имеют одинаковую силу.

За Правительство
Российской Федерации

За Правительство ____________________________
(название иностранного государства)

292 The 2012 US Model BIT is a lightly exaggerated example of this phenomenon when compared to the bulk of Model BITs. It contains no less than twelve articles on the investor-State arbitration, while there is solely one article on the State-State arbitration.

293 See discussion above in Article 8.

294 Unofficial translation: “Done in duplicate on ..., each in Russian and ... languages, both texts being equally authentic. For the Government of the Russian Federation – for the Government of ... (name of the foreign government).”
E. Conclusion

While the US BIT program was already on its second wave of BIT negotiations by 1989, the Russian Federation was only established after the collapse of the Soviet Union two years later. The subsequent chaotic emergence of the new states and their tough transition to a market economy, a process of which Russia was part of, explains the country’s model negotiating text as it is today. Only one revision has been conducted, and the latest Model BIT – even though it is fifteen years old by now signifies a great advancement when compared to the first Model BIT, which omitted basic provisions such as national treatment of foreign investors. However, even if it is fifteen years old, the 2001 Russian Model BIT still contains the core substantive protections that a modern BIT should contain. It is also in line with model BIT texts from other countries, especially when compared with European model BIT texts, which are similarly not as extensive as for example the US Model BIT. Thus the 2001 Russian Model BIT is not an absolute negative as not so long ago the country had a 100% centrally planned economy.

Overall, the 2001 Russian Model BIT is liberal in its outlook, and the degree of investment protection offered is quite high when its core protection provisions are examined, including compensation for expropriation in Article 4 and the transfer of payments in Article 6. Even though the Russian Model BIT does not include other mainstream protective provisions regarding constraints on performance requirements or prohibition of nationality restrictions on top managerial staff, the negotiated BITs concluded with other nations invariably incorporate these provisions, with the degree of protection varying from one treaty to another.

Thus, the actual Russian BITs do not diligently follow the Model BIT, and have to be read on a treaty-by-treaty basis in order to understand the protection level offered by a particular bilateral agreement.

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295 After having concluded ten BITs from 1982 to 1986, a break was taken in the US BIT negotiations in order to provide the Senate with the time to give advice and consent for the ratification of those ten BITs, and especially to ensure that the Senate supported the whole BIT program, before commencing new negotiations. See K. J. Vandevelde, *US International Investments Agreements: Policy and Practice*, Oxford, Oxford University Press, 2009, 2.

296 Two revisions if we take the 1987 USSR BIT into consideration.

297 E.g. USSR-Germany BIT of 1989.

298 For example, the prohibition of certain performance requirements in the Russia-Japan BIT and Russia-Germany BIT, limitation on allowed exceptions for national and MFN treatment obligation in the Russia-Thailand BIT and transparency obligations in the Russia-Kazakhstan BIT. Further, the Russia-US BIT mentions ‘respect for the internationally recognized rights of working people’ and Russia-Hungary BIT makes exceptions to national treatment based on public health and environment. For a comprehensive overview of all Russian BITs that contain such additional protections. See D. Collins, *The BRIC States and Outward Foreign Direct Investment*, Oxford, Oxford University Press, 2013, 60-73.
This makes sense, since a BIT sprouts from negotiations between two parties and is not a carbon copy of the original, as each state has individual needs and distinct interests that requires both to give and take in order to reach a compromise. Thus, the finalized BIT should be a product of joined national policies on transmission of investments between the two states that will spur the flourishing of their economies and lead to mutual economic growth. In addition, the reciprocal spirit of a BIT leads to the awareness that Russia’s FDI in foreign states will also be subject to the same conditions – both protective measures and restrictions – contained in the BIT.

A remarkable feature of the Model BIT is the dichotomy of the Model BIT. Take for example Article 3(1), which obliges a state to treat an investment fair and equitable only with regard to “management and disposal of investments.” This is a remarkable limitation, as most BITs by other states require that fair and equitable treatment is granted to all dimensions concerning the investment. Moreover, the same limitation applies to the national treatment and most-favored nation treatment provisions in the next paragraph. In addition, Article (3) curbs the offered protection even more by enabling a contracting state to deviate from the (already limited) national treatment standard without any justification, including on the health and environment protection grounds. Therefore, a host state is unrestricted in implementing carve-outs to this essential and indispensable protection measure to foreign investors.

On the other – more liberal – end of the spectrum, there is Article 6 on transfer of payments, which unlike the vast majority of other countries’ BITs does not permit any exceptions to the transfer of payments besides with regard to taxation. Hence, in this provision, the Russian Model BIT is lowering the threshold and affording more protection to foreign investors than the majority of BITs. In addition, no national security interest exception can be found or any other generally qualified exception.

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299 Which is surprising for a great political and military power as Russia. Model BITs of Germany, the US, Canada, India and similar states typically do include such an exception based on the protection of vital national security interest. Overall, the trend to include the national security exemption has been spreading since the 9/11 tragedy in the United States, which led to a palpable change in the national policies toward foreign investors and an increased protection of national industries and important infrastructures against foreign acquisitions on national security grounds. K. P. Sauvant, *Yearbook on International Investment Law & Policy 2008-2009*, Oxford, Oxford University Press, 2009, 50-53.

300 For example, Canada uses general exceptions in the majority of its BITs, see for example Canada-Peru BIT Article 10: General Exceptions “1. Subject to the requirement that such measures are not applied in a manner that would constitute arbitrary or unjustifiable discrimination between investments or between investors, or a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures necessary: (a) to protect human, animal or plant life or health; (b) to ensure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement; or (c) for the conservation of living or non-living exhaustible natural resources.”
just as no policy areas of importance to national sovereignty, such as tax matters\textsuperscript{301} or subsidies,\textsuperscript{302} are excluded from the jurisdiction of an investment treaty dispute, unlike in many other investment treaties.\textsuperscript{303} Thus, the Russian Model BIT does not contain limitations or exclusions on all of the protections it provides. Lastly, in the dimension of investor-State arbitration in Article 8, the scope applies to “all disputes arising in connection with investments”, which again encompasses more protections than other state’s BITs.

The question remains whether this asymmetry in strong and weak standards of treatment is to be attributed to specifically implied motivations of the Russian government, or rather to the carelessness and the inexperience of officials when drafting model agreements, together with the lack of experience with arbitrations under bilateral investment treaties as the Russian state has not, thus far, been involved in many arbitration cases as respondent. Only time will tell how the Russian Model BIT will be remodeled. Nevertheless, it appears that the Russian government does not see a revision of the text as one of its main priorities or feel the urge to reexamine the 2001 Model BIT – an attitude which possibly can be ascribed to the Model’s flexibility during BIT negotiations or a lack of a voluminous litigation history.

**Comparison of Model BITs**

After analyzing both Model BITs thoroughly, we can now grasp the differences and similarities in the level of protection offered to foreign direct investments by the United States and the Russian Federation. As every bilateral investment treaty is a reciprocal agreement shaped by negotiations wherein states give and take, the Model BITs only represent the initial level of protection a state intents

\begin{itemize}
\item [\textsuperscript{301}] Which can be found in Article 21(1) of the Energy Charter Treaty, Article 2103 of NAFTA and Article 13 of the 2012 US Model BIT, which delineate the circumstances in which taxation measures may be submitted to arbitration. See more in M. Gregoire, “Taxation and expropriation under bilateral investment treaties: setting the standard”, Butterworths Journal of International Banking and Financial Law, Vol. 30, 2015, 629-31.
\item [\textsuperscript{302}] For example, the 2016 Indian Model BIT contains an even more narrow scope of policy areas in Article 2.4: “This Treaty shall not apply to: (i) any measure by a local government; (ii) any law or measure regarding taxation, including measures taken to enforce taxation obligations. For greater certainty, it is clarified that where the State in which investment is made decides that conduct alleged to be a breach of its obligations under this Treaty is a subject matter of taxation, such decision of that State, whether before or after the commencement of arbitral proceedings, shall be non-justiciable and it shall not be open to any arbitration tribunal to review such decision; (iii) the issuance of compulsory licenses granted in relation to intellectual property rights, or to the revocation, limitation or creation of intellectual property rights, to the extent that such issuance, revocation, limitation or creation is consistent with the international obligations of Parties under the WTO Agreement; (iv) government procurement by a Party; (v) subsidies or grants provided by a Party; (vi) services supplied in the exercise of governmental authority by the relevant body or authority of a Party.”
\end{itemize}
to provide. As such, these model texts set out the minima or maxima of FDI protection standards that a state is willing to confer to alien investors and their private capital.

The first, general conclusion upon examination of both model agreements, is that the US Model BIT is considerably more comprehensive and for that reason, much more protective with respect to foreign investors. However, we should not evaluate exclusively based on the length of a BIT. Applied to the Model BITs in question, the extensive 42 pages of the US Model BIT do not offer pro rata more FDI protection when compared to Russian Model BIT’s eight pages. For example, almost half of the whole US model agreement consists of provisions exclusively dealing with dispute settlement and the according arbitral proceedings that have to be followed, while the Russian model agreement leaves the details to the applicable arbitration rules and elaboration by the arbitral tribunal.

Yet, in the present case, the US Model BIT does indeed offer slightly more protection than the Russian one, however proportionally, it is not that much more. On the whole, the Russian eight-page model has the vast majority of the core FDI protection measures which the elaborated US model also contains. Moreover, a Model BIT of eight pages is not exceptional. When we examine European Model BITs, they are all rather brief and concise. Besides, when we take a look back into the history of the development of Model BITs around the world, this observation likewise explains the briefness of the Russian model agreement, as it was drafted on the basis of those European BITs.

Regarding the impression we get about the exact provisions of the two Model BITs, one can detect many analogous core protections. These measures include: the national and MFN treatment, guarantees against expropriation and payment of “prompt, adequate and effective” compensation, commitment to fair and equitable treatment, free transfer of payments and neutral dispute settlement through international investment arbitration under ICSID or UNCITRAL rules.

Because of its past with the NAFTA, the US Model BIT has included its “lessons learnt” in the latest text version and consequently, it yields more regulatory space to a FDI host state in the area of environmental and labor rights protection. As Russia has not (yet) experienced such massive

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304 Some assert that the high level of commonality between these core treaty provisions can be explained by the fact that all these guarantees and commitments stem from customary international law. SOURCE

305 Basically the only three mainstream protection measures that are not mentioned in the Russian Model BIT, are the full protection and security guarantee, prohibition of performance requirements and nationality restrictions on top managerial staff.

306 Nota bene, this is primarily a modification with the goal of protecting the United States itself from future NAFTA-like litigation.
negative litigation, the Russian government subsequently continues to operate under its current Model BIT.\textsuperscript{307} However, this dimension of the Model BITs does not add much FDI protection; hence it remains of minor importance when comparing the presented FDI protection by the US and Russia, in order to attract foreign investors to their territories.

After all these considerations – when we conclude that the overall level of protection offered to foreign investors by the US Model BIT and the Russian Model BIT is roughly the same and there are no outliers among the respective core provisions – an essential question instantly arises.

If one – for the sake of argument – would ignore the smaller differences in character and nature and would consider the US and Russia to be fairly similar on three levels: an abundance of natural resources, a large consumer market and a highly educated workforce – which seem like the perfect incentives for attracting foreign investors – what is then the reason that the US strongly succeeds in attracting foreign investors while Russia has fared poorly in its similar bid? In addition, over the years, Russia has ratified substantially more bilateral treaties when compared to the amount of BITs that the United States has concluded, and the overall level of Russian FDI protection is approximately the same when compared to the protection level offered by the US model, which is one of the most protective texts in the world.\textsuperscript{308}

Hence, how is it possible that the Russian Federation does not even make it to the top ten of FDI destination countries, while the US has been number one for decades?

\textsuperscript{307} This may change in the future, seen the notorious Sedelmayer and Yukos cases. In addition, the Ukrainian crisis has stirred investors from both nations to submit claims under the existing Ukraine-Russia BIT. This can likewise influence Russia’s negotiation attitude and future BIT program.

As such, this peculiarity purports that another – more important – factor is playing in the decision-making process of foreign investors. If the offered FDI protection level through international investment law and bilateral investment treaties is not the decisive factor, what is it then?

Chapter 2.3 – Russia-US BIT of 1992

A. History

Having analyzed the Model BITs of the United States and Russian, this dissertation now turns to the reciprocal BIT between the two nations.

The United States was already on its second wave of international BITs when the Soviet Union disintegrated. Before this disintegration, talks about a future USSR-US BIT were ongoing; however, no such BIT was ever concluded as the USSR shortly thereafter had ceased to exist. Nevertheless, after the dissolution of the Soviet Union the negotiations resumed, but this time for a Russia-US BIT. They were based on the previous text that was being discussed with the former USSR and many of the Russian negotiators had worked previously on the USSR-US investment treaty.

Source: UNCTAD\textsuperscript{309}


\textsuperscript{310} Senate hearing of 4 August 1992, 47. See at https://babel.hathitrust.org/cgi/pt?id=pur1.32754074685102;view=1up;seq=11;size=75.
This Russia-US BIT was signed in 1992 by both nations and was submitted the same year to the US Senate for consideration. In response to a question posed by Senator Pell during the Senate hearing regarding the investment barriers in Russia for US investors, the Bush Administration acknowledged “the uncertainty of the investment climate – while law, regulation and the bureaucracy are in an ongoing state of flux.”

Nevertheless, the BIT was ratified by the US Senate in 1993. Ironically, while it was the first BIT between the United States and a republic of the Commonwealth of Independent States (CIS) to be ratified by the Senate, it remains the only one that has yet to enter into force. It has not entered into force because the BIT is still awaiting ratification by the Russian Duma. Unfortunately, despite exactly 24 years having passed since the signing of the treaty, Russian ratification is unlikely in the near future given recent political developments between the two nations. Moreover, the treaty is by now fairly outdated according to contemporary norms: both countries have issued a new Model BIT that are substantially different from the ones under which the 1992 Russia-US BIT was negotiated. In addition, both nations have gained litigation experience over the course of the years and learned from arbitral decisions, the balance between protecting FDI and maintaining their nations’ regulatory space has come more to the front in BIT negotiations, and the economic situation in Russia has changed significantly with the dissolution of the Soviet Union and the ascendance of President Putin.

B. Treaty Provisions

The “Treaty between the United States of America and the Russian Federation concerning the Encouragement and Reciprocal Protection of Investment” includes: fair and equitable treatment; reciprocal national and most-favored nation treatment; full protection and security; guarantees to establish and operate the investment; protection from direct and indirect expropriation and the provision of “prompt, effective and adequate” compensation when there is expropriation for a “public purpose” in accordance with “due process of law”; the prohibition of impairment of the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposition of investments by arbitrary or discriminatory measures; guarantees for the right of both parties to hire top managerial personnel of their choice regardless of their nationality; the prohibition of performance

312 Not in the original or latest Russian Model BIT. For the original Russian Model BIT, see http://ivo.garant.ru/#/document/12142677/paragraph/14.
313 Idem, no “establishment of investment” – protection obligation in the original or latest Russian Model BIT.
requirements;\textsuperscript{314} the transferability of freely convertible currency; and the establishment of common dispute mechanisms for investor-State and State-State arbitration.\textsuperscript{315}

Overall, the Russia-US BIT was at the time a standard bilateral agreement with provisions mirroring those of most sovereign nations.\textsuperscript{316} It promoted reciprocal investments between the contracting nations, provided all conventional protection standards to foreign investments and elaborated thoroughly upon each of them.

Of note, the level of protection provided in the Russia-US BIT is significantly higher than the original 1991 Russian Model BIT granted to alien investors. In addition to the common exceptions to national treatment standard in matters such as banking, critical infrastructure and telecommunications, Russia has particularly emphasized the exception apropos “ownership of land and use of subsoil and natural resources.” In this specific area, the Russian government reserved the right to make exceptions to the national treatment provision, and the following letter was attached to the agreement as an integral part of the BIT, and affirms the mutual understanding shared by both countries regarding this negotiated exception: “Based on the Law of the Russian Federation on Subsoil and legislation relating to natural resources, the Russian Federation has reserved the right to make or maintain exceptions to national treatment for the use of subsoil and natural resources.”\textsuperscript{317}

C. Ratification Failure

It is still unclear why exactly the Russian government never ratified the BIT, and the government has yet to comment on the matter. On the question why the Russian Federation still has not ratified the signed 1992 BIT with the US, Professor Vandevelde had provided me with the following insightful information, based on his personal experience as a US BIT negotiator:

“Regarding the BIT with Russia, my recollection is that the Russian parliament did not approve the treaty because some members of the Russian parliament believed that it gave the United States too many rights with respect to the petroleum sector of the economy. The U.S. Model BIT has changed a great deal since 1992. If Russia and the United States were going to have a BIT now, I believe that they would negotiate a new treaty rather than merely bringing the 1992 treaty into force.”\textsuperscript{318}

\textsuperscript{314} Not in the original or latest Russian Model BIT.
\textsuperscript{315} Being the ICSID Rules, the ICSID Additional Facility Rules, the UNCITRAL Rules or any other institutional arbitration facility the parties have agreed upon. See Article VI and VII of the US-Russia BIT.
\textsuperscript{316} Full US-Russia BIT text is available in both Russian and English at http://investmentpolicyhub.unctad.org/IIA/country/175/treaty/2862.
\textsuperscript{318} Email d.d. February 21, 2016.
Other experts share Professor Vandevelde’s explanation for Russia’s failure to ratify the BIT. According to commentators Aslund and Kuchins of the Peterson Institute, a non-profit think tank focused on international economics, the main reason was “a parliamentary majority that opposed President Boris Yeltsin.” However, Aslund and Kuchins also note that “since December 1999 President Vladimir Putin could easily have had the treaty ratified in the parliament.” The implication is that something else is preventing the Russian government from ratifying the BIT. What that reason may be remains unknown, however: it may be the constantly wavering political relation between the two global powers, or the reciprocal lack of trust and prevailing suspicion dating back to the Cold War, or the little FDI amounts that are involved in the reciprocal investment flows in each other’s territory. At this point one can only speculate.

**D. Outlook**

Diverse authors argue that a new Russia-US BIT would be a means to bolster commercial ties between the two governments, provide protection to Russian and US investors, and spread confidence among their investors. In 2008 there was a brief hope for a resumption of BIT talks, when negotiations of a new investment treaty were placed at the top of the bilateral investment agendas of both nations in the US-Russia Strategic Framework Declaration.

The 2008 policies were scheduled for execution in 2014. One of the last statements that was made regarding these plans, came on the occasion of a meeting between Alexei Ulyukayev, Russia’s Minister of Economic Development, and his US counterpart, Penny Pritzker, the U.S. Secretary of Commerce, on the resumption of bilateral trade talks between the two states and finalizing this long-discussed treaty. After the meeting, the President of the US-Russian Business Council (USRBC), Daniel Russell, subsequently declared that: “A bilateral investment treaty would close the gap in the overall bilateral

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320 Russian investments in the US or US investments in Russia have never concerned large FDI flows, as only a small amount of investors and investments are involved. Hence, the lack of a BIT does not pose major problems that affect large capitals and most investors (just have to) manage with the domestic legal protection mechanisms of both nations.
economic framework. USRBC firmly supports the finalization of a bilateral investment treaty as soon as possible. It’s important because it would send a signal to the respective business communities of each country – our governments are serious about developing two-way trade and investment. This treaty establishes terms and conditions for two-way private investment. It also provides for equitable treatment for investors and their investment and gives then the right to dispute with the government of the other party in international arbitration.”

However, the Russian intervention in Ukraine in 2014, the subsequent sanctions by the Russian and US governments, and the overall cooling off of the diplomatic relations between the two nations have put these promising BIT negotiations on hold. According to a statement by the Office of the U.S. Trade Representative in March 2014, while Russia and the United States have started to discuss a new BIT, the scheduled visit by US trade officials to discuss that treaty had been cancelled due to events in the Ukraine: “We have suspended upcoming bilateral trade and investment engagement with the government of Russia that were part of a move toward deeper commercial and trade ties.” Thus, this modern “Cold War” severely affects the current investment relation of the two nations.

Despite the ongoing problems facing its adoption, a new bilateral agreement between the United Stated and Russia would not only represent a political statement today – just as it was in 1991 after the collapse of the USSR – but would be a wise move from a purely economic perspective, as Russia is in great need of FDI in order to boost its economic growth and utilize its full capacity, while the US needs assurance that private US investments will be safe and secure in Russia. Both of these objectives can be reached through the conclusion of a new Russia-US BIT that takes into account recent developments in international investment treaties and devotes the needed attention to each party’s interests and concerns.

As former United State Ambassador, Steven Pifer, has stated: “Washington should seek to expand the trade and investment part of the bilateral relationship with Moscow. It remains significantly underdeveloped for economies the size of those of the United States and Russia. Expanded economic

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323 For the full interview of 24 February 2012, see http://www.russia-direct.org/qa/russia-and-us-discuss-ambitious-trade-treaty.
325 See for the modern development of key provisions in IIAs, e.g. transparency, policy space and sustainable development, in the diverse UNCTAD reports, available at http://investmentpolicyhub.unctad.org/IIA/KeyIssueDetails/43
326 Steven Pifer is a former United States Ambassador to Ukraine (1998-2000), and is specialized in matters with regard to the former Soviet Union. Mr. Pifer had also postings in London, Moscow, Geneva, and Warsaw.
relations would not only generate new export possibilities, but could provide economic ballast to the broader relationship, much as the economic ties between the United States and China provide a cushion for that relationship.”

Chapter 3 – Legal Investment Regime in the US and Russia

It is unclear why Russia is doing as poorly as it is in attracting foreign investors and increasing the inflow of foreign direct investment. It is, after all, the largest country in the world and a major political power. It has also concluded a substantial number of bilateral investment treaties, certainly more than the United States, and its Model BIT provides almost all of protections in the US Model BIT and is in most aspects comparable to models established by European countries. Thus the question remains: why is it doing so badly in attracting foreign investors and increasing its overall FDI inflows?

In order to get some insight in this paradox, I approached the internationally renowned expert on FDI and former US BIT negotiator, Professor Kenneth J. Vandevelde, who has shed some light on this issue. The answer, Professor Vandevelde posits, lies as much, or even more, with domestic rule of law systems than it does with BITs and economic capacity. Now I apprehend that because the initial objective of my thesis was narrowly focused on the comparison of the US and Russian Model BITs, in order to assess which one was offering most protection to an incoming foreign investor, I had been overlooking this important nuance.

Rather than an exclusive focus on BITs, he recommends that a comprehensive assessment be taken of the Russian and US legal systems to gain a broader contextual understanding of their BITs and domestic legal protections, and the ways those protections influence the decisions of investors. Professor Vandevelde writes:

“Remember that BITs are a substitute for a good domestic legal system. That is, if every country had a domestic legal system that provided a good climate for foreign investment, there would be no BITs. BITs exist to remedy defects in the domestic legal system.

So, the reality is that your Indian investor [who wishes to invest in either Russia or the US] would also consider the quality of the domestic legal system in each country. If the domestic legal system is a good one, then the BIT almost does not matter. If the domestic legal system has flaws, then the investor

327 On 21 March 21 2012, Steve Pifer outlined US-Russian relations and offered recommendations for future engagement before the US House of Representatives Committee on Foreign Affairs and. See for the full speech http://www.brookings.edu/research/testimony/2012/03/21-arms-control-pifer
must ask whether the BIT offers enough protection to compensate for the flaws in the domestic legal system.

My point is that your Indian investor, in reality, would compare the treatment it could expect in Russia under Russian law and in the United States under U.S. law. If that protection was very good in one of the countries, then the investor would not care as much about the BIT. If the protection was not very good, then the investor would care more about the BITs.

Of course, you can -- as an analytical exercise -- compare just the BITs of the two countries and ask which country’s BITs are stronger. That is a legitimate question to ask and to answer. But if you are thinking about the issue in practical terms and trying to determine which country truly has the best legal environment for investment, then you would have to consider the domestic legal system as well the BITs. 328

This analysis highlights the paramount importance of assessing the entire Russian and US legal system to see how it is applied to foreign investments. This comprehensive assessment allows for a determination of how much legal protection a foreign investor actually receives when investing in Russia and the United States. As pointed out by Vandevelde, when weighing all the decisive factors about investing in one nation or another, an investor will primarily look at the amount of protection that the domestic legal system offers. If it is comprehensive, transparent, reliable, protective and investor-favorable, he will not need to consider international investment agreements, as they will be only his second choice for redress.

Professor Vandevelde’s analysis is shared by others. For example, according to the “World Bank Guidelines: Legal Treatment of Foreign Investment”, the inflow of FDI depends on the enacted policy measures for the facilitation of investment flows by the host and home state, with international financial institutions performing a catalytic role between the two. 329 The role of host country policies is of crucial importance in attracting FDI, and can be divided into three different areas. First, there is a need for a solid economic and financial system with adequate infrastructure and institutions, a liberal trading environment and long-term sustainable growth. Second, there is a need for a stable political regime, a business-minded culture and openness of the private sector towards alien investors. Third, there is a need for comprehensive, transparent and predictable domestic legal structure reassures foreign businesses that their property and investments are protected against impairment, both by public and private actors, and that they have recourse to impartial and efficient legal institutions, which

328 Email d.d. 22 February 2016.
will decide and enforce their disputes in a fair manner. Additionally, many legal regimes offer tax breaks and other incentives to attract foreign investors. Hence, as commentators Rudolph Dolzer and Christopher Schreuer note, it is important that a foreign investor perceives that the host state provides a sufficient degree of legal protection for his investment, and presents a stable investment climate in general.\textsuperscript{330}

To examine this analysis further, it is necessary to examine the Russian and US domestic legal systems, their strong points and flaws, together with the political contexts within which they operate. This will draw out salient facts and allow for a comparison of the two legal systems with respect to attracting and protecting FDI.

\textbf{Chapter 3.1 – Legal Investment Regime in the Russian Federation}

As Yuri Adjubei acknowledges, the modest inflow of foreign entrepreneurial capital to Russia is for a substantial part caused by the country’s legal regime.\textsuperscript{331} Foreign investors are increasingly concerned about the unpredictable, rapid and abrupt changes in legislation, which interfere with their original business plans and conducted feasibility studies of investment projects. As a result, such a wavering legal framework deteriorates Russia’s overall investment climate and attractiveness for alien capital, which in its turn has been translated into poor international risk ratings.

\textbf{A. Background}

After the collapse of the communism and the dissolution of the Union of the Soviet Socialist Republics in December 1991, after almost 70 years of existence, the country was faced with the Sisyphean task of converting the world’s largest state-controlled economy into a market-oriented one. This conversion was executed through “shock therapy” reform at a fast pace, with little coordination. In addition, the Russian successor state to the Soviet Union had to reform its political institutions, laws and judiciary at the same time, without which the transition could not occur. As the country had to make a 180 degree turn, both politically and economically over a short period of time, it is evident that this post-Soviet transition did not go as efficiently or effectively as hoped. The shock therapy brought tumultuous times for the Russian economy, which led in part to its permanent low rank on the world investment map.


Russia’s mission after the fall of the Soviet Union was to transform the role of state, establish new institutions and create private enterprises all at once. One of the most worrisome consequences of this rushed reform was the emergence of an oligarch class during this mass privatization, as right after the dissolution of the Soviet Union a select amount of businessmen rapidly acquired vast wealth during the Yeltsin government between 1991 and 1999. These biznesmen achieved enormous wealth by acquiring state assets very cheaply or sometimes even for free.

To borrow from and adapt Bill Gates aphorism, with great wealth comes great power,\textsuperscript{332} which aptly characterizes the events after 1991 and the rise of the oligarch class. Today it is widely speculated that these post-Soviet business oligarchs gained – and still retain – great political power in Russia, especially as the emerging class of oligarchs include politicians and their relatives or close acquaintances. They are not only involved in Russian politics, but some members of this oligarch class are former criminal bosses who specialize in corruption, violence and organized crime.

With regard to its economy and the envisaged economic liberalization, with the exception of the energy sector, the Russian economy is still in transition, even though Russia itself joined the International Monetary Fund (IMF), the World Bank and most recently the World Trade Organization (WTO) in 2012. Hence, the transition logically impacts the country’s level of development and economic wellbeing, as well as existing trade barriers and its attitude towards foreign investors. In addition, this reflects itself in Russia’s domestic legislation, judicial organization and informal, customary behavior when conducting business on the Russian territory.

Not only did Russia have to integrate in the global economy in a rough and hard way, over a short period of time, the country was battered by the financial crises of 1998 and 2008-09. It is currently in a recession that dates back to 2014, due to the Ukrainian crisis and subsequent Western sanctions. For a country that has entered the market economy just 25 years ago, it is understandable that such crises affect not solely its economic and financial situation, but also had an adversative effect on the mindset and attitude of Russian citizens, judicial personnel and politicians towards foreign investors.

All of this has delayed and hindered Russia’s full integration into the world economy. Situations such as the recent sanctions actively hinder the country’s integration in the globalized economy and add obstacles for the country to overcome. Hence, it is not reasonable to compare this transitional economy to nations in the West, or to criticize the country’s economic environment for making it

\textsuperscript{332} Bill Gates said this when he was planning on retiring from Microsoft and work only at the Bill and Melinda Gates Foundation, in order to focus on helping other people who are less fortunate than himself.
difficult for firms to operate, through imposing obstacles such as punitive taxation measures, red tape and restrictions on payments.  

In the beginning of its transition period, the Russian government regarded capital outflow by Russian firms critically, resulting in passive discouragement of outward FDI. This approach indirectly shaped the incentive for the Russian firms to protect themselves against similar domestic hindrance of outward investments and harsh national regulations by creating their versions of safety nets abroad. This is called the “escape rationale,” which obliged Russian companies to place their accounts and assets in tax havens as “shell companies”. Over 50% of Russia’s 2014 inward FDI came from offshore jurisdictions, with Cyprus, the Netherlands, Bahamas and Bermuda the most common source. As these countries are habitually labelled as “tax havens”, the investment flowing into Russia from these territories can hardly be called international.

This has also been confirmed by Dmitry Mikhailov, Political Adviser to the Russian Embassy in Belgium. During an organized meeting in the embassy on April 22, 2016, he declared that: “The United States has never been a big investor in Russia or our primary trading partner. It is countries such as Luxembourg and Cyprus who are our number one sources of investment, while the European Union is – and remains despite the Ukrainian crisis in 2013 – Russia’s number one trading partner.”

The resulting capital flight from this “round tripping” poses a critical problem for the outward FDI in Russia, and has been mentioned several times by Vladimir Putin, who insists that these practices be given more policy attention in the future. This overwhelmingly wide recourse to offshore tax havens

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335 Supra note 333.
336 These four countries alone account for 61% of the total inward FDI in Russia. See https://en.santandertrade.com/establish-overseas/russia/foreign-investment
338 Round-tripping is the practice where domestic investors move money out of a country though a foreign corporate vehicle, i.e. they both illegally and legally “invest” capital, and then pump it back in the country disguised as a foreign investment. By doing so, the responsible entity can launder money, take advantage of tax breaks and other perks.
339 In his state of nation speech in 2013, Putin had announced plans to “impose state taxes on foreign-registered companies owned by Russian investors, and to deny them access to state contracts or loans.” In addition, he estimated that US$ 111 billion of Russian investments passed through offshore companies in 2012, which “stands for the drain of capital that should be working in Russia and direct losses for the national budget.”

Even worse, according to him more than 50% of inward FDI comes from Dutch or Cypriot companies, and thus are suspected of being round-tripped from Russian investors. The President demanded that the government introduced “a legal act that will ensure these round-tripped funds are subject to taxation, ... as we need to think of a system to seize this money and a comprehensive system of measures for the deoffshore-ization of our economy.” However, this issue is not only problematic in Russia, as the recent Panama Papers data leak about
means that actual outward and inward FDI flows are rather insignificant in Russia and do not represent genuine globalization and economic liberalization. However, in the pursuit of his agenda on “de-offshorization” of Russia’s economy, Putin has encouraged the government to develop legislation to combat this phenomenon. This policy has already borne fruit, as on February 15, 2016 he signed the 2016 Federal Law on Amending the Budget Code of the Russian Federation. This law “prohibits state support to foreign legal entities, including [read: especially] offshore companies, in the form of subsidies, public investments from the Russian Federation’s budget system and state guarantees.”

While the government is now officially promoting outward FDI – among others through increased use of BITs and the country’s accession to the WTO – Russia does not have an explicit and elaborated policy framework to provide assistance for outgoing investments and information on business environments of potential host states for Russian investments. Outward FDI remains a novel, not so welcome policy area for the government. Next to the discomfort regarding investment outflows, Russia’s ministries and financial institutions lack resources and expertise to formulate effective outward FDI policies and frameworks.

As for inward FDI, FDI was – and still is, even though moderately less – subjected to scrutinious political inspection, since the Russian government wishes to avoid intense competition for the local businesses and the sudden westernization of the country. In addition and as mentioned above, widespread capital flight poses a severe problem for the Russian economy, not only for outward FDI, but also with regard to inward FDI.

**B. Legal Foreign Investment Framework**

1. **General Framework**

The Russian Federation is a federal republic consisting of 85 regional administrative entities. The federal Constitution demarcates the exact scope of power of federal and regional authorities, with shared competencies in several fields. Because of this separation of power, there is no unified and regulated economy. This causes great frustration among domestic and foreign investors, as this absence results in inconsistent and even contradictory legislative acts, a mass of successive amendments and diverse interpretations of economic laws and practices.

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the thousands offshore business entities, has demonstrated that almost every single nation copes with this problem and that it is a global phenomenon.


Russia maintains a civil law system, and thus statutes and codes are the predominant legal source of Russian law. The 1993 Constitution of the Russian Federation and the Russian Civil Code officially established and elaborated the country’s transformation into a market-oriented economy. As the territory is divided into 85 federal subjects, each with the authority to issue its own legislation as long as it does not conflict with the Constitution and federal laws. Further, the executive branch is headed by the President serving a four-year term, who has the power to issue decrees and directives, provided that they do not infringe on federal legislative acts or contradict the Constitution. The President’s core responsibilities are to determine the direction of Russia’s domestic and foreign policy.

The Russian Federation is a monist state, as a result of which the national and international legal systems form a unity: international treaties do not require implementing legislation to have effect, as they are directly incorporated into national law and have direct effect. Therefore, if a domestic law contradicts an international treaty, the latter will be applied even if it is not in conformity with national legislation. In addition, as a monist state, international law can be invoked directly before national courts and likewise supersedes national legislation. As a result, if a BIT stipulates a more beneficial regime than the domestic laws on foreign investment, the treaty’s provisions will prevail.

2. Specific Legislative Acts

Compared to most nations, investment legislation of the Russian Federation has a brief history, as the country was involved in a turbulent and rapid transition period and did not have sufficient time and means to consider and construct an adequate legal framework. Ironically, because of this, Russia’s investment laws are a patchwork and accordingly of the most complex systems in the world.

The principal piece of Russian legislation on foreign investments is the 1999 Foreign Investments Law. It replaced the earlier law of 1991, which was enacted right before the break-up of the Soviet Union. The 1999 Law entitles foreign investors to protection and grants them a legal regime that is no less favorable than the one provided to Russian investors. This national treatment is a core guarantee of Russian law, and restrictions can only be imposed by federal laws. The 1999 Law also provides a broad scope of other protections, including full legal protection of property rights, “prompt,

343 85 federal subjects of six different types, namely 22 republics, 9 krais, 46 oblasts, 3 federal cities, 1 autonomous oblast, and 4 autonomous okrugs.
adequate and effective compensation” upon expropriation, most-favored nation treatment, the right to repatriate profits from investment activity, immunity from disadvantageous changes in the existing legislation (the so-called “stabilization clause,” which serves as a special incentive), and many other widely accepted and internationally enacted legal protections.347

Further, Russian domestic regulatory measures offer protections to alien investors. In fact, the right to stable and enforceable private property protection and compensation upon expropriation – the most important right – is included in the Constitution of 1993. The 1993 Constitution provides that “the right of private property shall be protected by law” and “nobody may be deprived of property except under a court order. Forced alienation of property for State requirements may take place only subject to prior and fair compensation.”348 Nevertheless, Russia is known for the discrepancy it manages between laws on paper and laws in practice, for which it is accordingly widely criticized.

It is important to highlight that the 1999 Foreign Investment Law is supplemented by sector-specific federal laws in diverse areas like natural resources, taxation and competition. In addition, there are specific FDI regulations at the regional level. These regional regulations vary among the 85 different federal states, making the complete Russian investment framework a complex web of numerous laws and regulations.

As mentioned above, restrictions on and exemptions from these legal safeguards can only be imposed by federal laws. In particular, the 1999 Foreign Investment Law itself inflicts exemptions on the national treatment obligation to the extent “needed for protection of the constitutional order, morality, and national security of the Russian Federation.”349 Particular attention is devoted to transactions made by foreign investors who acquire control over business entities of strategic importance to national defense and national security. This emphasis on the protection of strategic sectors of Russia’s defense industry is further elaborated in the 2008 Strategic Sectors Law.350

The Strategic Sectors Law restricts the access of FDI into sectors which the government considers of strategic importance. Namely, it governs mergers and acquisitions by foreign investors, foreign states

348 Article 35(1) and (3).
349 Article 9(4) “The provisions of clause 1 of the present article shall not extend to ... or the newly enacted federal laws and other regulatory legal acts of the Russian Federation in order to protect the fundamentals of the constitutional system, morals, health, rights and lawful interests of other persons, national defense and state security.”
or foreign state-owned enterprises, of Russian businesses that operate in one of the 42 identified strategic industries, including: aviation, nuclear energy, space, major transportation services, the fishing industry, military equipment production, data encryption, insurance, and radio and television broadcasting.\textsuperscript{351} The oil industry is of paramount importance to Russia. As Professor Alexei Kuznetsov,\textsuperscript{352} an internationally recognized authority on FDI in Russia informed me in an email d.d. February 29, 2016, the country does not see any particular threats to the great majority of its strategic sectors as declared in the Strategic Sectors Law. The only real concern is control over natural resources. More precisely, Russia is only really concerned with “expelling foreigners from the oil industry.” However, Professor Kuznetsov added, because of the Western sanctions and Russia’s countersanctions, foreign investors are not particularly active in this sector in any case.

The Strategic Sectors Law effectively requires that where a foreign investor is interested in acquiring a controlling interest in a strategic company, he must pass an administrative screening procedure and gain prior approval from a special governmental commission, which is headed by the Prime Minister of the Russian Federation. In his capacity as Chairman of this Government Commission on Monitoring Foreign Investment, the Prime Minister may impose particular requirements upon the foreign investor, such as the obligation to mobilize the investment in case it is necessary for the protection of national security.\textsuperscript{353}

There are many other specific federal laws that restrict foreign business activities or further elaborate upon the strategic sectors limitations, including banking, insurance, mass media and air transport.\textsuperscript{354} This once again highlights the complexity of the Russian body of law wherein the foreign investors have to navigate.

Even though these laws and regulations are rather restrictive and protectionist towards foreign investors, it is necessary to recall the role that Russia plays on the global stage. For a state of its size, power and importance, enacting legislation that restricts FDI infiltration in areas that are seen as having strategic importance is logical. The Russian government strives to protect its national defense

\textsuperscript{351} For the full enumeration, see Article 6 of the 2008 Strategic Sectors Law.
\textsuperscript{352} Alexey Kuznetsov is the Deputy Director of IMEMO (Institute of World Economy and International Relations of the Russian Academy of Sciences) and professor at the MGIMO-University in Moscow. Just as Professor Kenneth Vandevelde has advised me in the part on the United States, Professor Kuznetsov did the same thing on the part on the Russian Federation.
\textsuperscript{353} Article 12 of the 2008 Strategic Investment Law.
and state security, which is a practice that is common among sovereign nations worldwide and is common among other super powers, including the United States.

As such, the Russian Federation is not unique when screening FDI that implicates the country’s national safety and security, and indeed many nations have similar screening procedures when reviewing foreign investments for the benefit of their national security. Therefore, these laws should not be portrayed as overly protective or isolative, which some commentators have done, asserting that “the passage of the Law on Foreign Investment in Strategic Sectors (“Strategic Sectors Law”) in 2008 raised the specter of increased Russian protectionism,” that “the Strategic Sectors Law represents another variable in judging Russia’s overall commitment to open markets” and that “the Strategic Sectors Law is reflective of Russia’s general wariness towards foreign investment.”

While such statements rather represent a one-sided view popular in the West, a fair observation of this legislative trend is that the Russian approach indeed has reduced FDI inflows and potentially limited its economic growth. In addition, these laws have diluted the country’s ability to shift the focus of its national economy from natural resources to more diverse fields, including the services industry.

The final building block of this massive legislative pyramid is made up of regional acts, as the Russian Federation is a federal republic that encompasses 85 federal states. All these constituent entities have autonomy over certain internal political and economic matters, and have promulgated their own regional laws and regulations, some of which regulate investment activities. In particular, these regional regulations usually address taxation of foreign investments. A widely repeated criticism is that these various regional regulations are unclear, contradictory (even to federal laws), change rapidly and impose heavy burdens on foreign investors.

As such, even though the Russian legal system does provide for internationally recognized legal protections, such as national treatment and compensation upon expropriation, when studying the

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355 E.g. the Committee on Foreign Investment in the United States (CFIUS) likewise periodically examines foreign acquisitions of US businesses that might have national defense and security implications.
357 Ibid.
358 Ibid.
360 See on conducting business in all these 85 regions, World Business, “Russia Investment and Business Guide: Strategic and Practical Information”, World Business and Investment Library, 2015, 316.
361 They are that complicated, that even a new business idea has developed with regard to guiding foreign firms through this legislative maze.
complete Russian legislative pyramid from the top to the bottom, it becomes clear that it is complex and labyrinthine at different levels. This makes it quite tough to operate in for the alien investors. As long as Russia’s legal investment framework is not transparent and simplified, it will remain obscure not only to domestic investors, but even more to foreign investors.

C. Investment Environment
Russia is the world’s largest country, with a consumer market of over 140 million people, abundant natural resources, a highly educated populace and a rule of law – five factors that conventionally make countries perfect destinations for foreign investors. Yet, a chief dimension of a country’s business environment is its adherence to the rule of law, which provides economic stability to foreign investors and their property rights, and thus which is a sine qua non for foreign investors.

Unfortunately, the rule of law Russia is significantly underdeveloped. Its key deficiencies include widespread corruption at all levels of the judicial system, a weak system of legislation enforcement, large numbers of inefficient bureaucratic procedures, low levels of transparency and a persistent governmental control over key assets. Taken together, these shortcomings damage Russia’s reputation on the global investment market and deter foreign investors, in particular small and medium-sized enterprises who view doing business in Russia as a high-risk activity which they cannot afford to engage in. Therefore, the country has under-performed in attracting foreign investments to its territory.

In addition, international investments play a highly political role in the country, especially as in the aftermath of the collapse of the Soviet Union, protectionism was the key method used to boost national economy. In general, the Russian government has purposely maintained a significant degree of control and ownership over its largest companies since 1991. As Russia is endowed with substantial natural recourses, it is not surprising that state controlled or owned companies operate in the energy industry. These companies are known as “Eagle multinationals”, e.g. Gazprom and Lukoil.

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362 Russia is number nine in the global rank of world population with 143 million people. CIA World Factbook, https://www.cia.gov/library/publications/the-world-factbook/geos/rs.html, last accessed on 10 May 2016.
363 Natural resources (i.e. oil, natural gas, coal, metals and minerals) potential of Russia is estimated to be between 20% and 30% of the world’s natural resources reserves.
364 Russian judicial system and the law enforcement system have a lengthy list of problems, including long delays, suspicion about the fairness of procedures, impartiality of the judges, and the probability of actually being able to enforce the judgement.
365 Presently, there is an ongoing diversification of the type of enterprises that are active in the FDI world; while traditionally, large multinational enterprises (MNE) were the dominant players in FDI transactions, recently small and medium-size enterprises (SMEs) also increasingly participate in FDI.
two of the world’s biggest enterprises operating in the extractive sector. State ownership poses one of the ample problems for (a paucity of) foreign investment inflow to Russia.\textsuperscript{368}

Even though it is understandable that Russia could not completely reform its regulatory and legislative structures during the turbulent and rapid privatization period it had to bear in the ‘90s – which consequently resulted in incomplete, delayed and insufficiently far-reaching reforms – it is inexcusable that the government has not taken sufficient action over the course of the last years to achieve the needed structural reforms. As a consequence, Russian investors, as well as possible foreign investors, have to deal with an unstable, shady and labyrinthine investment setting, which in turn deters large-scale foreign firms from entering the country. Taken together, this accounts for the overall low level of FDI inflow. As long as no structural reforms are undertaken, Russia will remain in this cycle of lacks of reforms and low levels of FDI.\textsuperscript{369}

In recognition of these serious obstacles and dangers to Russian economic prosperity, the Foreign Investment Advisory Council (FIAC) was founded in 1994 by the Russian government and a group of foreign investors, and mandated with improving the country’s investment climate. Next to adding an innovation-based perspective to the Russian economy, the key activity of this institution is the provision of assistance to the Russian government in fostering a healthy investment climate in the country. FIAC operates by fostering direct dialogue between the government and investors using a process that is based on global expertise and the experience of international companies operating in Russia.\textsuperscript{370} The membership is open to other companies that do business in priority investment areas for the Russian economy and are active on the Russian market.\textsuperscript{371} Nevertheless, since its foundation in 1994, it clearly has not done very much because the country is still unattractive to investors.

A more recent undertaking by the Russian government is the establishment of the Russian Direct Investment Fund (RDIF) in 2011, which is mandated to “act as a catalyst for foreign direct investment, talent and technologies into Russia by attracting leading international co-investment partners.”\textsuperscript{372} In

\textsuperscript{368} See further in this section.
\textsuperscript{370} See http://www.fiac.ru/.
\textsuperscript{371} See for a detailed list of important facts on geography, infrastructure, incentives for investment projects, taxes, etc. for foreign investors when investing in Russia, the recent FIAC Report of June 2015 http://www.fiac.ru/pdf/Facts%20&%20Figures_by%20Ministry%20of%20economic%20development.pdf
\textsuperscript{372} See http://www.rdif.ru/Eng_About/.
addition, the Ministry of Foreign Affairs tries to organize annual international conferences dedicated to economic and business issues, as well as other trade exhibitions and investment events.

If the websites of these bodies and programs are any indication of their work, it is noteworthy how dynamic and interactive they are: their agendas are full of scheduled meetings, conferences and events; concluded partnerships and diverse initiatives are listed; the press release center and media sections are updated on a daily basis; information for foreign investors and the available brochures and reports are sharp and comprehensive. Together with the swift functioning of these websites, which form the primary information source for a bulk of prospective investors on all continents, these gradual improvements testify of Russia’s first efforts in changing its investment setting.

Other attempts to attract foreign capital are situated in the beneficial treatment of foreign investors. The government is trying to provide foreign investors with diverse incentives, including preferential custom regimes and tax exemptions. A significant example of such an incentive is the creation of 28 Special Economic Zones (SEZs), which provide beneficial investment conditions, advantageous treatment and assistance from local authorities to foreign investors. The zones were established as a large-scale federal project with the principal aim of promoting Russia as an investment zone, acquiring (actual and not round tripping) FDI, and to promote international best-practices and expertise, together with innovative scientific, manufacturing and management technologies.

All SEZ fall under a special legal status that provides foreign companies with fiscal preferences, access to land plots with modern engineering, logistical and business infrastructure, research laboratories, facilitating custom regimes, reduction of administrative barriers with the implementation of a "single window," and a simplified visa regime for qualified foreign staff. The objective is to grant investors

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373 E.g. the St. Petersburg International Economic Forum (SPIEF), which has its next meeting in June 2016. “SPIEF attracts over 10,000 international and Russian participants, including government and business leaders from the emerging economic powers, as well as leading global voices from academia, the media, and civil society.” See http://www.forumspb.com/en/2016/sections/38/materials/38. Also the annual ”Russia Calling!” Investment Forum in Moscow, which is a platform for developing dialogue between the Russian business community and international investors. See http://www.vtbcapital.com/events/promo.php.

374 Already almost 30 events scheduled for the next months all across Russia. See for the full overview of events with the according dates: http://www.ved.gov.ru/eng/events/?loc=&doc_type=&search=&tnved_values=&okved_values=&count=50=&search. Last accessed 10 May 2016.

375 From personal experience, Russian websites are generally not interactive or structured at all, and are rather outdated. Thus it was a genuine surprise to find internet sources which are user-friendly, comprehensive and have an attractive layout. See for example the current “Invest in Russia” website: http://www.investinrussia.ru/.

376 Which in their turn are divided into four types: 5 technical/innovation zone, 6 industrial/production zone, 14 tourist/recreational zone and 3 port zone. For a complete overview of the zones, types and the accorded regions in which they are to be found, see http://www.ved.gov.ru/eng/investing/sez/.

377 The establishment and operation of these SEZs is governed by the Federal Law No.116-FZ of 22 July 22 2005 “On Special Economic Zones in the Russian Federation”. For more information, see
full access to Russia’s investment capacity, while avoiding the typical problems the investors encounter when investing in Russia. Currently, SEZs host over 340 investors from more than 20 countries,\textsuperscript{378} and guarantee them that “the costs of a project realized in a SEZ are in average 30-40\% less compared to Russia’s general practice.”\textsuperscript{379}

In order to further improve its business climate and attract inward FDI, the Russian government established the Russian Investment Agency (RIA) in 2013, as a mechanism for increasing investment levels in the 85 Russian federal subjects.\textsuperscript{380} Further, the Ministry of Economic Development of the Russian Federation provides a wealth of information for prospective investors through an Integrated Foreign Economic Information Portal (IFEIP), which explains the status quo in the enhancement of the investment climate by the Russian government and the special regional opportunities for foreign investments.\textsuperscript{381}

Another element that affirms the attractiveness of Russia’s investment climate is the 2015 World Bank’s rating of Russia on its Ease of Doing Business Index. Its ranking in 2012 was 120 out of 183 countries; however, this year, the country rose sixty-nine spots and now positions itself in 51\textsuperscript{st} place.\textsuperscript{382}

After being inaugurated for his third presidential term in 2012, this rise in the Doing Business Index was one of President Putin’s stated objectives in Presidential Decree No. 596 on Long-Term National Economic Policy.\textsuperscript{383} This target – together with other economic objectives such as the diversification of the economy,\textsuperscript{385} greater privatization of state-owned and politically connected companies, and advancement of competitiveness – is making Russia more appealing to foreign investors.

\textsuperscript{378} “Between 2006 and 2013, more than 340 companies from 23 countries became SEZ residents, and this process is gaining momentum. Existing residents include such global giants as Yokohama, Isuzu, Sojitz, Air Liquide, Bekaert, Rockwool, Novartis, Arcray, 3M, General Motors, Nokia Siemens Networks and others. Their total committed investment is over RUB 400 Bn (ca. $13 Bn) together with a total of 350 obtained industrial patents.” http://eng.russez.ru//management_company/.

\textsuperscript{379} See http://eng.russez.ru/


\textsuperscript{381} See http://www.ved.gov.ru/eng/investing/.


\textsuperscript{383} The Presidential Decrees (the so-called “May Decrees”) of 7 May 2012 outlined the areas of the development of Russia in the coming years. One of the fourteen decrees, No. 596, addresses the “Long-Term National Economic Policy.” See Указ Президента России от 7 мая 2012 года № 596 “О долгосрочной государственной экономической политике”. See http://rg.ru/2012/05/09/gospolitika-dok.html.

\textsuperscript{384} To be precise, the target in the Presidential Decree No 596 is to move to the 50\textsuperscript{th} place by 2015, and the 20\textsuperscript{th} place by 2018.

\textsuperscript{385} While worldwide FDI has been shifting away from manufacturing and resource extractive industries that were dominating the 20th century, towards the service sector, in Russia this shift did not proceed and the raw materials industry remains the main FDI source. The nation has tried to resist the growth and expansion of its service sector, because of its low-cost labor and massive natural resources. Consequently, a concentration in
These recent efforts on better informing foreign investors and actively attracting their foreign capital are part of Putin’s pro-reform and pro-investment agenda, which he has advocated both during his terms as Prime Minister\textsuperscript{386} and as President. Yet, when we evaluate the outcome of his pursued economy reforms, four years later almost none of them have been effectively implemented and paid off with additional FDI flows.

Thus, despite all of these governmental pledges and Russia’s investment capacity, Russian inward FDI has fallen from US$ 21 billion in 2014, to US$ 2 billion in 2015,\textsuperscript{387} a decrease of over 90\% in just one year. This is an extremely low investment level compared to the investment capacity Russia has to offer to foreign investors and represents an insignificant fraction of global FDI inflows.\textsuperscript{388}

Furthermore, Russia remains at the bottom of various international reports, of which the leading and most comprehensive one is the annual Ease of Doing Business Index from the World Bank. This index ranks 189 countries – from Afghanistan to Zimbabwe – according to domestic business-related regulations; the higher the ranking, i.e. a low numerical value, the better, more reliable and simpler regulations a country provides for foreign businesses.\textsuperscript{389} World Bank’s latest report, Doing Business 2016: Measuring Regulatory Quality and Efficiency, ranked Russia, for example, 170\textsuperscript{th} in “Trading across borders,”\textsuperscript{390} 119\textsuperscript{th} in for “Dealing with construction permits,”\textsuperscript{391} and 66\textsuperscript{th} for “Protecting minority manufacturing and extraction occurred; however, extraction is not sustainable and as it is essential that foreign investors get access to the service markets of the developing countries to grow their economies, increase the living standard and employment opportunities, diversification from the extractive sector should be the next step. “With its vast size and regional differentiations, Russia had for a long time well-developed regional markets, each with its own special characteristics in terms of supply and demand. Under normal economic and political conditions, the economic diversity of the regions would be a natural basis for the development of a dynamic national market. But the conditions in Russia are far from normal. There is a point at which healthy economic regionalization can slip into economic and political separatism which jeopardizes national integrity.” W. Butler, J. Cooper, D. Dyker, D. Humphreys, S. Manezhev and J. Stern, Investment opportunities in Russia and CIS, Royal Institute of International Affairs, Washington DC, 1995, 259.

\textsuperscript{386} From 2008-2012.
\textsuperscript{389} Doing Business Series are annual reports comparing and benchmarking domestic regulations which are related to conducting business in 189 economies, published by the World Bank Group, with Doing Business 2016 as its thirteenth publication. Every report addresses 189 countries’ domestic regulations in eleven areas of everyday business activity. The eleven indicators are: Starting a business, Dealing with construction permits, Getting electricity, Registering property, Getting credit, Protecting minority investors, Paying taxes, Trading across borders, Enforcing contracts, Resolving insolvency, and Labor market regulation. The report is available at https://openknowledge.worldbank.org/handle/10986/22771.
\textsuperscript{390} In the area of ‘Trading across borders’, the time and cost to export a product of comparative advantage and import auto parts are measured.
\textsuperscript{391} In the area of ‘Dealing with construction permits’ business regulation, what is measured, are: the procedures, time and cost to complete all formalities to build a warehouse and the quality control and safety mechanisms in the construction permitting system. In Russia there are on average 19 administrative procedures required, which take in total no less than 236.5 days.
investors,” all positions that underscore the fact that Russia’s regulations are not business-friendly. Furthermore, Russia was classified by the 2016 Index of Economic Freedom of the Heritage Foundation as a “Mostly Unfree Economy”, with a 153rd position – preceded by Lesotho and followed by Algeria – among 178 countries.392

As mentioned by leading Russian economist Sergei Guriev: “Russia suffers from a number of deep-seated problems, including endemic corruption, a weak rule of law, overregulation, and the dominance of state-owned and politically connected businesses and monopolies. The simplest way to understand the impact of these flaws is to look at investment flows. In the past few years, Russia has experienced substantial capital flight, as Russian and international investors have flocked to safer investment destinations. Since 2011, Russia has been losing four to eight percent of GDP annually in capital outflow—a significant amount given that total capital investment in Russia makes up 20 percent of GDP. Investors, fed up with Russia’s poor protection of property rights and unpredictable judicial system, have moved their money elsewhere.”393

What follows is a list of the most commonly cited problems and major hurdles that foreign investors confront when doing business in Russia, and which undermine investors’ confidence and sentiment:394

– poor institutional infrastructure;
– entangled legal framework through the adoption of unclear laws and many amendments;395
– lack of official guidelines for investors to find their way through the legislative maze;
– incoherent and sometimes conflicting legal rules that vary from the federal to the regional to the local level;

392 The Index of Economic Freedom measures economic freedom based on ten factors, grouped into four categories, namely: (1) Rule of Law (property rights, freedom from corruption); (2) Limited Government (fiscal freedom, government spending); (3) Regulatory Efficiency (business freedom, labor freedom, monetary freedom); and (4) Open Markets (trade freedom, investment freedom, financial freedom). The Index stated about Russia the following: “Russia’s prospects for long-term, diversified, sustainable economic growth remains bleak. There is no efficiently functioning legal framework, and government continues to interfere in the private sector through myriad state-owned enterprises. Corruption pervades the economy and continues to erode trust in the government.” See at http://www.heritage.org/index/country/russia.
395 Russia’s legal framework is described by some commentators as follows: “The legal frameworks of the successor states to the Soviet Union are anything but user-friendly for the Western investors. Investors are often poorly briefed on peculiarities of local commercial law stemming from the Soviet inheritance, or from local usage. Tax regimes, regulations on repatriation of profits etc. are less uniformly hostile than unstable, confused and confusing, with different members of the same government often saying quite different things on key issues to the Western business audience.” W. Butler, J. Cooper, D. Dyker, D. Humphreys, S. Manezhev and J. Stern, Investment opportunities in Russia and CIS, Royal Institute of International Affairs, Washington DC, 1995, 2.
– perpetual uncertainty for businesses due to rapidly changing legislation;
– weak enforcement of judgments and arbitral awards by the judiciary;\(^{396}\)
– wariness about the impartiality of judges;
– distrust over the fairness of trials and rulings, and concern over arbitrariness and the lack of predictability;
– long bureaucratic administrative procedures for permits and licenses;\(^{397}\)
– excessive corruption by government officials, mainly in regional administrative bodies and courts;
– compulsory payments of “protection money” to organized crime;\(^{398}\)
– inconsistent taxation regimes at the federal, regional and local levels, with frequently changing tariffs;\(^{399}\)
– “voluntary” contributions to extra-budgetary funds;
– uncertainty about the recognition and execution of clearly enforceable international arbitral awards;
– lack of transparency in decision making process of administrative, legislative and judicial institutions; and
– unpredictable hurdles, such as unforeseen licensing requirements and sudden additional conditions for the acquisition of a permit.

The international NGO Transparency International (TI)\(^{400}\) ranked Russia in 2015 as 119\(^{th}\) out of 168 countries (in decreasing order, thus the lower position, the more corrupt), with a score of 29/100 on a scale of 0 (highly corrupt) to 100 (very clean). No Western nations scored this low, and only Somalia, Democratic Republic of the Congo and South Sudan, Afghanistan, North Korea and Venezuela rank lower than Russia.

As Mr. Alexander Milyutin, the Economic Attaché of the Russian Embassy in Belgium, stated during a meeting organized in the embassy on April 22, 2016:

“As I live in Russia myself and walk these streets every single day, I realize very well that corruption in Russia is present at all levels and even poses a threat to Russia’s national security. Obviously, legal

\(^{396}\) Meaning even if you prevail in a case, it is not sure if you will be able to execute the judgement and obtain your compensation. In some cases, you have to pay bribes to public officials to execute the court ruling.

\(^{397}\) E.g. for obtaining a construction permit in Russia, on average an investor has to pass 19 administrative procedures, which take averagely 236.5 days.

\(^{398}\) Called a крыша (“roof”) in Russian.

\(^{399}\) Sometimes even being “negotiable/flexible” rather than statutory.

\(^{400}\) TI annually publishes the Corruption Perceptions Index (CPI), which ranks countries by their perceived levels of corruption in the public sector. For the CPI 2015 see http://www.transparency.org/cpi2015.
measures are being taken to combat it. Yet, this is a step-by-step process, as we cannot tackle this grave issue all at once.”

Even though corrupt practices can be found in all Russian institutions, the most worrisome that within the judiciary, which forms the basis for the rule of law and measures Russia’s adherence to it. The motivation of corrupt judges and other court officials lies in their poor remuneration, which in its turn stems from a general lack of resources accorded to Russia’s judiciary. This under-funding thus incentivizes the judicial staff to accept bribes and other corrupt behavior. 401

D. Conclusion

Taken together, this analysis paints a clear picture: it is absolutely necessary for the Russian government to launch legislative and institutional changes in order to reposition the country on the world investment map in accordance with its full capacity and growth potential. It must remove the current barriers – legal, institutional and informal – encountered by foreign investors and reassemble Russia’s wrecked image. The country already possesses all the crucial ingredients for attracting foreign capital; it just has to manage them wisely by strengthening the nation’s adherence to the rule of law.

In order to become a FDI recipient in harmony with its investment capacity, Russia needs to reorganize its institutions, untangle its legal framework, implement more efficient and less time-consuming administrative procedures, and diligently supervise law enforcement by the judiciary. It is also essential that Russia simplify administrative procedures, protect property rights (without having to pay bribes in both cases) and unify legislation on the federal and regional level. 402 Further, it should gather relevant investment information in one place in order to facilitate the support and guidance of the alien investors.

Lastly, all of these adjustments have the potential to strengthen the actual adherence to rule of law and put an end to corruption that is omnipresent at all levels of Russian state institutions. By tackling the enumerated obstacles – problem by problem – Russia could exterminate these breeding grounds of ubiquitous corruption. 403

If the Russian government were willing to implement all these proposed measures and remove the existing impediments to foreign investments, it would underpin further economic growth of the Russian Federation and bring to it the investors the country is currently missing out on. In that way

401 Therefore, the Russian government needs to increase the remuneration of government authorities in order to decrease their motive to take bribes and be corrupt.
Russia would be able to reap all the benefits FDI has to offer, which is crucial for the Russian business climate. Only such reforms can convince the international community that Russia is keen to become a secure, market-oriented business environment.

It should be noted that some commentators believe that Russia is not exactly in a situation where it truly needs to attract foreign capital in order to increase overall investment levels. This argument is founded on the belief that as the country has legally limited outward FDI transmitted by Russian companies abroad, the Russian government does not see any need in restricting its freedom and discretion to act in relation to incoming investors.404

President Putin has further hinted at the importance that Russia attaches to its freedom in his annual Presidential Address to the Federal Assembly in 2014, stating: “I will cite one quote: “He who loves Russia should wish freedom for it; above all, freedom for Russia as such, for its international independence and self-sufficiency; freedom for Russia as a unity of Russian and all other ethnic cultures; and finally, freedom for the Russian people, freedom for all of us: freedom of faith, of the search for truth, creativity, work, and property.” This makes a lot of sense and offers a good guideline for all of us today.”405

However, when we look at the general behavior towards foreign investment today, we clearly see that Russia is trying to attract foreign capital by organizing diverse trade fairs and investment fora, gathering annual economic summits, promoting its SEZs in diverse exhibitions and giving incentives to alien investors. Even though the change of mind does not translate itself in visible and immediate institutional or legislative reforms, these signals cannot be ignored or forgotten.

As such, it is clear that doing business in Russia is on the informal and implicit side, rather than being formal and reformative. It is during these economic summits and meetings that deals are negotiated, hands are shaken and investments are made, despite established legal and procedural hurdles. By devoting more time, energy and resources to face-to-face business with alien investors – instead of complex restructurizations of its institutions and regulations – Russia is hoping to regain its FDI losses and locate new business partners in new places.

This increasing ambition in attracting FDI has further been declared by President Putin during his latest state of nation speech in December 2015: “Colleagues, we are interested in broad business cooperation with our foreign partners, and we welcome investors who focus on long-term work on the Russian

market, even though the current circumstances they face aren’t always favorable. We highly appreciate their positive attitude to our country, and the fact that they see advantages for growing their respective businesses in our country. Russia is involved in integration processes designed to open additional avenues for expanding economic ties with other countries.”

He finished with the following message, by which he makes clear that while there are existing trade barriers, procedural hurdles and other legal impediments, the Russian government is willing to address them in order to integrate in the global economy and use the country’s largely untapped potential: “At the same time Russia is a part of a global world that is changing rapidly. We understand well the complexity and scale of existing problems – both foreign and domestic. There are always difficulties and obstacles on the path to progress and development. We will respond to all challenges; we will be creative and productive; we will work for the common good and for the sake of Russia.”

Other countries have successfully implemented such reforms, and there is no reason that Russia should not be able to do so as well.

Chapter 3.2 – Legal Investment Regime in the United States

A. Background

The history of the United States of America – even though the US is a young nation when compared to other countries around the world – goes quite further back in time, when compared to the history of the Russian Federation, which only begun with the end of the Soviet Union in 1991.

Individual liberty and economic entrepreneurship are embedded in the US Constitution of 1787. Together with the natural and inalienable rights identified by Thomas Jefferson in the Declaration of Independence, namely the right to “life, liberty, and the pursuit of happiness,” these principles laid the foundation for a unified common market, where no internal tariffs or any taxes on interstate commerce were allowed. All the more, the Constitution opened the country’s physical borders to the US market, in order to have investments, goods and ideas freely flowing from all corners of the world into the nation. In the early years, this was additionally stimulated by the Treaties of Friendship, Commerce, and Navigation, which the United States concluded in large numbers; their terrestrial spread reveals the immense expansion of US foreign trade after its independence.

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408 The United States entered into its first FCN treaty with France in 1778. After the conclusion of the US-Thailand FCN treaty in 1967, the United States did not negotiate additional FCN treaties with other countries.
The United States transitioned from an agricultural culture towards an industrialized economy over the course of the 19th century, which was mainly due to the victory of the industrial North over the agricultural South in the American Civil War of 1861-65. After the end of the Civil War, the instituted slave system was abolished and the Northern industry thrived, which consequently led to rapid economic growth of the country. This was the beginning of the great economic success of the United States, which rapidly became one of the world’s wealthiest nations.

Over this period, export production shifted from agricultural goods to machinery and consumer goods, but this time on a much larger scale. An “innovation boom” followed and including things such as the steam turbine, the light bulb, bicycles and automobiles, trams, typewriters and telephones. All these new transformative tools and machinery helped the American market to surge ahead of other nations. The apex of this came in the legendary “Roaring Twenties”. However, a fast end came to this abundant opulence, as in October 1929 with the notorious Wall Street Crash of 1929.\textsuperscript{409} The global economy did not spare the country, as after the Wall Street Crash the world fell into the 1930s Great Depression for ten full years, and then plunged into World War II in 1939.

However, the odds turned, and after WWII an economic golden era arose in the United States. While parts of Asia and Europe lay in ruins, this post-WWII era saw the rise of a well-educated labor force, tremendous productivity and the growth of GDP, the emergence of influential labor unions and a “baby boom.”\textsuperscript{410} The US continued its radical population and economic growth after the war.

This postwar economic wealth was, comparatively speaking, distributed equally among citizens, brought prosperity and stability to the whole nation and saw the United States rise to the top of the world economy. Despite the beginning of Cold War with Russia in 1947, this American prosperity and success lasted through the early ‘70s. It came to an end with the 1973 oil crisis, a major productivity


\textsuperscript{410} “Baby boom” is a demographic phenomenon, which results in an exceptionally increased birth rate. After World War II, between 1946-1964, the birthrate exploded in the US, as many young soldiers - who had to postpone marriage and childbirth - returned back home, the government stimulated the family expansion by offering low-cost mortgages for houses in the suburbs, and even the popular culture promoted parenthood and big families and urged women to leave their work and become a wife and mother. It is estimated that 78.3 million people were born during this period. http://www.history.com/topics/baby-boomers
drop and another crash of financial markets. A direct consequence of this crisis was the historical increase of the income inequality level in the United States which persists until this very day.

This was the status quo of the US economy when the country entered the globalization phenomenon of the ‘90s, wherein highly developed telecommunications interlinked all economic systems of the world. Nevertheless its weak condition, the country managed fairly well, with an increase in productivity, a low unemployment rate and dynamic growth of the Internet and commercial digital sector, known as the “dot-com boom.” These progresses got the US economy back on track, and were supported by governmental deregulations of the Clinton Administration, elimination of trade barriers and a deepening of economic ties with its largest trading partners, best proven by the concluded NAFTA with Canada and Mexico in 1994.

The millennium took off harshly for the nation, especially when recalling the attacks of September 11, 2001; productivity lessened, many businesses went bankrupt, unemployment rose, and the “dot-com bubble” burst. All of this paved the way for a recession in 2001. In order to enhance the confidence of citizens about the strength of the US economy, the government stimulated the housing market and subprime mortgage lending for several years. Through this, the Bush Administration strived to extend the “American dream” of home-ownership even to low-income borrowers, who had inadequate credit histories and a higher risk of loan default. This approach set a domino effect in motion and eventually made this real estate bubble burst, which in its turn collapsed the stock market and led to the breakdown of established banks in the US and Europe. As such, the United States entered into the “Great Recession” that pulled the rest of the world down into its abyss, better known as the global financial crisis of 2008.

President Obama took over the US government in the midst of the Great Recession, and it was his prime task to restore the US financial system.

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415 Some banks filed for bankruptcy, like Lehman Brothers, others such as the insurance company AIG and the bank Citigroup were bailed out by the government, and Merrill Lynch was forced to sell itself to the Bank of America.
416 A task which he conceived with the enactment of the American Recovery and Reinvestment Act of 2009 (ARRA), Pub.L. 111-5.
It took years for the US economy to recover and to erase 8.8 million crisis-generated job losses.\textsuperscript{417} However, today days the United States’ economy is steadily growing again, even though at a slow and fragile pace. According to the 2016 IMF report, “despite the recent rebound in asset prices, financial conditions in the United States have been on a tightening trend since mid-2014. While very accommodative monetary policy and lower oil prices will support domestic demand, still-weak external demand, further exchange rate appreciation—especially in the United States—and somewhat tighter financial conditions will weigh on the recovery.”\textsuperscript{418} IMF concludes with: “Growth is projected to continue in the United States at a moderate pace, supported by strengthening balance sheets, no further fiscal drag in 2016, and an improving housing market. These forces are expected to offset the drag to net exports coming from the strengthening of the dollar and slower growth in trading partners, the additional decline in energy investment, weaker manufacturing, and tighter domestic financial conditions for some sectors of the economy (for example, oil and gas and related industries). As a result, growth is projected to level off at 2.4 percent in 2016, with a modest uptick in 2017. Longer-term growth prospects are weaker, with potential growth estimated to be only about 2 percent, weighed down by an aging population and low total factor productivity growth.”\textsuperscript{419}

**B. Legal Foreign Investment Framework**

1. General Framework

The United States functions under a legal system that is described as the “common law”, which is opposed to the “civil law” systems of the majority of countries.\textsuperscript{420} A defining characteristic of the “common law” is its strong reliance on case law and court precedents to guide the applications of laws, whereas the “civil law” systems exclusively rely on codices, or enacted laws with rules for settling disputes. In the common law (often described as “judge-made law”), judicial determinations in prior cases in like matters are of paramount importance to a judge’s resolution of a case; in civil law, the former case resolutions are neither binding nor relevant in the determination of cases at bar.


\textsuperscript{418} International Monetary Fund, *World Economic Outlook: Too Slow for Too Long*, Washington, 2016, 14-16.

\textsuperscript{419} Ibid.

\textsuperscript{420} The biggest countries that operate under a common law system are the US, Canada, United Kingdom, Australia and New Zealand. The rest of the world functions mainly under a civil law system, and some countries have adopted mixed legal systems. For a comprehensive and interactive map of the world and its legal systems, see “Alphabetical Index of the 192 United Nations Member States and Corresponding Legal Systems”, on the website of the Faculty of Law of the University of Ottawa, http://www.juriglobe.ca/eng/syst-onu/index-alpha.php.
The US Constitution of 1787 is the “supreme law of the land,” and contains the essential rights and freedoms in its first ten amendments, better known as the “Bill of Rights.”

The body of laws consists of federal laws enacted by the US Congress, as well as statutes passed by the fifty state legislatures and local laws enacted by counties and cities, all of which are hierarchically located under the US Constitution and federal laws.

The US Constitution establishes a federal government system and explicitly endows it with specific powers. This means that all legislative powers that are not specifically granted to the Federal government— in particular under Article 1, section 8 – are left to the states. Consequently, each state has its own constitution and a system of criminal and civil laws, which leads to fifty additional legal systems, and fifty additional governments with their own law enforcement agencies and courts.

As there are federal and state systems of legislative, executive and judicial power, while at the same time certain powers among states and the federal government are shared, it is a challenge for US governmental and judicial institutions to balance between these two flanks.

2. Specific Legislative Acts

The role of the United States as one of the world’s primary destinations for FDI is directly explained by its deep protection of private property rights, its liberal domestic business legislation and its rather limited regulation of FDI.

While domestic and foreign-owned companies must comply with same federal laws, state statutes and administrative procedures for acquiring an entity, merging with a business or establishing a greenfield investment, both are regulated under the same standard of legal protection, without distinction. As such, foreign-controlled companies on US territory are generally treated equivalently to domestic businesses; the few exceptions to this general rule are situated in the area of national security and will be discussed at the end of this section.

The right to private property is of crucial importance to foreign investors wishing to see their private capital being safe and secure in a foreign territory. The principal source of protection of the right to private property is the Constitution of the United States. As it constitutes “the supreme law of the

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421 According to Article VI, Clause 2 of the US Constitution (the Supremacy Clause) declares that “the Constitution, federal laws made pursuant to it, and treaties made under its authority”, form “the supreme law of the land”. In addition, this conflict-of-laws rule further provides that in case of conflict between federal and state law (even if it is a state constitution), the federal law prevails.

land” and is very hard to amend, foreign investors enjoy a very solid and stable protection of their private investment. In particular, the Fifth Amendment to the US Constitution recognizes that: “No person shall be ... deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.”

These clauses within in the Fifth Amendment delineate the constitutional boundaries under the government’s “eminent domain” power, and applies equally to the private property of US citizens investors and foreign investors. In particular, the right to private property is safeguarded in two ways under this Amendment: the first part is named the “due process” clause and the second one is called the “takings” or “just compensation” clause.

First of all, this Amendment guarantees that a person shall not be deprived of its private property by a federal or state government without due process of law, which implies fair procedures during the process of nationalization. Secondly, it guarantees that no government body shall seize private property of any person within the United States without the seizure being for a “public use” and the government paying “just compensation” to the owner of the property. The reimbursement of “just compensation” has been interpreted by the US Supreme Court as the “fair market value of the taken property,” which is “the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.” The domestic just compensation standard parallels the “prompt, adequate and effective compensation” of the Hull Formula that is widely used in the BITs of many nations.

Further, this right to private property and the same boundaries on police procedures are likewise recognized by and incorporated in all fifty state constitutions. In addition, there are many federal

423 In total, the US Constitution counts 27 Amendments to it, with the last constitutional amendment being passed in 1789. Article V of the Constitution states how an amendment can be added; while there are two ways, only one has ever been used. The first option, and the only one used until now, is for a proposed amendment to be approved by ⅔ of the House and Senate and be send to the states for a vote. Then, ¾ of the states must approve the proposed amendment for it to be ratified. The second way of passing an amendment, requires a Constitutional Convention to be called by two-thirds of the states, which can propose as many amendments as it believes necessary. Then, all those amendments must be affirmed by ¾ of the states.

424 Fifth Amendment to the US Constitution. While this provision originally applied only on federal level, the Supreme Court has interpreted it in such a way as it is fully applicable to the states as well, via incorporation to the states by the Due Process Clause of the Fourteenth Amendment. Therefore, as the US is a common law country, the Fifth Amendment now equally applies to the federal government as to the states.


428 E.g. the Constitution of the State of Illinois provides in Section 15: Right of Eminent Domain that “Private
acts and state statutes that highlight and further elaborate on this right, for example regarding the exact scope of the “public use” aspect. 429

Next to its deep commitment to protecting private property rights, the United States does not put any significant restrictions on investments within its borders. Hence, the US government operates a lightly regulated market economy and, as such, the foreign investor is largely endowed with the same treatment as the domestic investor. This is attested by the additional rights of the US Constitution that protect foreign investors, such as the protection against impairment of contractual obligations by states and local government 430 and restraints on discrimination against aliens. 431

Given that these protective measures are granted to foreign investors by the US Constitution and the US government is open and unrestrictive towards foreign investments, there is barely any need for specific federal and state acts that are exclusively applicable to alien entities. In the event there are such rules, then they are located in areas related to national security.

One set of restrictions applies to foreign participation in sensitive industries, while the other set is focused on information-gathering and disclosure to governmental agencies of planned mergers and acquisitions by foreign investors.

429 E.g. the State of Kansas statute K.S.A. 26-501a (a) which proclaims that “Private property shall not be taken by eminent domain except for public use and private property shall not be taken without just compensation. The taking of private property by eminent domain for the purpose of selling, leasing or otherwise transferring such property to any private entity is prohibited except as provided in K.S.A. 2009 Supp. 26–501b, and amendments thereto” and the statute of the State of Minnesota which clarifies that “The public benefits of economic development, including an increase in tax base, tax revenues, employment, or general economic health, do not by themselves constitute a public use or public purpose.”

430 Article I, Section 10 US Constitution. This provision, also known as the Contracts Clause and applicable only to the state and local governments, strives to prevent governmental entities from modifying contract rights after a contract has been concluded between two private contracting parties, without their consent. However, the Supreme Court has moderated the application of this clause in Home Savings and Loan Ass’n v. Blaisdell, 290 U.S. 398 (1934), allowing states to make temporary alterations of contractual obligations, mainly in times of economic emergency. In addition, the Court recognized in Energy Reserves Group v. Kansas Power & Light Co., 459 U.S. 400 (1983) that some agreements are inherently subject to governmental regulations and permitted the government to modify the terms of such contracts. On the other hand, in the case of contractual relations between a private party and state/local government, the Supreme Court operates a quite stricter standard, basically forbidding changes to the agreement that the public authority originally made. See, U.S. Trust Co. v. New Jersey, 431 U.S. 1 (1977). The federal government, in contrast to the state and local governments, is free to adjust contractual terms.

431 Except in the case of the exercise of political rights or employment as a public officer. Amendments V and XIV of US Constitution.
As mentioned above, in critical economic areas – in particular those that affect the national safety and security – a federal law or regulation can set limitations on company-ownership or control by foreign investors. Other examples of such sensitive industries are the nation’s critical infrastructure, maritime industry, exploitation of natural resources, nuclear and power sector, land ownership, telecommunications, aviation industry, mining and banking. In certain cases, complete ownership or control above a certain percentage is restricted to US citizens and corporations. In other cases, the ownership or control is subject to review by the Committee on Foreign Investment in the United States (CFIUS). This interagency committee conducts a review of investment proposals by foreign entities, and facilitates the President of the United States in overseeing the national security implications of foreign investments in the US economy. The outcome of the review process allows the President to prohibit or suspend a certain FDI if he concludes that it would pose a threat to the country’s safety and security.

Further, while some federal laws do not expressively restrict foreign ownership, they can still have a significant impact on the alien investment, as foreign investors are subject to all domestic laws as well. In particular, this is the case with personal and corporate taxation and antitrust law. Regarding the latter, FDI by foreign businesses may elicit an antitrust review by the Justice Department and the Federal Trade Commission if such an operation would possibly establish a monopoly or another trade barrier on US territory. With regard to taxation, an alien investment is taxed in the same way as domestic investors; thus, his investment will be subjected to federal income tax, but at the same rate. However, the US has ratified 68 double taxation treaties that minimize the risk of double taxation of the same income by two countries through the provision of reduced tax rates and

432 On the federal level, there is 50 App. U.S.C. §2170, which allows the President of the United States to prohibit or suspend foreign transaction that “threaten to impair the national security of the United States.”


434 E.g. regarding the maritime industry, laws that restraint to foreign investment can be found throughout Title 46 of the United States Code (46 U.S.C. §12102 et seq.) and in the energy sector, according to 16 U.S.C. §797(e), licenses for the construction, operation, or maintenance of facilities for the development, transmission, and utilization of power on land and water over which the federal government has control may be issued only to United States citizens and domestic corporations; while according to 42 U.S.C. §2133(d), a license for nuclear facilities cannot be acquired by a foreign citizen or by a corporation believed to be controlled by a foreign citizen or government.

435 As we can notice, the federal government has the exclusive power over foreign trade and international relations in the United States; nevertheless, states are allowed to interfere in certain situations, for example to put limitations on ownership of agricultural land by foreign investors.

436 50 U.S.C. App. §2170 et seq.


438 The US federal tax laws are contained in Title 26 of the US Code, usually referred to as the Internal Revenue Code.
Beyond federal income tax, investors are also subject to state, municipality and city income taxes.

Next to these actual restrictions on alien investments, there are four major federal laws with respect to information-gathering and disclosure to governmental agencies of the intended M&As by foreign investors.

The first one is the International Investment and Trade in Services Survey Act of 1976, which provides the President with the authority to “collect information on international investment and United States foreign trade in services, including related information necessary for assessing the impact of such investment and trade, to authorize the collection and use of information on direct investments owned or controlled directly or indirectly by foreign governments or persons, and to provide analyses of such information to the Congress, the executive agencies, and the general public.”

Through an executive order, the President delegated this responsibility with regard to FDI to the US Commerce Department.

The second act is the Foreign Direct Investment and International Financial Data Improvements Act of 1990, which is related to the Services Survey Act and requires that the US Bureau of the Census exchanges any information that is collected with the Commerce Department if the Secretary of Commerce deems that the information is needed to improve the data collected under the Services Survey Act.

The third law governing foreign investment in the United States is the Agricultural Foreign Investment Disclosure Act of 1978. This act requires that (1) “any foreign person who acquires or transfers any interest, other than a security interest, in agricultural land must submit a report to the Secretary of Agriculture not later than 90 days after the date of the acquisition or transfer;” and (2) “any foreign person who holds any interest, other than a security interest, in agricultural land on the day before the effective date of this act must submit a report to the Secretary of Agriculture not later than 180 days after the effective date of the act.”

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441 22 U.S.C. §§3141 et seq.
442 13 U.S.C. § 11. The Bureau of the Census is part of the Commerce Department and is a central agency of the US Federal Statistical System, which has the task of producing data about the US citizens and the country’s economy. Its principal mission is conducting the US Census every decade, which allocates the seats of the US House of Representatives to the states according to their population. In addition, the Census Bureau permanently conducts many other counts and diverse surveys, e.g. Current Population Survey. See https://www.census.gov/about/what.html.
443 7 U.S.C. §§3501 et seq.
The fourth disclosure statute regarding FDI is the Domestic and Foreign Investment Improved Disclosure Act of 1977, which aims to improve the capability of the federal government to monitor alien investments in the United States.\textsuperscript{446}

These are the four specific laws limiting or affecting FDI due to national security considerations and information-gathering requirements. In order to promote a free market economy and a dynamic flow of extra capital into the country, there are no other substantial constraints imposed on FDI in the United States. This means that US legislation is largely liberal towards foreign investors and the investment field is only lightly regulated.

C. Investment Environment

The United States is the third largest nation on earth by geography, with a population of over 320 million people,\textsuperscript{447} a well-educated and productive workforce, substantial natural resources, and a technologically advanced and innovative economy.\textsuperscript{448} Other advantages that the United States offers include a well-developed national infrastructure, a large and wealthy consumer market, diversified industries, world-renowned universities and research institutions, and an embedded entrepreneurial culture. Beyond that, it operates a free market economy, provides lucrative markets regardless of sector and is home to a strong business climate.\textsuperscript{449}

These are the perfect ingredients for attracting and hosting foreign investments. Thus, it is no surprise that the United States is the number one recipient of FDI in the world. Inward FDI flows reached a historical high US$ 384 billion in 2015, bringing the nation back to the number one spot.\textsuperscript{450} Regarding the outflow of FDI, the US likewise ranks first, with US$ 337 billion of outflows in 2015.\textsuperscript{451}

The high quality of the US investment climate is further testified to by an established rule of law, a transparent legal framework and the country’s stable democracy. Consequently, all of these elements represent powerful incentive to foreign investors. They help to ensure that investments are protected on US territory and foreign businesses are confident in the nation’s business climate. As a result, since

\textsuperscript{447} Spread over fifty states, the District of Columbia, the Commonwealth of Puerto Rico and a number of smaller territories. For a full overview, see https://www.usa.gov/states-and-territories.
\textsuperscript{448} https://www.cia.gov/library/publications/the-world-factbook/geos/us.html
\textsuperscript{449} For a comprehensive overview of all the competitive advantages that the US offers as a FDI destination, see https://www.whitehouse.gov/sites/default/files/docs/winning_business_investment_in_the_united_states.pdf
World War II the United States has become the leader of the global economic system and the world’s largest economic power.

The World Bank’s 2016 Ease of Doing Business Index affirms this conclusion, ranking the United States as 7th out of 189 countries.\(^{452}\) According to the European Central Bank (ECB): “The US economy is very often seen as “the engine” of the world economy. As a result, any sign of slowdown in the United States raises concerns about harmful spillovers to the other economies.”\(^{453}\)

Overall, the US government welcomes foreign investors from all around the world. With regard to inward FDI, all fifty states have issued beneficial regulations for foreign investors, through which the incoming companies are endowed with independence, specific tax exemptions and other legal concessions. A widespread example is the “investment contract” provided by a state’s economic development agency, commonly known as “economic development agreement.” With such agreements that contain special and customized advantages for alien investors,\(^{454}\) states aim to encourage foreign companies to localize their business in a particular city or region of their state. In fact, this vigorous quest for drawing foreign investors to their state has led to true competition among the fifty states. Their development agencies contrive strategies to market themselves, build relationships and improve the business climates in their states to attract FDI. As a result, the conditions presented to investors is advantageous and entices investors to the United States generally, as well as to particular states. In contrast to the state governments, the US federal government does not take part in these activities, and only rarely offers special incentives to alien investors.\(^{455}\)


\(^{454}\) The agencies offer a variety of inducements to the foreign firms, which vary from generous tax incentives to assistance with the development of enterprise infrastructure, to loan programs, to provision of suitable parcels of land for the entity, to special customs procedures. E.g. the Texas economic development program, see http://www.austintexas.gov/ economic-development-compliance; South Carolina South Carolina presented the tire company Michelin with an incentives package which enticed the company to both expand an existing tire plant in Greenville, and create a new facility in Starr in 2012, which had led to the creation of 500 new jobs and a US$ 750 million investment in the area; Virginia has attracted over the years more than 700 foreign-controlled companies, such as Canon and Rolls-Royce, and in 2014 a Chinese pulp and paper manufacturer, Shandong Tranlin Paper, invested US$2 billion in Virginia’s Chesterfield County, which in its turn created 2,000 jobs over five years; all with the help to the Governor’s Opportunity Fund that provided a US$5 million grant to assist Chesterfield County with the project. For more examples, see http://www. area development.com/LocationUSA/2015-US-inward-investment-guide/how-us-states-target-fdi-strategies-2727261.shtml.

\(^{455}\) One famous incentive provided by the federal government is when an individual invests at least US$ 1 million, it may obtain a special visa outside the usual limitations and quota for immigrants (EB-5: Investment Based Green Card). See http://www.immihelp.com/greencard/employmentbasedimmigration/eb-5-alien- entrepreneur-investment.html.
The International Trade Administration,456 a federal agency under the Department of Commerce, established the eminent SelectUSA program in 2007 as part of the longstanding US Open Investment Policy.457 SelectUSA is the United States’ primary government mechanism to manage FDI promotion and provide alien investors with a single point of information on investing in the US. It provides “an overview of the many advantages the country offers as a location for business and investment,”458 while helping investors find their way and identify the many business incentives, investment programs, domestic federal and state legislations, specific tax treatments and other aspects of importance to foreign investors.459 The program further organizes annual summits in Washington DC, which attract investors from all around the world, and as such brings together companies seeking to launch or expand their business in the US, and US government leaders and economic development agencies.460 In this way, investors and government officials collaborate on a mutual FDI (ad)venture.

SelectUSA simultaneously functions as an ombudsman for the international investment community in the US, and publishes policy papers on topics which are of great importance to incoming alien investors, such as “Visas and Foreign Direct Investment,” “U.S. Litigation Environment and FDI”461 and “Invest in America: Guide to Federal Incentives and Programs Available to Investors.”

456 The International Trade Administration (ITA) is the central place that brings together all information, contact and other resources concerning FDI for foreign investors, with SelectUSA as its main mechanism to reach this goal.

“The defining purpose of the ITA is helping to create economic opportunity for American workers and businesses. By promoting trade and investment we are promoting prosperity and a better world. To increase trade and investment, ITA helps U.S. companies navigate foreign markets. We help educate companies about how to tailor their activities to the specific market with respect to their product slate, financing, marketing, assembly and logistics. While the United States exports more than any other country, making that first export can still be a daunting challenge for a small or medium sized business. ITA helps equip those businesses with the knowledge and tools that they need to meet that exporting challenge, and by extension, promote the trade and investment that helps us all. The U.S. Commercial Service is the trade promotion arm of the U.S. Department of Commerce’s ITA. The Commercial Service has 108 offices located throughout the country and 150 around the world, covering 96 percent of U.S. export markets.” See http://trade.gov/promotingtrade/index.asp.


459 See for an extensive overview of all programs and incentive, http://selectusa.commerce.gov/.

460 This is the summary on the latest summit of SelectUSA, which was held in March 2015. “The 2015 SelectUSA Investment Summit hosted by President Barack Obama on March 23-24 was a tremendous success for the United States and the entrepreneurs who invest in our communities. We welcomed close to 2,600 participants to Washington this March from more than 70 international markets, including companies and business associations, as well as EDOs from all 50 U.S. states, the District of Columbia, Puerto Rico, and Guam. Global CEOs and other business leaders representing major international firms such as BMW, Google, Nissan, Sony, and many more joined entrepreneurs at the Summit who have successfully grown their startups and SMEs in the United States. Participants of our last Summit announced approximately $3.6 billion in new U.S. investments, supporting an estimated 7,779 U.S. jobs, according to data compiled by FDI Markets through September 2015.” See http://selectusa.commerce.gov/2016-summit.html.

461 The respectively 2007, 2008 and 2009 policy papers “Visas and Foreign Direct Investment”, “U.S. Litigation
Another incentive for foreign enterprises to come to the United States is the much greater flexibility by which companies can expand and develop new products when compared to businesses operating in Europe and Japan. This liberalism and openness of US markets towards foreign firms is further evidenced by the much higher obstacles US investors are faced with when entering those foreign markets. Moreover, the US government does not screen incoming foreign investment in general and, unlike most nations, there are no “minimum investments required” regulations or other similar conditions for alien private capital.

A last proof of the US government’s commitment to FDI is how it eagerly reaches to foreign investors in order to attract their assets, including an infinite list of programs, investment guides, papers, fact sheets, publications, private and public sector contacts, and other resources that the economic development agencies provide for FDI, as well as the overall enthusiasm that all governmental agencies show when addressing FDI. When realizing how much information is out there on the Five W’s for investing in the US, it is truly surprising to find all of it in one place.

This proves the United States’ favorable business environment and conducive attitude towards foreign investors. The motivation behind this mentality is that foreign investors contribute to American prosperity, with capital, new technologies and ideas, and by stimulating a competitive vigor within the United States. As such, US economic policy regards FDI as a way for capital formation, employment intensification, increased production capacity and the development of new technologies.

However, even though foreign investors are usually very welcome in the United States, there are some negative reactions, mainly due to the current security concerns in the world and in the United States in particular, especially due to the events of September 11, 2001. Some critics of the open system contend that alien investors are granted too much management freedom and flexibility, while they easily acquire control of critical US industries and strategic sectors. As stated in one Congressional report: “It is believed by some that the United States has an unusually liberal policy which allows foreigners to invest in virtually all American businesses and real estate and that these foreign


463 With the exemption of business transactions with national security implications for the nation, which are overseen by CFIUS, see above for more information on this agency. However, this is not a mandatory investment screening body. CFIUS is authorized under a voluntary review mechanism to review FDI transactions to decide if they have an impact on the national security of the US; the big majority of FDI transactions thus is not submitted to a CFIUS review.

464 For a complete overview, see http://trade.gov/investamerica/resources.asp.
investments undermine the American economy by making it vulnerable to foreign influence and domination. These critics argue that there is even foreign domination of some key defense-related industries and that the ability of the country to protect itself in a time of national emergency could greatly suffer. These critics further argue that extensive foreign investment in this country drives up prices which Americans have to pay for investments and, even more importantly, for houses and farmland in areas where there is a significant amount of foreign ownership.”

Just as the US government tries to attract inward FDI and facilitate foreign investors in their US endeavors, the government does the same for outward FDI. It tries to stimulate investment outflows to its state business partners and to guide its national investors the best as it can. All of the above-mentioned agencies, including the ITA and the US Department of Commerce, are available to US investors as well; in this case they deal only with investments flowing in the opposite direction. Once again, this organization underlines the transparency and centralization of information, and the available guidance to all investors.

Even though they are not numerous, there are still a few difficulties that the investors face when arriving in the United States. On its attractiveness-scale for foreign investors, the United States loses points for its highly competitive markets, wide array of laws and regulations, and financial system that has been seriously affected by diverse financial crises. The country is still feeling the aftershocks of the subprime lending crisis that caused the 2008-09 recession, which is reflected in the changing confidence of investors, and the concerns they have about US indebtedness and security of their assets. Other factors that weigh on trust of foreign investors are the United States’ international relations and its policy on sensitive topics, expensive workforce and general rise of cost of doing business in the US, which accordingly requires a higher level of private capital.

D. Conclusion

The United States is a crucial player in the world economy and one of the key driving forces behind global economic growth. With its large and lucrative consumer market, rich natural resources, protective legal framework, business mindset, investment incentives and stable political system, it is an extremely attractive destination for FDI around the world.

In particular, because of its strong constitutional protections of private property, the United States can grant solid protection to foreign investors on its territory. Next to these private property protections,
the US government operates a lightly regulated – even too lightly according to some critics – free market economy. As it is also a major political and military player on the global stage, it is evident that the United States, just as governments in the same position around the world, will pay the necessary attention to its national security interests. Therefore, this protective facet of its legal system is not exceptional.

Overall, the US enjoys significant advantages to alien investors and from this analysis it is clear that it does so in a wise and effective way. As a result, FDI is pouring in as nowhere else in the world. While there are admittedly some difficulties that foreign investors encounter when doing business in the United States, they are manageable and heavily outweighed by the many attractive aspects the country provides. Thus the United States is one of the world’s most important economic actors, with a reputation of an open, reliable, foreigners-friendly and entrepreneurial business partner.

Lastly, even though the diverse financial crises have weakened US economy and the country is now restoring its economic vitality, a new set of increasingly competitive economic powers, like China and India, is rising. In order to keep its place at the top of the economic pyramid, the United States will have to rapidly and ingeniously adapt in the future in order to cope with these high-growth, emerging markets and follow their fast pace.

**Final Conclusion**

Having analyzed the Model BITs of the United States and Russia, it is time to return to the question posed at the beginning of this dissertation, namely: which factor plays the crucial part in the decision-making process of foreign investors. In order to answer this question conclusively, it was necessary to zoom out of the BIT-focused approach to gain a comprehensive view of the FDI protections by the two nations.

As Professor Vandevelde previously argued, a good domestic legal system is of paramount importance to foreign investors. Indeed, if every country had a domestic legal system that provided a secure climate for foreign investment, there would be no need for BITs in the first place. Consequently, it is possible to compare the flaws of the Russian and US domestic legal systems to determine which one exposes the investor to the biggest risks and imposes the greatest hurdles; the outcome of this comparison is essential for an investor’s decision-making process and reveals the answer to the question posed by this thesis.
After conducting the assessment on the Model BITs of the United States and Russia – wherein the difference between the two model texts was rather moderate – we will now compare the domestic legal systems of the United States and Russia, which reveal a significantly bigger difference among them. A number of points can be made to in a comparative assessment of the US and Russian legal climates for investors.

First, the standard of treatment of foreign investors and the protections provided in US BITs reflects the United States’ strong advocacy of property rights protection for foreign investors. This protection was also enshrined in the US Constitution since 1787, provided for in early Treaties of Friendship, Commerce and Navigation and other multilateral agreements such as NAFTA, and underpinned by the Hull Formula of “prompt, adequate, and effective” compensation in cases of expropriation. Additionally, this national legislation has greatly contributed to the establishment of modern and internationally accepted standards for property and contractual rights protection of foreign investors. As a result of US domestic constitutional and statutory safeguards, foreign investors are not likely to lose their investments, which makes the United States a particularly attractive destination for foreign private capital.

Given these extensive guarantees, foreign investors are expected to find remedies for any expropriation or other impairment of their property rights through US federal and state courts, without needing to invoke international agreements and resort to international arbitral tribunals.

Conversely, while the right to private property is officially recognized in the Russian Constitution and in its laws, the protection of private property remains problematic, and is often linked to the Russian mafia.\(^{467}\) It is even asserted that “whereas extortion rackets and other forms of physical intimidation once posed the gravest threat to property rights, state actors are now the primary aggressors” against property in Russia.\(^ {468}\) Thus, compared to the United States, the right to private property of foreign investors is under perpetual threat of expropriation and monetary loss in Russia. Even large property holdings have to cooperate with Russian power structures, and also their rights are often infringed

\(^{467}\) After the collapse of the USSR and in the absence of state institutions and effective law enforcement, businesses turned to alternative forms of private property protection and contract enforcement. Criminally organized protection rackets and private “security agencies” provided physical protection to businesses, collected debts and settled disputes among companies.

upon, as in the Yukos case.\textsuperscript{469} These threats come both from “authoritarian” governmental seizures and acts of organized crime.\textsuperscript{470}

Second, even though both countries have complex legal frameworks due to their federal structures, the level of transparency between the United States and Russia differs substantially. While the United States has an equally complex legal framework, it nevertheless remains transparent for foreign investors and manages a single point of information on the competitive and regulatory landscape in the United States through its SelectUSA program. Whereas Russian legal system is also complicated, it is not transparent and outcomes are inconsistent. The lack of transparency and predictability is detrimental to the Russian investment climate because of the danger that arbitrary decisions by public authorities will adversely affect investors. In addition, the Russian legal government is infamous for making hasty amendments to the law and implementing sudden changes to its tax regulations, which consequently are often contradictory and interfere with investors’ business plans and projects, which adds further unpredictability to the whole Russian legal and business framework.

Third, both the United States and Russia are major political and military players on the international stage. Thus, it is normal for states of their sizes and importance to insert limitations into BITs due to national security and safety considerations. However, the two nations approach these considerations in different ways. Russia enacted an exhaustive Strategic Sectors Law that identifies not less than 42 industries where foreign investments are restricted and narrowly controlled, together with many other sector-specific laws with similar restraints. On the other hand, the United States focuses primarily on information-gathering and disclosure acts, rather than real restrictions on foreign investments. The US legal framework does insert some limitations on FDI in security-sensitive industries, however, they are far from extensive or numerous when compared to the Russian legal framework. In reality, the majority of transactions in the United States that could affect national security issues are voluntarily filed and optionally reviewed by CFIUS.\textsuperscript{471} As there is no mandatory investment screening body to review and approve incoming foreign investments in the United States, the screening of such transactions is rather the exception than the rule.\textsuperscript{472} This means that the barrier for FDI is lower in the United States than in


\textsuperscript{470} Most widespread threats include: seizing firms’ assets, illegal corporate raiding, extortion, illicit fines, and unlawful arrests of businesspeople.

\textsuperscript{471} However, CFIUS also has the authority to compel a filing if it autonomously identifies a transaction that possibly poses national security concerns.

\textsuperscript{472} “The Committee on Foreign Investment in the United States (CFIUS) has the authority under a voluntary review mechanism to review individual FDI transactions to determine their effects, if any, on national security. The overwhelming majority of FDI in the United States does not necessitate a CFIUS review. Where CFIUS reviews have been conducted, risk mitigation assurances are requested for only a few transactions per year,
Russia, where FDI screenings and widespread government authorization requirements are the rule. Additionally, in most screenings, CFIUS’ primary concern is that technology or funds attained from a US business are not transferred to a country facing US sanctions, as a result of acquisition of a majority foreign ownership by an alien investor. Whereas in Russia, the restraining attitude is located in an Orwellian mentality.

As follows, apart from a few restrictions, the US government operates a lightly regulated market economy for FDI compared to Russia, where numerous strategically valuable sectors and sectors related to national security interests are closed to foreign investment. Beyond that, considering Russia’s long standing mistrust towards foreigners and the pervasive level of political control over every aspect of the Russian economy, it is likely that the investments will be constantly watched by the appropriate power structures.

Finally, law enforcement systems in Russia remain a major stumbling block to foreign investors. In the past, as has been proven by the notorious Sedelmayer and Yukos affairs, Russia has often failed to honor investment arbitration awards rendered against it. In fact, it is the biggest flaw in Russia’s legal system, both with regard to execution of national judgments and international arbitral awards. Such cases send a warning to the international community and prospective investors about how Russia may react if it loses an arbitration case and outlines the daunting challenges confronting investors seeking to obtain compensation for expropriation.

It should be noted, however, that just as Russia has been accused of violating investment agreements, the United States has likewise on a number of occasions been accused of violating those agreements. Yet, to date, no arbitral tribunal has found that the United States was liable for violation of one of those investment agreements. Thus, no precedents exist regarding enforcement of investment agreements and when these assurances are met the transaction is allowed to proceed.”

http://selectusa.commerce.gov/frequently-asked-questions.html. In addition, “most cases are concluded in the first 30 days and result in the transaction being approved without condition” and until 2015, “there have been only two cases — in 1990 and 2012 — where the President has blocked a foreign merger, acquisition or takeover on national security grounds.” See http://www.ofii.org/sites/default/files/OFII_CFIUS_Primer.pdf.

473 For a complete overview of the sanctions programs, see https://www.treasury.gov/resource-center/sanctions/Programs/Pages/Programs.aspx.


475 International disputes registered by UNCTAD: United States has been involved in 15 cases of disagreement concerning foreign investment as a respondent state and all of them were settled or decided in favor of the US. Russia has been involved in 21 cases on FDI as a respondent state: in 7 of them Russia was found liable, 10 of them are pending (6 of which have recently been initiated by Ukraine), 1 has been settled and 3 were decided in favor of Russia. See http://investmentpolicyhub.unctad.org/ISDS/FilterByCountry. Last accessed on 10 May 2016.
arbitral awards by the United States, which may give investors pause. Nevertheless, the United States is party to all the major international conventions on arbitration, which instills additional confidence in alien investors.

In assessing all of the aforementioned characteristics of the Russian and US legal systems, it becomes clear that there is a big difference in the quality of the domestic legal systems of the United States and Russia, and thus the protection a foreign investor in each country would enjoy.

For all of the above reasons, it is no surprise than that the United States is seen as a favorable jurisdiction for guaranteeing investments due to its legal protectiveness and overall political stability. As a result, in determining whether to invest in Russia or the United States, an investor will have to explore whether the BIT between Russia and his home state, if there is one, offers enough protection to compensate the flaws of Russia’s legal regime. It is hard to give a clear-cut answer to this issue, as we know that Russian BITs vary greatly from one another; however, usually they do offer greater protections than the 2001 Russian Model BIT. Hence the answer to this question will be a positive one, as Russia’s BITs are generally protective. However, once an arbitration against Russia has been commenced and concluded, the essential question is whether it will be possible to enforce the arbitral award. Here, the answer is most likely negative. Thus, the treatment that a foreign investor will receive under Russian domestic law in the most crucial part of the arbitral proceedings – the enforcement stage – is unreliable and unfavorable to foreign investors.

These flaws are not manifest in the US legal system, and investors can rely on the payment of damages in the case of a violation of the BIT. The predictability and reliability of the US legal systems helps to ensure that business investments are comparatively safer in the United States and hence, alien investors are endowed with broad protection of their investment rights. In these circumstances, BITs are of subordinate importance.

When we zoom out of US and Russian legal regimes, and consider the complete investment environment wherein these systems operate, the discrepancy between the US and Russian level of FDI protection becomes even greater. Ubiquitous corruption, racketeering, persisting government control, “economic wardlorism,” red tape, and so on, make it extremely tough to do business for foreign investors to do business in Russia. Consequently, Russia’s enormous potential for natural resource

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development, a large consumer market and an inexpensive labor force, remain largely under-utilized capacities. More importantly, these factors undermine Russia’s adherence to the rule of law, which is, as mentioned previously, is critical and the decisive factor for attracting foreign investors. 477

The United States operates an open investment climate with low barriers to FDI, ranks high in the World Bank’s Doing Business reports and is one of the world’s strongest economies that was able to recover from many financial crises. E.g., when looking at the data of the New York Stock Exchange, the US economy is currently twice as high as before the subprime mortgage crisis of 2008-09, while the Moscow Stock Exchange was just able to recover to the same level as right before it entered the crisis. 478 Because the US government has learnt from the preceding litigation and its past mistakes with the NAFTA, it has adapted a new Model BIT and an altered investment policy; the country took a step ahead by inserting provisions in order to better preserve itself from future claims.

At the present time, the US is much more attentive regarding striking a fair balance between its “offensive” interest in protecting US investors abroad, and its “defensive” interest in preserving governmental regulatory space for public health and safety. This balancing exercise is in particular reflected in the great augmentation of environment protection carve-outs, health exceptions, labor rights reservations and self-judging, national security provisions. 479

From the perspective of a rational foreign investor, if he can choose between a stable, transparent and protective legal environment of the United States that promotes and facilitates foreign investments in many ways and where his foreign investment faces few restrictions, and an unstable, ambiguous and largely restrictive legal regime in Russia, which is surrounded by corruption, bureaucracy and a lax law enforcement system on top, the choice becomes clear.

The Russian Federation and the United States are, respectively, the first and third largest countries on earth, have a vast consumer market, abundant natural resources and highly educated labor forces; ingredients that seem perfect to attract enormous FDI volumes. Nevertheless, the two nations have respectively attracted US$ 2 and 384 billion in 2015. This means that Russia has an FDI inflow of just 0.5% of what the US has received.

478 See the both indexes on Bloomberg: http://www.bloomberg.com/quote/INDEXCF:IND.
Yes, the United States offers a more developed and innovative infrastructure for foreign investors, diversified industries, and an embedded entrepreneurial culture – all of which Russia does not have – and yes, Russia is facing geopolitical problems with Ukraine that have substantially contributed to the plummeting inward FDI. Nevertheless, even before the Ukrainian conflict arose, Russia was attracting only a fraction of the capital the United States has continuously received over past years. Over the past five years, between 2011 and 2015, Russia attracted a total of US$ 197 billion as opposed to the US$ 1.107 billion of inward FDI flowing into the United States. This means that Russia attracted not even one fifth of US’ FDI total. By way of comparison, last year the United States received the lion’s share of FDI, attracting US$ 384 billion out of a worldwide US$ 1.7 trillion, which is more than 20% of total global FDI for 2015.

Nevertheless, in the light of the geopolitical crisis with Ukraine and its consequences for the Russian economy, it will be interesting to keep track of the direction Russian investment policy will take. Questions remain: will the Russian government revise its fifteen-year-old Model BIT? Will it review its existing BITs and possibly terminate some of them – for example with Ukraine, as litigation is rapidly rising under the Russia-Ukraine BIT? Will it loosen up its Strategic Sectors Law and gradually liberalize investment policies in protected industries, or will it retain the careful and restrictive status quo? Will it (ever) become supporting and less evasive regarding the enforcement of international arbitral awards? Will it endorse effective measures to defeat rampant corruption at all governmental levels? Will it tighten its legal system and amend provisions to include rigorous laws for investors such as the announced Law on Confiscation of Property belonging to Foreign Companies, by which the Russian courts may seize foreign assets on Russian territory, and use them to compensate individuals and businesses being hurt by Western sanctions over the Ukraine crisis?


482 Announced by Chairman of the Federation Council Committee for Constitutional Legislation, Andrey Klishas, in October 2014.
In any case, Russia’s attitude thus far has not inspired much confidence in foreign investors, who remain skeptical towards Russia’s domestic legal system and its business environment. As such, the present circumstances do not encourage them to invest in Russia, and it is expected that they will continue to turn to other countries until these issues are resolved.

Even so, it must be remembered that Russia remains an economy in transition; an economy that was severely derailed during the early transition period, plunged into an institutional vacuum, and has limited funds – which are swallowed by corruption – together with an insufficiently developed infrastructure. Despite a number of prominent investment programs initiated by the government, as long as the Russian government does not carry out structural reforms that will establish a protective legal framework, a reliable judicial system, a safe informal business environment, and voluntary compliance with arbitral awards, Russian investment capacity will remain generally underutilized and the country will continue to struggle to attract FDI. Only after these reforms have been conducted will Russia be able to enjoy the benefits of full integration into the global economic system, boost the confidence of alien investors and compete for foreign investments with powers such as the United States in an earnest way.
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