



## **Sharing Pre-investment Rules in the Energy Sector**

### ***Domestic and international predictable options to mobilise sustainable energy investments***

*A discussion paper for the Energy Charter expert meeting*

**REMOVING PRE-INVESTMENT BARRIERS IN ENERGY**

*Mobilising energy investments towards universal access and energy transition*

*Brussels, 14 June 2016*

This discussion paper on pre-investment in the energy sector presents, in a simplified manner, the main policy options that regulate the establishment of foreign energy investments, and in particular those that aim at removing barriers and at facilitating and mobilising energy investments.

Increasing predictability is a key step towards mobilising energy investments and at the same time preserving the policy space to balance public interest in sensitive policy areas. Rules based on transparency and on rule of law are the enabling factors that favor energy investments.

The discussion on available policy options covers: (A) predictable domestic rules for the entry and establishment of sustainable investments; (B) mobilising energy investments towards universal access to energy and clean energy transition; (C) the benefits for sustainable energy investments from predictable, transparent, and stable rules; (D) rules for the entry of foreign investments in international investment agreements; (E) investment facilitation and regulatory cooperation.

**Participants are invited to discuss the proposed working questions and suggest direction for future expert meetings and further work by the Secretariat.**

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## Sharing Pre-investment Rules in the Energy Sector

### *Domestic and international predictable options to mobilise sustainable energy investments*

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**Table 1. Definition of pre-investment**

**For the purpose of this discussion, pre-investment activities (or pre-investment phase) are defined as the entry and the establishment of foreign companies within their territory as well as the acquisition of interest in domestic ventures and the expansion of existing business.**

**Other definitions of pre-investment currently provided under selected International Investment Agreements and other international agreements are available under Annex I.**

#### **A. Domestic rules for the entry and establishment of sustainable investments**

The starting point for any discussion on pre-investment in the energy sector is that **States enjoy the sovereign right, subject to commitments in any international agreements, to control and regulate the entry and the establishment of foreign companies within their territory** as well as the acquisition of interest in domestic ventures and the expansion of existing business.

UNCTAD provides an in-depth analysis and a comprehensive repertoire of the available policy choices to regulate pre-investment<sup>1</sup>. This 2002 report serves as a useful reference and as a starting point for the purpose of this discussion.

<sup>1</sup> UNCTAD Series on issues in international investment agreements, *Admission and Establishment*, 2002, available under [http://unctad.org/en/Docs/iteiit10v2\\_en.pdf](http://unctad.org/en/Docs/iteiit10v2_en.pdf).

**Table 2. Classification of pre-investment rules**

Pre-investment rules are classified as:

- measures related to the admission and establishment of foreign investors (including acquisition of interests in local businesses);
- measures related to foreign ownership and control of local businesses.

Such rules and measures may consist of absolute restrictions (bans) or of discriminations against foreign investors.

Pre-investment rules regulating the admission and establishment of foreign investments include:

- entry control over access to the host-country economy
  - o quantitative restrictions
  - o registration in the host country
  - o screening and monitoring
- conditional entry into host-country economy
  - o performance requirements (local sourcing, national development criteria)
  - o fees, taxes and specific guarantees
  - o capital and exchange restrictions.

Pre-investment rules regulating foreign ownership and control of local business include:

- controls over ownership
  - o quota of foreign ownership
  - o mandatory transfers to local entities
  - o mandatory joint ventures or partnerships
- controls based on the limitation of shareholders powers
  - o restrictions on shareholders rights
  - o restrictions on the right to transfer the shares
- controls based on governmental intervention in the running of the investment
  - o direct governmental intervention in the management
  - o restrictions on the management

Pre-investment rules that affect specifically the energy sector are commonly found in relation to:

- registration and screening of energy activities:
  - o incorporation or registration in host country;
  - o special or reserved rights to local companies;
- energy upstream and downstream concessions or licenses requiring:
  - o performance requirements in relation to local employment and to export quotas;
  - o local content rules that investors are supplied by local entities;
- land and real estate:
  - o access to ownership and lease;
  - o building and environmental permits;
- access to grants or financial assistance:
  - o for energy technology research and development;
  - o for clean energy investments;
- ownership and control:
  - o quota of local ownership or compulsory local partnership;
  - o public controls on shareholders or management rights.

In this respect, it is worth recalling that the Energy Charter Conference keeps a regular record of discriminatory measures with regard to the establishment or the acquisition of energy investments notified by the Contracting Parties [Art. 10(9) ECT]. The so-called Blue Book contains an interesting collection of discriminatory measures specific to the energy sector<sup>2</sup>.

Indeed, many pre-investment rules are instrumental to achieving investment policy coherence with productive capacity building such as: human resources development, technology and know-how transfer, local infrastructure and enterprise development. In this respect, the 2015 UNCTAD *Investment Policy Framework for Sustainable Development* recommends that the potential for achieving productive capacity building is evaluated and taken into account and made an integral part of a comprehensive ‘**investment and sustainable development**’ strategy<sup>3</sup>.

Screening and entry restrictions, ownership restrictions or limitations on the entry of foreign investments – which are, as anticipated, an integral part of the country’s right to regulate – should therefore be **consistent with the overall investment strategy** and be **balanced by legitimate national policy objectives** such as: national security, control over strategic resources, critical and sensitive infrastructures, public service obligations, protection of the health and of the environment, national development strategic objectives<sup>4</sup>.

More specifically:<sup>5</sup>

- restrictions on foreign ownership should be **clearly specified, reviewed periodically, and implemented according to pre-established and objective criteria**;
- investors should have an **access to register titles to land in a secure, effective and timely** manner to facilitate access to debt finance;
- governments should **avoid direct and indirect intrusions** in business management and respect the freedom of operations of private companies;
- performance requirements should be **used sparingly as necessary to achieve public policy objectives**.

#### **A. Working Questions (Panels I, II and IV):**

A.1. What is the energy dimension of the national ‘investment and sustainable development’ strategy in your country?

A.2. What are the domestic rules regulating foreign investors which are specific to the energy sector in your country?

- registration and screening
- upstream and downstream concessions or licenses
- land and real estate
- access to grants or financial assistance
- ownership and control

A.3. How do these rules balance the objective of energy investment promotion and the objective

<sup>2</sup> Available under <http://www.energycharter.org/what-we-do/investment/the-blue-book/>.

<sup>3</sup> UNCTAD, *Investment Policy Framework for Sustainable Development (IPFSD)*, National Investment Policy Guidelines at 1.1 “Strategic investment policy priorities” and 1.2 “Investment policy coherence for productive capacity building”, Geneva 2015, available under [http://unctad.org/en/PublicationsLibrary/diaepcb2015d5\\_en.pdf](http://unctad.org/en/PublicationsLibrary/diaepcb2015d5_en.pdf).

<sup>4</sup> UNCTAD, IPFSD, National Investment Policy Guidelines at 2.1 “Entry, establishment and operations of foreign investors”.

<sup>5</sup> *Ibidem*. In the sense that pre-investment rules require consideration of the policy trade-offs implications and the range of possible alternatives, see: IIED, *Investment treaties and sustainable development: investment liberalization*, London 2014, available under <http://pubs.iied.org/pdfs/17239IIED.pdf>.

of national sustainable development?

A.4. Are there available alternatives that minimise restrictions or discriminations against foreign energy investors?

## **B. Mobilising energy investments towards universal access to energy and energy transition**

**Energy is an essential component of the sustainability equation.** Combining energy strategy and sustainable development is not a new challenge to national governments. At a global level, the same challenge was addressed in 2015 by the UN 2030 Agenda for Sustainable Development<sup>6</sup> and by the Paris Agreement<sup>7</sup>.

Energy is placed as an important element of the UN Sustainable Development Goals (SDGs) which aim to promote prosperity and at the same time protect the planet and its inhabitants. According to the SDG7, which is entitled ‘**Ensure access to affordable, reliable, sustainable and modern energy for all**’, achieving universal access to energy shall be among the major challenges and opportunities that the world and governments face today<sup>8</sup>. The Sustainable Energy for All (UNSE4All) initiative led by the UN Secretary-General Ban Ki-moon aims at supporting governments in ensuring universal access to modern energy services, improve efficiency and increase use of renewable sources<sup>9</sup>.

**Climate change is another essential component of the sustainability equation.** The Paris Agreement responded to the climate change challenge with the firm commitment to the transition to a low-carbon economy holding global warming increase 2°C below pre-industrial levels. The Intergovernmental Panel on Climate Change (IPCC) estimates the nexus between climate change and energy as follows: 78% of global emission is originated from the energy sectors<sup>10</sup>.

Governments and industry are called to identify and deliver policies which simultaneously address energy security, universal access to affordable energy services, and environmentally sensitive production and use of energy. The three core dimension of the so-called ‘**world energy trilemma**’<sup>11</sup>, i.e. energy security, energy equity, and environmental sustainability, represent also three important dimension of sustainable development strategies which are at the core of the **2015 International Energy Charter**<sup>12</sup>.

According to the IEA, the demand for energy will grow by approximately 33% by 2040 as a result of increasing demand in developing countries. To sustain the global developing trend would require total \$68 trillion investment in the global energy sector (including energy efficiency, oil, gas and renewables) from 2015 to 2040.<sup>13</sup> **Current energy investment flows are insufficient to**

<sup>6</sup> [http://www.un.org/ga/search/view\\_doc.asp?symbol=A/RES/70/1&Lang=E](http://www.un.org/ga/search/view_doc.asp?symbol=A/RES/70/1&Lang=E)

<sup>7</sup> <http://newsroom.unfccc.int/paris-agreement/>

<sup>8</sup> <http://www.un.org/sustainabledevelopment/energy/>. The seventeen UN Sustainable Development Goals all contribute to build economic growth and addresses a range of social needs including education, health, social protection, and job opportunities, while tackling climate change and environmental protection.

<sup>9</sup> <http://www.se4all.org/our-vision>

<sup>10</sup> IPCC, 5<sup>th</sup> Assessment Report Third Working Group “summary for policy makers”, p.6.

<sup>11</sup> World Energy Council <https://www.worldenergy.org/work-programme/strategic-insight/assessment-of-energy-climate-change-policy/>

<sup>12</sup> International Energy Charter, preamble: “Recognising the global challenge posed by the trilemma between energy security, economic development and environmental protection, and efforts by all countries to achieve sustainable development”, available under <http://www.energycharter.org/process/international-energy-charter-2015/>

<sup>13</sup> IEA, World Energy Outlook 2015 and its Factsheet, available under [https://www.iea.org/media/news/2015/press/151110\\_WEO\\_Factsheet\\_GlobalEnergyTrends.pdf](https://www.iea.org/media/news/2015/press/151110_WEO_Factsheet_GlobalEnergyTrends.pdf)

achieve the ambitious objectives of universal access to energy and of clean energy transition. Projections by the IEA estimate that total investment of more than \$1 trillion would be required to achieve universal energy access by 2030<sup>14</sup>. The IEA also estimates \$7,4tn global investments in renewable energies and \$8tn in energy efficiency are needed in the climate change policy scenario to 2040.<sup>15</sup>

Such a scenario strengthens the **political demand to mobilise sustainable energy investments**. Energy efficiency and renewable energy investments have high capital and low operating costs and often depend on public support. Upstream and downstream oil and gas investments are long-term and capital-intensive. Investors need **predictable regulatory and legal frameworks** and, on the other hand, **remedies for losses** in case of unnecessary or arbitrary changes.

At a time of budgetary constraints and low oil prices, governments have limited recourse to public finance to spur energy investments. They can, however, ensure a **legal and regulatory environment that mitigates legal and regulatory risks, reduces insurance costs and enables sound energy investment decisions**.

Both the **IEA and IRENA** constantly call for **clarity and consistency** in national energy policies. Along the same lines, the **G20 Energy Access Action Plan**, established in 2015, supports developing countries in attracting energy access-related investments by reforming policy, legal and regulatory frameworks<sup>16</sup>. This is certainly in line with **UNCTAD** and **OECD** recommended investment policy options of **predictable rules based on the rule of law and on good governance**<sup>17</sup>.

#### **B. Working Questions (Panels I, II and IV):**

- B.1. What are the goals and strategies for universal access to energy and for clean energy transition in the energy strategy of your country?
- B.2. What are the estimated energy investments required to achieve these goals?
- B.3. What are the measures adopted to mobilise sustainable energy investments?

#### **C. Benefits for sustainable energy investments from predictable, transparent and stable rules**

There has been considerable efforts by way of **international cooperation** to support governments in **creating enabling environments for sustainable investments**. Below the recommendations by the World Bank, the International Finance Corporation (IFC) and the OECD are briefly set out in relation to removing barriers and promoting equal treatment of foreign and domestic investors.

<sup>14</sup> <http://www.worldenergyoutlook.org/resources/energydevelopment/energyaccessprojections/>

<sup>15</sup> The full implementation of climate pledges will require the energy sector to invest \$13.5 trillion in energy efficiency and low-carbon technologies from 2015 to 2030, representing almost 40% of total energy sector investment. IEA, *World Energy Outlook 2015 Special Briefing “Energy and Climate Change”*, at p. 4. available to download free at [www.worldenergyoutlook.org/energyclimate](http://www.worldenergyoutlook.org/energyclimate)

<sup>16</sup> G20 Energy Access Action Plan: Voluntary Collaboration on Energy Access, adopted by G20 energy ministers in Istanbul (Turkey) on 2 October 2015. See key option under section 1. Policy and regulatory environment: “*Participating members undertake to support efforts to help governments at country-level to strengthen their domestic policy setting, energy sector planning, regulatory framework, regulatory institutions and the technical capacities of their power utilities and to improve sector governance in order to increase public and private investments in energy access according to their national circumstances and priorities*”. Available under <http://www.mofa.go.jp/files/000111117.pdf>

<sup>17</sup> UNCTAD, *Investment Policy Framework for Sustainable Development (IPFSD)*, National Investment Policy Guidelines at 2.2 “Treatment and protection of investors” and at 3. “Investment-related policies”. OECD, *Policy Framework for Investment*, Paris 2015, at p. 15.

The **World Bank** database *Investing Across Borders* collects data on regulations and administrative processes for foreign direct investment, and concludes that while restrictive frameworks and poor implementation impede investments, **good regulations and efficient processes and institutions** matter<sup>18</sup>. Indeed, the World Bank recognises the **financial value** of **predictable regulation, implementation and enforcement** and estimates that investing in high regulatory risk countries require more than twice the rate of return they would in lower risk countries<sup>19</sup>.

In its 2015 *Policy Framework for Investment*, **OECD** suggests that, besides **transparency and predictability**, the principles of **non-discrimination and openness** to foreign investment should be core components of domestic investment policy creating a quality investment environment for all<sup>20</sup>. In this respect, the OECD *FDI Regulatory Restrictiveness Index* measures national restrictions to foreign investment<sup>21</sup>. OECD suggests that even partial foreign investment **restrictions have a strong impact on investment flows** and that there is an inverse correlation between restrictions and trade flows<sup>22</sup>.

The International Finance Corporation (IFC), the World Bank and the Multilateral Investment Guarantee Agency (MIGA) collect very significant data and indicators on **regulations** and their **enforcement**<sup>23</sup> and more in general on **governance**<sup>24</sup>. Such various aspects of the investment climate, used in combination with foreign investment restrictions are a critical determinant of a country's **attractiveness to foreign investors**.

Keywords are **predictability, transparency, regulatory stability and market confidence**, in other words the **rule of law** in the energy sector<sup>25</sup>.

A comprehensive **sustainable investment strategy** that aims at universal access to energy and at clean energy transition should therefore focus on **factors enabling sustainable energy investments**. At a minimum, criteria for granting investment rights should be **transparent, reasonably stable and enforceable**, without unnecessary bureaucratic complexities and delays. **National energy strategy, law and regulations** – including energy market structure and prices - should also be transparent and comprehensive as well as **properly implemented at all levels**. Responsibilities of public authorities should be clearly defined and enforceable against crime and corruption.

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<sup>18</sup> The project presents quantitative indicators on economies' laws, regulations, and practices affecting how foreign companies invest across sectors, start businesses, access industrial land, and arbitrate commercial disputes. Investment Climate Advisory Services of the World Bank Group, *Investing across borders – indicators of foreign direct investment regulation*, Washington (2010), at p. 8 et ff., available under <http://iab.worldbank.org/>.

<sup>19</sup> World Bank, *World Development Report 2005 “A Better Investment Climate for Everyone”*, pp.23-24, available under [http://siteresources.worldbank.org/INTWDRS/Resources/477365-1327693758977/complete\\_report.pdf](http://siteresources.worldbank.org/INTWDRS/Resources/477365-1327693758977/complete_report.pdf).

<sup>20</sup> OECD, *Policy Framework for Investment*, Paris (2015), at p. 24, available under <http://www.oecd.org/daf/inv/investment-policy/Policy-Framework-for-Investment-2015-CMIN2015-5.pdf>.

<sup>21</sup> The database looks at four main types of restrictions: equity limitations, screening or approvals, restrictions on foreigners as key personnel, operational restrictions e.g. on branching and on capital repatriation or on land ownership. The FDI Restrictiveness Index is part of the OECD activities on FDI statistics, including FDI financial flows, income and positions and is available under <http://www.oecd.org/investment/statistics.htm>.

<sup>22</sup> One way to see this is to compare FDI Index scores across ASEAN countries with the recorded FDI stock as a share of GDP. The relationship between FDI restrictions and FDI stocks normalised for market size is highly negatively correlated (-0.68), as seen in the figure. The two most restrictive countries (Philippines and Myanmar) have the lowest stock of FDI to GDP, even if one adjusts for the possibility of under-reporting of FDI in the Philippines. Similarly, the two most open economies for foreign investment in the region (Singapore and Cambodia) have the highest stocks of FDI relative to GDP.

<sup>23</sup> The World Bank Group, *Doing business – measuring business regulations*, available under <http://www.doingbusiness.org/>.

<sup>24</sup> The World Bank, *Worldwide Governance Indicators* (including: Voice and Accountability; Political Stability and Absence of Violence/Terrorism; Government Effectiveness; Regulatory Quality; Rule of Law; Control of Corruption), available under <http://databank.worldbank.org/data/reports.aspx?source=worldwide-governance-indicators>

<sup>25</sup> OECD qualifies the notion of the rule of law as the bundle of several principles: predictability, transparency, credibility, accountability and fairness. OECD, *Investment Policy Framework*, at pp. 13 and 15.

**Restrictions on foreign investors** should be **transparent and justified by legitimate policy objectives, proportional, specific, monitored and reviewed periodically**.

In particular in the **clean energy** sector, the OECD recognises that **restrictions** are likely to result in sub-optimal flows of investment. **Stable and predictable** investment environment for foreign investment in clean-energy generation is critical. Predictability concerns in the first place access to domestic **support policies** and specific performance requirements (minimum investment, local content) as well as the **enforcement of intellectual property rights, contract and land right**. The OECD further recommends to re-orient investment **incentives** toward clean energy according to **long-term goals**, to **streamline licensing** of renewable energy projects and to ensure **policy coherence**, coordination and monitoring<sup>26</sup>.

### **C. Working Questions (Panels I, II and IV):**

C.1. How is predictability, transparency, stability of legal and regulatory framework (*i.e.* the rule of law) provided and protected in your country? Please, consider constitution, investment legislation, sectoral regulation.

C.2. How is confidence in the energy market (e.g. structure and prices) ensured?

C.3. How can the rule of law and market confidence be improved and strengthened?

### **D. Pre-investment rules in international investment agreements: practice and options**

In order to ‘lock in’ the domestic pre-investment rules, host countries commit themselves by means of **international investment agreements (IIAs)** to specific obligations on the entry of foreign investor in the domestic energy market. In this sense, IIAs provide investors the additional predictability and security they seek. The degree of **pre-establishment rules in IIAs** is varied in order to balance between binding international commitments and domestic policy flexibility.

**UNCTAD registered a rise** in the number of agreements that include investors to the acquisition and the establishment of investments (10% of all investment agreements in 2014). By the end of 2014, **228** instruments (125 “other IIAs” and 103 BITs) contain pre-investment protections.<sup>27</sup> Additionally, **9** instruments (7 “other IIAs” and 2 BITs) extend protection to pre-establishment stage<sup>28</sup> among the 19 instruments signed by February 2016, whose texts are available.<sup>29</sup> **70%** of all signed IIA includes pre-investment protection involved **developed** economies.<sup>30</sup>

The practice of international investment agreements focuses on eliminating domestic rules that discriminate against the establishment of foreign investments compared to domestic ones and establishing a **non discriminatory standard** in the treatment of pre-investment. In such agreements, ‘**national treatment**’ (NT) or ‘**most favored nations**’ (MFN) clauses prohibit domestic rules that are more restrictive to foreign investors than to national or than other ‘most favored’ foreigners.

<sup>26</sup> OECD, *Policy Guidance for Investment in Clean Energy Infrastructure*, Paris (2015), available under <http://www.oecd.org/environment/policy-guidance-for-investment-in-clean-energy-infrastructure-9789264212664-en.htm>

<sup>27</sup> World Investment Report 2015: Reforming International Investment Governance, p.110

<sup>28</sup> UNCTAD, IIA Database

<sup>29</sup> The total 32 BITs and IIAs were signed from January 2015 to February 2016

<sup>30</sup> *Supra* note. 1 and 2

Some IIAs **liberalise** the entry and the establishment of foreign investments under **Market Access** articles and provisions<sup>31</sup>.

**Table 3. Pre-establishment rules in international investment agreements (IIAs)**

|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>Overall approach:</p> <ul style="list-style-type: none"> <li>- <b>No binding pre-establishment provisions</b>,</li> <li>- <b>Positive list</b>: Selective liberalisation by drawing up a list of industries in which investors enjoy pre-establishment rights,</li> <li>- <b>Negative list</b>: Liberalisation across the board with the exception of those industries and sectors that are specifically listed,</li> <li>- <b>Market access</b>: granting of the full right of establishment to foreign investors and prohibition of certain non-discriminatory practices that can inhibit the right of establishment.</li> </ul> <p>Substantial <b>standards</b>:</p> <ul style="list-style-type: none"> <li>- National treatment (NT),</li> <li>- Most favoured nation (MFN) treatment,</li> <li>- Market access,</li> <li>- Prohibition of Performance Requirements,</li> <li>- Prohibition of Nationality Requirements for Senior Management and Board.</li> </ul> <p><b>Reservations</b>:</p> <ul style="list-style-type: none"> <li>- Reserve non-conforming measures ("grandfathering" or "standstill"),</li> <li>- Retain the right to adopt new conforming measures,</li> <li>- REIO clauses,</li> <li>- Country specific reservations: sectoral, policy-area, government procedure, other,</li> <li>- Flexibility mechanisms: altering of reservations, transitional arrangements.</li> </ul> |
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*UNCTAD IPFSD, "Policy Options for IIAs", 2015*

In the current practice of IIAs, **various combination** of the above mentioned approaches are available. Below is a brief illustration of concrete examples from negotiated IIAs in the definition of investment activities, National Treatment, MFN extending to establishment, acquisition of investment, prohibition of performance requirement, market access.

**Table 4. Definition of Investment and Substantial Standards of Protection in IIAs**

|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p><u>Definition of investor or investment activities</u></p> <ul style="list-style-type: none"> <li>● CETA (definition of investor): "a Party, a natural person or an enterprise of a Party, other than a branch or a representative office, that seeks to make, is making or has made an investment in the territory of the other Party",</li> <li>● Japan-Mongolia EPA (definition of investment activities): "establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment and sale or other disposal of an investment",</li> <li>● Chile-Korea FTA, Art 10.1: The acts of an investor of a Party in the territory of the other Party towards establishing, acquiring and/or expanding an investment in the territory of the latter.</li> </ul> <p><u>National Treatment, MFN extending to establishment, acquisition of investment</u></p> <ul style="list-style-type: none"> <li>● CETA: Article 8.6 (National Treatment), Article 8.7 (MFN Treatment),</li> </ul> |
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<sup>31</sup> In a WTO perspective, pre-establishment rules under IIAs overlap with GATS provisions. Mode 3 under GATS covers establishment of service as 'measures by Members affecting trade in services' within the meaning of Article 1.1 of the GATS.

- TPP: Article 9.4 (National Treatment), Article 9.5(MFN Treatment),
- Eurasian Economic Union<sup>32</sup> - Viet Nam FTA: Article 8.21(National Treatment), Article 8.22(MFN Treatment).

#### Prohibition of Performance Requirement

- CETA: Article 8.5: A Party shall not impose, or enforce the following requirements, or enforce a commitment or undertaking, in connection with the establishment, acquisition, expansion, conduct, operation, and management of any investments in its territory to: (listing PR),
- TPP: Article: Article 9.10,
- Eurasian Economic Union - Viet Nam FTA: Article 8.24.

#### Market Access

- CETA: Article 8.4,
- Eurasian Economic Union - Vietnam FTA: Article 8.16.

Some IIAs also aim at the elimination of the **non-discriminatory barriers** that create unnecessary burdens to investors. Such non-discriminatory barriers arise for instance when domestic rules are **implemented** arbitrarily, or out of proportion with their objective, or in a non-transparent manner. Some IIAs therefore require host states to grant all permits which are necessary for the proper realization of the investment. **Transparency**<sup>33</sup> is widely considered to be a part of the concept of 'Fair and Equitable Treatment (FET)' standard provided under the IIAs<sup>34</sup>.

Notwithstanding the language in IIAs, recent arbitral awards have extended treaty protection to pre-investment activities preliminary to the establishment of the investment based on the terms of the concession contracts with the host country. In earlier cases,<sup>35</sup> the negotiation phase of the investment was taken into account (see case law in Annex III).

#### **D. Working Questions (Panel III):**

D.1. What is the current practice of your country in negotiating pre-investment rules in international investment agreements (IIAs)? Please consider the options: no provisions, positive/negative list, market access?

D.2. What kind of standards are provided to protect the establishment of investments? Please consider: NT, MFN, specific prohibitions

D.3. Are energy specific chapters provided under IIAs in order to specifically address barriers to the cross border flow of energy investments?

#### **E. Investment facilitation and regulatory cooperation**

The removal of **non-discriminatory regulatory barriers** plays an important role in mobilising energy investments. **Poor implementation, lack of transparency, excessive bureaucracy** create unnecessary burdens to investors and prevent sound business decisions.

<sup>32</sup> Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russian Federation

<sup>33</sup> For example, *Waste Management v. Mexico*, ICSID Case No. ARB(AF)/00/3, Award, 30 April 2004, para. 98; *Glamis Gold Ltd v. United States*, UNCITRAL Rules, Award, 8 June 2009, para. 605.

<sup>34</sup> UNCTAD Series on Issues in International Investment Agreements II, "Fair And Equitable Treatment", at p. vi.

<sup>35</sup> Added to Mihaly, *Generation Ukraine, Inc. v. Ukraine* (ICSID Case No. ARB/00/9), Award of 16 September 2003; *Nagel v. Czech Republic* (SCC Case 49/2002), Final Arbitral Award of 9 September 2003; *Petrobart Ltd. v. Kyrgyz Republic* (SCC Case 126/2003), Arbitral Award of 29 March 2005.

**Investment promotion agencies** aim to improve the overall investment climate and implement the enabling factors that facilitate sustainable energy investments. The benefits of favorable and rule-based domestic conditions may be larger when combined to **investment facilitation** (incentives, guarantees, linkages and spillover) by investment promotion agencies and international networks such as the World Association of Investment Promotion Agencies (WAIPA).

**Energy regulation** aims *per se* to facilitate infrastructure development and efficient market functioning. National Regulatory Authority (NRA) and regional regulatory associations are crucial institutional players to achieve these goals. Energy regulators play an important role in **defining and enforcing market design rules, ensuring open and non-discriminatory market access, and monitoring and promoting market competition**. NRAs facilitate investments, promote public interests and support political choices.

**Regulatory cooperation** among energy regulators at a regional level contributes actively to the implementation of the principles of **predictability, transparency, regulatory stability and market confidence**. Such is the experience of the Agency for the Cooperation of Energy Regulators (ACER), the Council of European Energy Regulators (CEER), the Economic Community of West African States (ECOWAS) Regional Electricity Regulatory Authority (ERERA), the Mediterranean Energy Regulators (MedReg) and the Regional Electricity Regulators Association of Southern Africa (RERA Southern Africa).

In particular, **ECOWAS** created a Private Sector Department with view to encouraging cross-border investments, eliminate red tape and creating an enabling environment both for internal investments and foreign direct investments<sup>36</sup>. In 2003 ECOWAS adopted the Energy Protocol, a text based on the Energy Charter Treaty, in order to integrate the national power generation systems in a unified regional power market system. Energy regulatory cooperation and policy integration under ECOWAS resulted in the establishment of ERERA in 2008 in order to improve energy governance in to expand the involvement of private sector in developing the electricity infrastructure.<sup>37</sup>

The European Union (**EU**) has been active in supporting energy regulatory cooperation with the establishment of ERGEG in 2003 which was succeeded by **ACER** in 2011. In the EU, regulatory cooperation has been provided by ACER and by CEER, a voluntary group of NRA officials. These institutions have provided a platform for the exchange of best practices, the promotion of competitive and transparent markets and the development of common approaches to regulatory issues including regulatory convergence with neighboring countries.<sup>38</sup>

#### **E. Working Questions (Panel IV):**

E.1. What is the role of investment promotion agencies and of energy regulators in facilitating the conditions for investments in the energy sector?

E.2. What are the domestic or regional initiatives in your country to eliminate barriers such as poor implementation, lack of transparency, excessive bureaucracy?

E.3. What are the perceived risks which regulations on establishment of investment are designed to address?

<sup>36</sup> The West African Common Industrial Policy (WACIP) (2010), p.18.

<sup>37</sup> ECOWAS, *Diagnostic Report on the Institutional and Regulatory Interfaces of the Ecowas Regional Electricity Regulatory Authority*, p.6.

<sup>38</sup> CEER annual report 2011, 2013.

## Annex I. Definition of pre-investment in recent IIAs

The definition of pre-establishment varies according to different IIAs. In fact, the common practice is to extend article by article the treaty protection to the pre-investment phase (establishment of investments). A less common practice is to provide a definition of investment to include the establishment of investments, sometimes referred to as ‘making of an investment’.

Article 10 of the Energy Charter Treaty provides an obligation of endeavour to protect the making of an investments:

Art. 10.2 "Each Contracting Party **shall endeavour to accord to Investors of other Contracting Parties, as regards *the Making of Investments* in its Area, the Treatment described in paragraph (3)**".

Article 10.4 of the ECT requests Contracting Parties to negotiate a ‘Supplementary Treaty’ with the objective to extend the principle of non-discrimination in a legally binding form to the making of an investment. Negotiations of the Supplementary Treaty started in 1995. When the draft was to be adopted by the negotiating parties in summer 1998, a number of political issues needed still to be resolved and therefore further work on the Supplementary Treaty was put on hold.

- BIT between Azerbaijan and the United States (1997)
  - Article II. 1. With respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of covered investments, each Party shall accord treatment no less favourable than that it accords, in like situations, to investments in its territory of its own nationals or companies or to investments in its territory of nationals or companies of a third country, whichever is most favourable.
- BIT between Canada and Costa Rica (1998)
  - Article III. 1. Each Contracting Party shall permit establishment of a new business enterprise or acquisition of an existing business enterprise or a share of such enterprise by investors or prospective investors of the other Contracting Party on a basis no less favourable than that which, in like circumstances, it permits such acquisition or establishment by its own investors or prospective investors.
- BIT between Iran-Ethiopia (2003)
  - Article 4.3 Neither Contracting Party impair by arbitrary or discriminatory measures, the management, maintenance, use enjoyment, acquisition or disposal of such investments
  - SADC<sup>39</sup> Protocol on Finance and Investment (2006)
  - Article 1.2 "investment" means the purchase, acquisition or establishment of productive and portfolio investment assets, and in particular, though not exclusively, includes ...
- ASEAN Investment Agreement (2009)
  - Article 5.1 Each Member State shall accord to investors of any other Member State treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the admission, establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.
- BIT between Japan and State of Kuwait (2012)
  - Article 2(1). Each Contracting Party shall in its area accord to investors of the other Contracting Party and to their investments treatment no less favourable than the treatment it accords in like circumstances to its own investors and to their investments with respect to investment activities.

<sup>39</sup> 15 member countries: Angola, Botswana, Democratic Republic of the Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, United Republic of Tanzania, Zambia, Zimbabwe

- Article 1(d). 'Investment activities' as 'establishment, acquisition, expansion, operation, management ...'

- BIT between Canada and Benin (2013)

- Article 5. 1. Each Contracting Party shall accord to an investor of the other Contracting Party treatment no less favourable 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 an investment in its territory.

- EU-Canada Comprehensive Economic and Trade Agreement (CETA) (2014)

- Article 8.1 investor means a Party, a natural person or an enterprise of a Party, other than a branch or a representative office, that seeks to make, is making or has made an investment in the territory of the other Party

- FTA between Eurasian Economic Union - Viet Nam (2015)

Article 8.2 This Chapter shall apply to measures by the Parties to this Chapter affecting trade in services, establishment, investments and movement of natural persons.

## Annex II. Pre-investment provisions in recent IIAs

In the practice of IIAs, **two general approaches** exist. The first one is the **liberalisation approach** to extend the certain standards of treatment to the pre-establishment of investment, found mostly in the practice by the United States of America, Canada, and Japan. The second approach is the **protection approach** that covers only the post-investment stage, and used mostly by the EU countries<sup>40</sup> and developing countries.

The liberalisation approach typically extends the protection of NT, MFN and prohibition of performance requirement to the pre-establishment stage<sup>41</sup>. Some practice expands the definition of covered investment to the making of investment, as found in the BITs and IIAs concluded by Japan. This broad definition is also found in the text of CETA between Canada and the EU.

### **“Liberalisation Approach”**

#### National Treatment, MFN, PR extending to establishment, acquisition of investment

- TPP: Article 9.4 (National Treatment), Article 9.5(MFN Treatment), Article 9.10(Performance Requirement)
- CETA: Article 8.6 (National Treatment), Article 8.7 (MFN Treatment), Article 8.5(Performance Requirement)

Trans-Pacific-Partnership “TPP” (2016 signed)

Article 9.4: NT

1. Each Party shall accord to investors of another Party treatment no less favourable 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...

Article 9.5: MFN

1. Each Party shall accord to investors of another Party treatment no less favourable than that it accords, in like circumstances, to investors of any other Party or 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...

Article 9.10: Performance Requirements

No Party shall, in connection with the establishment, acquisition, expansion, management, conduct, operation, or sale or other disposition of an investment of an investor of a Party or of a non-Party in its territory, impose or enforce any requirement, or enforce any commitment or undertaking:

### **“Protection Approach”**

A list of operations that **does not include “establishment and acquisition”** (e.g. management, maintenance, use, enjoyment or disposal of their investments)

- United Kingdom – Vietnam BIT
- The Netherlands – Korea BIT
- ASEAN – China Investment Agreement

United Kingdom – Vietnam BIT (2003)

<sup>40</sup> The recent practice as EU includes the protection on establishment of investment. (e.g. EU-Korea FTA article. 7.12 and 7.14. )

<sup>41</sup> UNCTAD, Recent Policy Developments and Key Issues, Chapter 3, pp.110-111

Article 3(NT and MFN)

(2) Neither Contracting Party shall in its territory subject nationals or companies of the other Contracting Party, as regards their **management, maintenance, use, enjoyment or disposal** of their investments, to treatment less favourable than that which it accords to its own nationals or companies or to nationals or companies of any third State.

The practice of the regional economic integration organisations, and some BITs between developing countries to have offered articles for the open admission of investment among the member states. **This third approach**<sup>42</sup> is to protect the pre-investment phase through substantial standards such as non-discrimination, transparency at admission of investment specific, but some extend to other investment facilitation measures. The regional economic (integration) agreement includes ‘the Right of Establishment’ which provides NT to all the member state. MERSCOUR, ECOWAS, and European Union are the examples of this third category, and are regardless of developed or developing countries.

**“The Third Approach to pre-establishment”**

The Right of Establishment:

- CARICOM: Article 35
- ECOWAS: Article 1

ECOWAS Article 1

“Right of Establishment” means the right granted to a citizen who is a national of the Member State to settle or establish in another Member State other than his State of origin, and to have access to economic activities, to carry out these activities as well as to set up and manage enterprises, and in particular companies, under the same conditions as defined by the legislation of the host Member State for its own nationals

Promotion and Protection:

- MERCOSUR Article 2
- Iran-Turkey BIT Article 3

Iran-Turkey BIT (1995 signed, 2005 came into effect.) Article 3

3.Either Contracting Party with respect to its laws and regulations admit investments of investors of the other Contracting Party in its territory, on a basis no less favourable than that accorded in similar situations to investments of investors of any third country.

4.Either Contracting Party after the admission of an investment shall grant all permits which are necessary in accordance with its laws and regulations for the proper realization of the said investment.

<sup>42</sup> UNCTAD, in *Admission and Establishment*, identifies five models of admission and establishment clause: Investment control, selective liberalization, the combined NT and MFN (full liberalization), the regional industrial program approach, the mutual national treatment approach. The latter two approaches are included in the third approach in this fact sheet.

### Annex III. Case law

#### **Mihaly v. Sri Lanka (ICSID Case No.ARB/00/2), Award of 2002 (US-Sri Lanka BIT)**

- Question: Whether “pre-investment expenditure” consists “investment”
- **Tribunal: No.**
- However, it did not reject the possibility that a pre-investment expenditure could constitute a investment under the ICSID Convention/ US-Sri Lanka BIT;
  - ✓ If there is an agreement between parties to regard pre-investment under ICSID Convention
  - ✓ If the investment materialized, pre-investment expenditures might be included in the category of investment, at least in terms of qualification for damages in the event of their loss or frustration retroactively.<sup>43</sup>

#### **Autopista Concesionada de Venezuela (Aucoven), C.A v. Bolivian Republic of Venezuela (ICSID Case No. ARB/00/5), Award of September 2003**

- Question: Whether “pre-investment expenditure” consists the loss that must be compensated.
- **Tribunal: Yes. (the concession contract provides so)**
- The specific wording - “all losses or damages, including lost profits and damnum emergens” to be compensated under the concession contract.
  - ✓ Damages to be covered are not limited to those incurred pursuant to the Agreement.<sup>44</sup>
  - ✓ Causation analysis was not applied in defining the loss to be included

#### **PSEG v. Turkey (ICSID CaseNo.ARB/02/5), Decision of 4 June 2004, Award of 19 January 2007 (US-Turkey BIT)**

- Question: Whether “pre-investment expenditure” consists “investment”
- **Tribunal: Yes. (the concession contract existed)**
- “(T)he Tribunal has jurisdiction on the basis of an investment having been made in the form of a Concession Contract”<sup>45</sup>
  - ✓ Substantial standard - FET violation - the costs of negotiation of a project<sup>46</sup>

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<sup>43</sup> UNCTAD, Investor–State Dispute Settlement and Impact on Investment Rulemaking, Ch.3, p.39

<sup>44</sup> Aucoven, *para.*240

<sup>45</sup> PSEG(2004), *para.*104

<sup>46</sup> PSEG(2007), *paras.* 316-319