

The Role of International Investment Law in Renewable Energy Investment; Focus on Build Operate and Transfer (BOT) Contracts

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Submission deadline: May 15, 2014

Number of words: 16,573



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List of Abbreviations and Acronyms

BIICL	British Institute of International and Comparative Law
BIT	Bilateral Investment Treaty
BOO	Build Own Operate
BOOT	Build Own Operate Transfer
BOT	Build Operate Transfer
CDM	Clean Development Mechanism
DBO	Design Build Operate
ECT	Energy Charter Treaty
ESMAP	Energy Sector Management Assistance Program
EU	European Union
FET	Fair and Equitable Treatment
FWCC	First World Climate Conference
GHG	Green House Gas
ICC	International Chamber of Commerce
ICJ	International Court of Justice
ICSID	International Centre for Settlement of Investment Disputes
IIA	International Investment Agreement
IIL	International Investment Law
ILC	International Law Commission
IPCC	Intergovernmental Panel on Climate Change
IPP	Independent Power Project
LCIA	London Court of International Arbitration
LDO	Lease Develop Operate
MFN	Most Favored Nation
MIGA	Multilateral Investment Guarantee Agency
NAFTA	North America Free Trade Area
OECD	Organisation for Economic Cooperation and Development
PARA	Paragraph

PCA	Permanent Court of Arbitration
PPA	Power Purchase Agreement
SIEL	Society for International Economic Law
TDM	Transnational Dispute Management
UN	United Nations
UNFCCC	United Nations Framework Convention on Climate Change
UNIDO	United Nations Industrial Development Agency
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
USA	United States of America
VS	Versus

1. INTRODUCTION

According to the fourth assessment of the intergovernmental panel on climate change, sustainable investment flows and effective technology transfer are needed to achieve greenhouse gas emission (GHG) reduction, at a significant scale.¹ Renewable energy has been known for its ability to produce low GHG emission.² Hence, the need for investment and technology transfer in this energy sector. Renewable energy is energy derived from natural processes that are replenished constantly.³ Its sources include solar, wind, biomass, geothermal and hydropower.

Renewable energy has also been seen as an instrument for sustainable development. It contributes to the sustainable development goals.⁴ In the developing countries, it provides access to energy, creates employment opportunities and reduces the cost of energy import. While in the developed ones, it helps to provide energy security, mitigate carbon emissions and provide new jobs.⁵ Technologies such as solar, wind, and small-scale hydropower have been found to be ideal for rural areas where the people have no access to the grid.⁶

Most of the developing countries lack the technical know-how, the time and capital to commence renewable energy project hence the need to attract foreign investors in this area.⁷ The just concluded EU-Africa summit, the World Bank clean energy fund and Japan's cool earth partnership depicts the developed countries' willingness to facilitate investment in renewable energy in developing countries⁸. However, lack of stable regulatory framework and other existing policies have made the developing countries unattractive to investors.⁹ Hence, one of the ways of attracting foreign investors is to make their country investor friendly by

¹Contribution of Working Groups I, II and III to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change. Core Writing Team, Pachauri, R.K. and Reisinger, A. (Eds.)*combact climate change IPCC*, Geneva, Switzerland. Pg68

http://www.ipcc.ch/pdf/assessment-report/ar4/syr/ar4_syr.pdf

²Panwar, N. L., S. C. Kaushik, and Surendra Kothari. "Role of renewable energy sources in environmental protection: a review." *Renewable and Sustainable Energy Reviews* 15.3 (2011): 1513-1524. Greenhouse gases emissions are gases that trap heat in the atmosphere and make the earth warmer

³<http://www.iea.org/topics/renewables/>

⁴Sathaye, J., et al. "Renewable energy in the context of sustainable development." *Special Report on Renewable Energy Sources and Climate Change*. Geneva, Switzerland, Intergovernmental Panel on Climate Change, <http://srren.ipcc-wg3.de/report> (2011).Pg 710. The goals are social and economic development, energy access, energy security, climate change mitigation and reduction of environmental and health impacts

⁵ *Ibid* pg718

⁶ *Ibid*pg 722-724

⁷ For example Nigeria, SouthAfrica, Malaysia

⁸Aaron Cosbey, Jennifer Ellis, Mahnaz Malik and Howard Mann; *Clean Energy Investment Project synthesis report* July 2008. http://www.iisd.org/pdf/2008/cei_synthesis.pdf; <http://www.africa-eu-partnership.org/>

⁹Aaron Cosbey, Jennifer Ellis, Mahnaz Malik and Howard Mann; *Clean Energy Investment Project synthesis report* July 2008. http://www.iisd.org/pdf/2008/cei_synthesis.pdf

making policies which will draw investors to this area. This involves public private partnership agreement between the investor and the government. One of such type of agreement is the Build Operate and Transfer (BOT) contract.

BOT contracts entail granting of concession to an investor to build and operate a project for a particular period of time after which such project is handed over to the host state.¹⁰ The BOT contract's duration ranges from 5 to 30 years. However, such investments are trailed with risks. One of such risks is change in policies when substantial resources have been spent on the investment. These risks sometimes affect return on investment. Investors analyze and assess these risks and challenges before embarking on projects. They seek guarantees from government, favourable contractual terms and stabilization clauses to help in mitigating these risks.

The main focus of International Investment Law's (IIL) is protection of foreign investment. It comprises of law that deals with international investments agreements (be it bilateral or multilateral). IIL through the provisions in the investment agreement provides a more secure investment environment. The existence of these enforceable protections can encourage investors' willingness to invest. IIL provisions also reduce cost of investment. The protections against political risk negate the need for very expensive political risk insurance. It reduces the risk associated with such investments thereby making it more financially attractive.¹¹ In addition, it provides a neutral frame work for settlement of dispute.

While the positive impacts of IIL have been applied generally; this thesis will be more specific by considering the impact of IIL on BOT type of contracts used in renewable energy projects.

In the BOT, the operation period is the time an investor is expected to recoup his capital and gets a considerable return on his investment. At this period, change in the governmental supporting schemes or the regulatory framework can adversely affect the returns. Can the government be held responsible for this shortcoming? What if the changes were necessary and it lasts throughout the operation period? What is the role of international investment law in

¹⁰Kumaraswamy, M. M., & Zhang, X. Q. (2001). Governmental role in BOT-led infrastructure development. *International Journal of Project Management*, 19(4), 195-205. doi: [http://dx.doi.org/10.1016/S0263-7863\(99\)00069-1](http://dx.doi.org/10.1016/S0263-7863(99)00069-1)

¹¹Sussman, Edna, Energy Charter Treaty's Investor Protection Provisions: Potential to Foster Solutions to Global Warming and Promote Sustainable Development. *ILSA Journal of International & Comparative Law*, Vol. 14, Spring 2008. Available at SSRN: <http://ssrn.com/abstract=1090261>pg 9-11

mitigating these risks in view of the challenges attributed to dispute settlement process under the International Centre for Settlement of Investment Disputes (ICSID)?

The main purpose of this thesis is to show that risks associated with BOT contracts investments in renewable energy can be mitigated through protection offered by international investment law.

1.1. Literature Review

Scholars have argued on the positive and negative effect IIL principles might have on renewable energy project. Among those who argued on the seemingly negative role are the co-authors Jacob Werksman, Kevin A. Baumert, and K. NavrozDubash in the article: "Will International Investment Rules Obstruct Climate Protection Policies."¹² The publication examines the Clean Development Mechanism (CDM) and the authors argued that the principles in the Kyoto protocol conflicts with that of the basic principles in International Investment Agreement (IIA) standards. One of the basic principles they highlighted is the non-discrimination standard. The application of Kyoto protocol standards between non-parties and parties might lead to discrimination against investment in CDM-related projects.

Kate Miles¹³ also argues that investment law principles will have a regulatory chill effect on effort of government to reduce carbon emissions. She discussed this point through decided cases where environmental regulations made by the state were alleged to be against investment law principles. She advocated for alignment of the objectives of environmental law and investment law.

However, these fears have been laid to rest by other authors who argued in favour of IIL. They claimed IIL play significant role in mitigating risks involved in renewable energy investment.

Anatole Boute in the article --"The potential contribution of international investment protection law to combat climate change" argued that international protection laws would not

¹²Werksman, Jacob, Kevin A. Baumert, and Navroz K. Dubash. "Will International Investment Rules Obstruct Climate Protection Policies? An Examination of the Clean Development Mechanism." *International Environmental Agreements* 3.1 (2003): 59-86.

¹³Miles, K. (2008). International investment law and climate change: issues in the transition to a low carbon world. Paper presented at the Society of International Economic Law (SIEL) Inaugural Conference

prevent the governments from making the necessary regulation in line with their commitment to reduce greenhouse gas emissions via the Kyoto protocol. According to him, it will instead protect the investors in low carbon projects especially in developing countries and countries that have economies in transitions where there are high risks of regulatory change. He postulated further that breach of fair and equitable treatment is not an absolute right in case of dispute on limits in carbon emissions to an investor in carbon intensive investment. This was reiterated through the *Saluka Investments BV v The Czech Republic Partial Award*¹⁴ where the tribunal held that

'No investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged. In order to determine whether frustration of the foreign investor's expectations was justified and reasonable, the host State's legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well'

The same author in subsequent article, "Combating Climate Change through Investment Arbitration"¹⁵, analyzed through decided cases how international investment provisions can help to mitigate the risks encountered by low carbon investors. This literature focused on the basic substantive provisions of IIAs which included; protection against expropriation, fair and equitable treatment, national treatment and umbrella clauses. He analysed the procedure for incurring project on trade of greenhouse emissions credits (CDM) in a host country and he concluded that although investment protection laws are not absolute, it could go a long way in helping to mitigate the income based approach risk of climate change.

Furthermore, Stephan W. Schill in his article - "Do Investment Treaties Chill Unilateral State Regulation to Mitigate Climate Change?"¹⁶ argued that investment treaties will not prevent government from taking general measures necessary for environmental protection. He further postulated that such measures should be non-discriminatory, proportionately balance the interest of investors and that of protecting the environment, and conform to due process. He stipulated that liability accorded by the tribunal in the notorious case of *Metalclad*¹⁷ is not based on regulatory takings but on assurances given by the Mexican government-legitimate expectation. Legitimate expectation is not an absolute right of the investor.

¹⁴Saluka Investments BV v The Czech Republic Partial Award, 17 March 2006 para 306

¹⁵Boute, Anatole. "Combating Climate Change through Investment Arbitration." *Fordham Int'l LJ* 35 (2011):613

¹⁶Schill, Stephen W. "Do Investment Treaties Chill Unilateral State Regulation to Mitigate Climate Change?" *Journal of International Arbitration*. 24(5), pg 469-477

¹⁷*Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award of August 30, 2000, para. 103

These authors have applied the investment law standards generally. This thesis will focus on BOT type of contract and examine if the IIL standards can be of help to investors involved in this type of project.

1.2. Methodology

McConville and Chui clearly explain what legal research entails.¹⁸ According to these writers, legal research is either doctrinal or non-doctrinal. They characterise doctrinal legal research as the kind of legal research which takes the law as an internal self-sustaining set of principles which can be accessed through reading court judgements and statutes with little or no reference to the world outside the law.¹⁹ Richard Posner adds that doctrinal legal research is the task that extracts doctrine from a line of cases or from statutory text, re-states it, criticise it or extend it for sensible results in legal principles and common sense, using logic, analogy, judicial decisions and legal principles.²⁰ To a large extent, the approach preferred for the present study is predominantly doctrinal. This is because the topic chosen for this study involves more of the use and analyses of primary sources of law.

Investment protections are found in International investment agreement either bilateral or multilateral. I used protection standards in both bilateral and multilateral investment treaties with the aid of decided cases to illustrate how BOT Risks can be mitigated. Most of these decided cases will be cases arbitrated through ICSID and UNICITRAL rules. In addition, I will analyze some of the decided cases on the recent economic emergency in Argentina. The Argentina cases were used because they provide recent decisions made by tribunals on non-precluded measures. The ICSID Convention will also be used while analyzing the shortcomings of ICSID. The Articles on ‘Responsibility of States for International Wrongful Acts’²¹ will also be used to illustrate state responsibilities with regards to foreign investment. The secondary sources will include books, articles and commentaries.

Most of the cases used in this thesis are not based on renewable energy projects. This is because BOT investments in renewable energy, associated with reduction of GHG emission, are still at its early stage.

¹⁸ M McConville and W Hong Chui, ‘Introduction and Overview’ in M McConville and W Hong Chui (eds), *Research Methods in Law* (Edinburg, Edinburg University Press 2007) 1.

¹⁹ Ibid

²⁰ Richard Posner, ‘Legal Scholarship Today’ (2002) 115:5 Har.L.Rev 1316

²¹ Responsibility of States for Internationally Wrongful Acts 2001

2. RENEWABLE ENERGY AND BOT CONTRACTS

A paper prepared by the UNFCCC in 2007 shows that in order to return global emissions to current levels by 2030, mitigating measures would require global financial flow and investments of about USD 200-210 billion per annum by 2030.²² Achieving the financial flow will require cooperation between the government and private investors. This chapter will address the need for renewable energy, the involvement of private investors through BOT contract and the risks associated with the contract.

2.1. Need for Increase in Renewable Energy Generation

In the 1970s, series of conferences were convened by the United Nations where change in climate and its impacts on the human society were of concern.²³ It has been known that this change is caused by CO₂ and other greenhouse emissions resulting largely from combustion of fossil fuel for energy.²⁴ This change can bring about disasters if not curbed on time. Recently, scientists have predicted that storms, flood and heat waves, rise in global temperatures and rising sea levels will be more frequent and intense.²⁵

Efforts have been made by the world at large to decrease greenhouse emission through reduction in fuel consumption and focus on use of energy source that produces zero or low level of carbon emissions.²⁶ Various agreements have been made from time to time. The Kyoto protocol however has been the only binding agreements under public international law while the other agreements like voluntary emission reduction are voluntary as it is called.²⁷ The protocol commits about 37 countries with the EU to reduce their gas emission by 5% from 2008-2012.²⁸

Under the UNFCCC Treaty, countries must meet their targets primarily through national measures. However, the Kyoto Protocol offers them an additional means of meeting their

²² Investment and financial flows to address climate change. UNFCCC Report 2007pg 72 www.un.org/ga/president/62/ThematicDebates/gpicc/iffacc.pdf

²³ https://www.wmo.int/pages/themes/climate/international_wcc.php#a, the United Nations Conference on Environment, Stockholm, 1972, the UN World Food Conference, Rome, 1974, First World Climate Conference (FWCC) 1979.

²⁴ Renewable energy and climate change by Godfrey Bevan, Significance, Volume 9, Issue 6, pages 8–12, December 2012 (Wiley online Library)

²⁵ World Outlook Energy Report 2013: Redrawing the energy Climate map ;found at http://www.iea.org/media/freepublications/2013pubs/WEO2013_Climate_Excerpt_ES_WEB.pdf

²⁶ Renewable energy and climate change by Godfrey Bevan, Significance, Volume 9, Issue 6, pages 8–12, December 2012 (Wiley online Library),

²⁷ Kyoto Protocol to the United Nations Framework Convention on Climate Change: Article 2; can be found at https://unfccc.int/essential_background/kyoto_protocol/items/1678.php.

²⁸ Kyoto Protocol to the United Nations Framework Convention on Climate Change; Article 3

targets by way of three market based mechanisms.²⁹ These market based mechanisms are the clean development, emission trading and joint implementation. The mechanisms stimulate development through technology transfer and investment and encourage private sector's participation.³⁰ The protocol also recognized the need for developed country to provide funds to the developing countries to help them in paying for incremental cost that they will incur during the change to clean and low carbon emission energy.

The first commitment period of the Kyoto protocol was deemed to end in year 2012. However, through an amendment to the protocol, it was extended to 2020 at the United Nations Climate Change Conference 2012 held on 8th of December in Doha, Qatar. The conference also agreed that a new agreement will come up in 2020 which will bind both developed and developing nations.³¹

Energy conservation and efficiency, nuclear and carbon capture and storage, fossils fuel switching and renewable energy are various options to combat climate change; but renewable energy has been seen to be more efficient.³²

Renewable energy has also been seen as an instrument for sustainable energy. Proper implementation of it could contribute to social and economic development, secure energy supply, energy access and reduced negative impact on health and environment.³³

Accessibility of energy especially electricity to the people in the rural areas have been the concern of the world at large. ESMAP estimates that about 1.4billion people lack access to electricity.³⁴ The World Bank has initiated several projects to help developing countries in alleviating this challenge.³⁵ Connecting the rural areas to main grid is costly and time-consuming, because they are widely scattered and far from the main grid. Hence, the need for

²⁹ Kyoto Protocol to the United Nations Framework Convention on Climate Change Article 12
http://unfccc.int/kyoto_protocol/items/2830.php

http://unfccc.int/essential_background/kyoto_protocol/items/1678.php (these mechanisms create the carbon market)

³⁰ibid

³¹The amendment was made by decision 1\CMP.8 , pursuant to Article 3, paragraph 9, in accordance with article 20 and 21 of the Kyoto Protocol.(FCCC/KP/CMP/2012/13/Add.1)

Can be found at https://unfccc.int/files/kyoto_protocol/application/pdf/kp_doha_amendment_english.pdf

³²Mitigating Climate change. "IPCC special report on renewable energy sources and climate change mitigation." (2011)

³³Mitigating Climate change. "IPCC special report on renewable energy sources and climate change mitigation." (2011) pg 3

³⁴ http://www.esmap.org/Energy_Access

³⁵Reiche, Kilian, Alvaro Covarrubias and Eric Martinot. Expanding Electricity Access to Remote Areas: Off-Grid Rural Electrification in Developing Countries. *Fuel 1.1.2 (2000)* 1-4.

https://www.esmap.org/sites/esmap.org/files/ESME_ESMAPCambodia.pdf

off grid means of providing electricity. Studies have revealed that forms of renewable energy like solar energy (solar home system) can help in meeting these needs if the necessary strategies are used.³⁶ At the initial stage, small scale renewable might require high cost finance. However, in the long run, it pays off as most of these small scale based renewables are located in the rural areas, where it allows for large scale development via production of stable power.³⁷

In order to facilitate the use of renewable energy, governments have involved themselves in public -private partnership. This connotes a partnership between the government and private individuals (investors) to provide clean energy and to meet up with the need to develop and provide infrastructure in the rural areas. The involvement of private investors could be in various forms. It could be as Build Operate and Transfer (BOT) contract, Build Own Operate and Transfer (BOOT) contract, Build Own Operate (BOO) contract, Build Transfer Operate (BTO) contract, Buy Build Operate (BBO), Lease Develop Operate (LDO) Design Build Own (DBO)³⁸, and Concessions.

2.2. Build Operate and Transfer

Build, operate and transfer (BOT) is a model wherein the private investors are allowed to participate in public enterprise through a concession given by the government. The three phases of 'Building', 'Operating' and 'Transfer' follows each other sequentially. In building phase, the private investors construct, design and finance a certain infrastructure. The operating phase entails: management and maintenance of the infrastructure; delivery of products and services; receiving of payment for investment cost; and making a margin of profit for a particular period by the investors. The last phase of Transfer involves handing over the infrastructure to the government after the period of concession expires, at no cost.³⁹

³⁶Martinot, Eric, and Kilian Reiche. Regulatory approaches to rural electrification and renewable energy: case studies from six developing countries. World Bank, Washington, DC, Working Paper (2000)

³⁷Hain, J.J., et al. "Additional renewable energy growth through small-scale community oriented energy policies. Energy Policy 33.9 (2005): 1199 - 1212

³⁸Yang, Jyh-Bin, Chi-Cheng Yang, and Chih-Kuei Kao. "Evaluating schedule delay causes for private participating public construction works under the Build-Operate-Transfer model." International Journal of Project Management 28.6 (2010): 569-579.

³⁹ Kumaraswamy, M. M., and X. Q. Zhang. "Governmental role in BOT-led infrastructure development." International Journal of Project Management 19.4 (2001): 195-205.

The use of BOT can be traced back to the 1970s and 1980s.⁴⁰ However, the use of concessions is dated back to the 1700s when concession for water distribution was granted to the Perier Brothers in Paris.⁴¹ Governments allow private participation in the provision of infrastructure. This is to enable the use of private expertise, technical know-how, capital and management to increase efficiency and reduce cost involved in construction, completion, operation and maintenance.⁴² Concessions can be granted to both local and foreign private investors. The Government who grants the concession is the host government in case of a foreign investor. The concession is granted through a contract. The operation period covers the time needed for the private investor to recuperate the capital invested into the venture through the revenue generated from the operation of the investment. The BOT enables government to provide infrastructure to the public without incurring large public expenditure or borrowing.⁴³ It also provides a new opening for private investors to contribute to world economic development.⁴⁴ It facilitates transfer of technology. In most cases, the government may be the only customer or be determined to purchase a particular portion of the output in order to ensure the recouping of capital used on such investment.⁴⁵ The primary feature of BOT is private financing. The private investor is responsible for providing the funds to develop and operate the project.⁴⁶ BOT is used mostly in power sector, water treatments, dam, irrigation, sewage, telecommunication infrastructure.⁴⁷

In power sector, it involves the Independent Power Project model (IPP) which is used due to increase in demand for power. The IPP is mostly used in developing nations where the government decides the resource allocation.⁴⁸ A good example is in Uganda where the

⁴⁰Privatized infrastructure, the BOT approach, Edited by C walker and AJ Smith.

⁴¹Privatized infrastructure, the BOT approach, Edited by C walker and AJ Smith.

⁴²Henrik M. Inadomi. Independent power projects in developing countries: legal investment protection and consequences for development. Vol. 7. Kluwer Law International, 2010. Pg 41

⁴³Yeo, K. T., and Robert LK Tiong. "Positive management of differences for risk reduction in BOT projects." International Journal of Project Management 18.4 (2000): 257-265.

⁴⁴ibid

⁴⁵ <http://www.investopedia.com/terms/b/botcontract.asp>

⁴⁶Prof. Drs. Ir. Sebastiaan C.M. Menheere, Prof. Spiro N. Pollalis, Dipl. Eng., SM., MBA, Ph.D: Case Studies On Build Operate Transfer .found at <http://www.gsd.harvard.edu/images/content/5/3/538865/fac-pub-pollalis-bot-part-1.pdf>

⁴⁷Auriol, Emmanuelle, and Pierre M. Picard. "A theory of BOT concession contracts." Journal of Economic Behavior & Organization 89 (2013): 187-209.

⁴⁸Henrik M. Inadomi. Independent power projects in developing countries: legal investment protection and consequences for development. Vol. 7. Kluwer Law International, 2010.

government via its 1999 Electricity Act allows for liberalization of the sector and also provides a regulatory framework for players in the sector.⁴⁹

IPP is also used in development of renewable energy via the vehicle of BOT.⁵⁰ This is due to the governmental need to retain control over the power sector, facilitate transfer of technology, provide funds for the needed change to use of renewable energy and partly bear the risks inherent in the relatively new area. This type of BOT involves the sponsors and the project company on one side, the host government and the power purchaser on the other side. The sponsors can comprise of the multinational energy companies, construction companies (due to construction work involved in power project) and national company (a company from the host country). The project company is the company formed for the sole purpose of undertaking and completing the project. It is the concessionaire of the BOT project. Its right and obligation are defined in the concession or project agreement with the government.⁵¹ Its responsibilities are to finance, design, build and operate the generation facility in order to receive a stable income once it is completed. To this end, it will enter into a number of contracts and agreement with other private sector participants. Such contracts/agreements include: agreement on equity financing from sponsors; debt financing from international banks or the financial markets; engineering procurement and construction contract; and operation and maintenance agreement.

The power purchaser as the names goes indicate the one who buys out the power generated by the project company during its operation period. The contract between the project company and the power purchaser is called the Power Purchase Agreement (PPA). The PPA is important in the BOT project in power sector because it ensures certainty that there will be demand for the power produced by the Project Company which in turns ensures returns on investment. The revenue generated is used to offset the operating cost, maintenance, repayment of debt principal, financing schemes and also provides a return for the shareholders (sponsors) of the special purpose. The power purchaser could be the government/ public utilities or private investors. The use of the power purchaser is adaptable to BOTs in the renewable energy sector because it is a new area and the revenue is uncertain. In addition, renewable energy competes with cheap energy from fossil fuel. Without a single buyer, the

⁴⁹ The Electricity Act, 1999, Part VI, Section 51 found at <http://www.opm.go.ug/assets/media/resources/145/ELECTRICITY%20ACT%201999.pdf>

⁵⁰ E.g. Stung Russey Chrum Krom Hydropower Plant, this a bot project in Cambodia <http://ppi.worldbank.org/explore/Report.aspx>

⁵¹ Guidelines for infrastructure development through Build Operate Transfer (BOT) Projects, 1996

investment might be jeopardized. This is applicable to investors in renewable energy that are connected to the grid. This sector has been made attractive for private investors through tax incentives or tax breaks, feed-in tariffs, subsidies, favourable energy policies, guarantees and good contract terms.⁵² The support given by the government is incorporated into the implementation agreement.⁵³ Off grid renewable investors have direct access to the consumers. Incentives received in this area are more of tax reduction, financial and production subventions.

However, risks are inevitable in business and construction work. This also applies to BOT. According to C Walker and A J Smith, these risks can be divided broadly into financial risk, political risk and technical risk. The risks can also be grouped based on the different stages of the project; Pre investment, Implementation, Construction, Operations and Transfer stage.⁵⁴

2.3. Risks in BOT

2.3.1. Political and Regulatory Risk

Political risk can be defined as action of government that serves as a threat to the profitability of a particular project.⁵⁵ It involves the political regime or atmosphere of the host country which is subject to change at any time. The new government may not favour the project or may have different expectations. Furthermore, it can unilaterally change the terms of investments (Obsolescing bargain)⁵⁶, due to public pressure. There might be outbreak of war or strife at the location of this investment, expropriation, currency transfer restriction based on political motives, unstable political and legal regime, lack of support from government, political violence and so on.

Expropriation involves taking over the property or investment of a foreign investor. It constitutes political risks when such taking over is not for public purpose, discriminatory and without adequate compensation.

⁵²Jumbe, Charles BL, Frederick Msiska, and Michael Madjera. "Biofuels development in Sub-Saharan Africa: Are the policies conducive?." *Energy Policy* 37.11 (2009): 4980-4986.

⁵³ <http://ppp.worldbank.org/public-private-partnership/agreements/concessions-bots-dbos>

⁵⁴Lam, Ka Chi, and Wing Sing Chow. "The significance of financial risks in BOT procurement." *Building Research & Information* 27.2 (1999): 84-95.

⁵⁵Butler, Kirt C., and Domingo Castelo Joaquin. "A note on political risk and the required return on foreign direct investment." *Journal of International Business Studies* 29.3 (1998): 599-607.

⁵⁶Henrik M. Inadomi. *Independent power projects in developing countries: legal investment protection and consequences for development*. Vol. 7. Kluwer Law International, 2010. Pg 32

Regulatory risk is an integral part of political risk. Both are closely associated because changes in laws, rules and regulations are made based on the social, economic, political and environmental pressure. At the time of investment, the existing laws might be favourable to the terms of the contract. Tax incentives might be given⁵⁷ and prices subsidized. However due to the long time duration of some of these projects, changes might occur in the legislation which might affect the core of the investment. This also applies more in renewable energy because of the large capital involvement. A study done in North Africa on risks to solar power energy emphasized this more.⁵⁸ The study shows that regulatory risk is the biggest concern of investors in this sector of renewable energy.⁵⁹ For example, Sri Lanka made a new regulatory framework for IPP in third Party Mini- hydro developers in 1997. These provisions provided for standardized non-negotiable power purchase tariffs and contracts. Investments were based on this provision. However, within the space of 2yrs, there was decline in the purchase tariffs. It dropped from 5cents /KWH to 3.5 cents. This development stalled the market and discouraged long term investment in Mini- hydro developers.⁶⁰ Another example of investor's dependence on regulatory framework is seen in Tamil Nadu Electricity Utility Saga in India. Indian's framework for IPP included long term tariffs, transmission wheeling and power banking. In 2001, Tamil Nadu Electric Utility refused power wheeling and banking for new wind power generation. In addition, "it did not provide automatic annual increases in rates to adjust inflation"⁶¹. This also led to less investment in this wind power.⁶²

2.3.2. Financial risk

The concessionaire provides the fund for the takeoff of BOT project. The funds can be through its own funds or through loans from large financial institution, banks or bond-holders.⁶³ The fund could also be through the project sponsors who worked through a vehicle called the project company. Through this company, they are able to minimize their financial

⁵⁷ NykombSynergetics Technology Holding AB v. The Republic of Latvia, SCC found at <http://italaw.com/cases/759>

⁵⁸ Komendantova, Nadejda, et al. "Perception of risks in renewable energy projects: The case of concentrated solar power in North Africa." *Energy Policy* 40 (2012): 103-109.

⁵⁹ Ibid pg 107-108

⁶⁰ Martinot, Eric, et al. "Renewable energy markets in developing countries*." *Annual Review of Energy and the Environment* 27.1 (2002): 309-348.

⁶¹ Ibid

⁶² Ibid

⁶³ Xenidis, Yiannis, and Demos Angelides. "The financial risks in build-operate-transfer projects." *Construction Management and Economics* 23.4 (2005): 431-441.

risk. Their liabilities will be based on the amount of capital plunged into the project. Financial risk is evident in all the phases of BOT.

Yiannis Xenidis and Demos Angelides identified 27 causes of financial risks based on their phases covered in the project.⁶⁴ It also went ahead to categorize these risks based on their origin for example: the concessionaire, and the market. Financial risks emanating from the state involves prolonged negotiation period prior to project initiation, unfavorable economy in the host country, import/export restrictions and rate of return restrictions. Financial risks from concessionaire involves lack of creditworthiness, inability of debt service, bankruptcy, unfavorable economy of the country of the main stakeholder, high bidding costs, errors in forecasting the demand, high construction costs and high design cost. Market-related financial risks includes: fall in demand, fluctuations in inflation rate, loan risk, taxation risk, competition risk and currency risk.

2.3.3. Technical risks

Technical risks are risk based on the technicalities of the investment itself. Amongst other things it involves the construction difficulties like equipment breakdown, completion delays due to change in project structure/design and operation risks.⁶⁵ Some of these technical risks are fall out from other risks. For example, completion delay can be due to undue interference from the government, delay in funding, lack of peace and stability at the investment location. These risks are inherent in all types of BOT projects be it in renewable energy sector, transport sector or water provision sector. Investors analyze these risks based on what is obtainable in each country.

These risks are higher in renewable energy sector than in other sectors. This is because the use of renewable energy is still at its infancy stage in a world where much reliance has been placed on the use of fossil- fuel. It is a relatively new area in most of the developing countries. Their regulatory policies in renewable energy are still at the infancy stage. Renewable energy has high transaction cost and huge capital requirement. It needs governmental support to ensure its viability. There may be need for price subsidy from the government because the public might not be willing to purchase power from renewable energy due to its high cost.

⁶⁴ *ibid*

⁶⁵ Privatized infrastructure, the BOT approach, Edited by C walker and AJ Smith

Various measures have been taken to help in mitigating risks associated with BOT. The formation of Multilateral Investment Guarantee Agency (MIGA) is a direct response to political risk and financial risk. National insurance scheme for company that is registered in the country where such national insurance scheme exists is also another measure.⁶⁶ In addition, risk assessment and models for such have been provided by literatures. Government guarantees and stabilization clauses in contract and bilateral agreements are also part of the measures to mitigate the risks involved in BOT. The government guarantees may be found in a detailed concession; where the host state gives assurances and undertakings to allay the fears of the investors. Such guarantees may include: unimpeded transfer of money in both foreign and local currency in and out of the host state country; protection against future changes and development in laws; protection against regulation of tax regime which might adversely affect the cost structure and profitability of the project.⁶⁷

This thesis will not access the market structure which is outside the IIL.

3. PROTECTION OFFERED BY INTERNATIONAL INVESTMENT LAW

Most of the protections offered by IIL are found in international agreement. The primary purpose of international agreement (either bilateral or multilateral) is to offer legal and financial protection to investments in developing country.⁶⁸ Nonetheless, it has recently been used to attract investment.⁶⁹ A country is presumed to be safe to an extent when it is a party to an investment treaty. The purpose of these treaties is to facilitate the flow of investment between the countries that are parties to it. The presence of investment treaty could be an added advantage to attract investors in renewable energy. This chapter will analyse these protections and how it can protect BOT investors in renewable energy.

⁶⁶Donovan, Patrick J. "Creeping Expropriation and MIGA: The Need for Tighter Regulation in the Political Risk Insurance Market." *Gonz. J. Int'l L.* 7 (2003): 1.

⁶⁷Henrik M. Inadomi. *Independent power projects in developing countries: legal investment protection and consequences for development.* Vol. 7. Kluwer Law International, 2010.

⁶⁸Hallward-Driemeier, Mary. *Do Bilateral Investment Treaties Attract FDI?: Only a Bit... and They Could Bite.* World Bank, Development Research Group, Investment Climate, 2003. pg 1

⁶⁹ *Ibid*

3.1. International Investment Agreements

The sources of international investment law include: the Convention on the Settlement of Investment Dispute between States and nationals of the other states (The ICSID Convention and the international agreements\ treaties (may be bilateral or multilateral). An example of multilateral international agreement is the energy charter treaty.⁷⁰ Other sources of international investment law are: customary international law; the general principles of law and unilateral statements; and case laws.⁷¹ Each of these sources offers protection directly or indirectly to foreign investments. They serve as the legal basis in settlement of dispute between states and investors.

The protection of foreign investments can be traced to the customary international law which obligated host state to treat foreign investment according to international minimum standard.⁷² In the 70s, state sovereignty on rights to nationalize and expropriate investments was recognized but the issue of compensation was not obligatory.⁷³ Where payment is necessary, it must be according to the national laws and not international laws.⁷⁴ The threat of uncompensated expropriation led to the emergence of Bilateral Investment Treaties (BIT). The treaties were made by the developed countries with developing countries. The principle of prompt, effective and adequate compensation was one of the main principles entrenched in the agreements.⁷⁵ In addition, the Most Favoured Nation and National treatment with fair and equitable treatment for covered investments were guaranteed. In 1965, the international convention for settlement of dispute (ICSID) was established. This provided a legal system for the arbitration of breach of treaty terms by the host states, thereby providing for means of settlement of dispute outside espousal. Another good feature of ICSID is that it allows the private investor to initiate arbitration directly against the host state.⁷⁶

⁷⁰This treaty is of more importance because it deals with investment in energy.

⁷¹Principles of international investment law, second edition by Rudolf Dolzer and Christoph Schreuer, Oxford university press, 2012

⁷²Vandevelde, Kenneth J. "Brief History of International Investment Agreements, A." UC Davis J. Int'l L. & Pol'y 12 (2005): 157pg 168

⁷³ Ibid

⁷⁴ ibid

⁷⁵Ibid pg 171

⁷⁶The convention on the investment settlement of dispute between states and the nationals of other state. (As amended and effective April 10,2006) Article 1

The 1990s witnessed the conclusion of several treaties which focus not only on protection of investment, but also on liberalization of investment flows.⁷⁷ In addition, countries engage more in signing of treaties because they believe the existence of treaties will attract more foreign investors and increase their foreign direct investment flows. On the other hand, the foreign investors believe the existence of the treaties will provide international legal protection and give security against political risks.⁷⁸

Initially, BITS were signed between developed and developing countries.⁷⁹ Later, treaties were signed between developing countries. However, treaties were rarely signed between developed countries as their legal systems have been developed over time with experience in such areas.⁸⁰ Apart from BITs, IIAs also involve regional and multilateral agreements on investments. Examples of regional agreements are: North American Free Trade Area (NAFTA); Agreements signed by European Union and Association of Southeast Asian Nations to promote and protect free flow of investments between the membership countries. Energy Charter Treaty is another investment treaty with open membership to all interested states. Energy Charter treaty exclusively contains provisions on energy investment. It provides multilateral framework for energy cooperation in energy investment under the international law. It helps to promote policies that remove barriers to flow of energy investment needed for energy security.⁸¹ The protections offered can be invoked by investors in renewable energy.

BITs allow the countries the opportunity to choose the country they want to partner with. Moreover, it allows for flexibility and development of the agreement according to their specifications. Rapid completion of agreement is another advantage of BITs. Most of the BITs deal with post-establishment stage of the investments and leave the pre-establishment to be decided autonomously by the host states.⁸² Most provisions on establishment provide that investment must be established according to the legal requirements of the host state.

⁷⁷ For example, Bit between Ghana and United Kingdom, Bit between Nigeria and United Kingdom, Bit between Greece and Albania

⁷⁸Hallward-Driemeier, Mary. Do Bilateral Investment Treaties Attract FDI?: Only a Bit... and They Could Bite. World Bank, Development Research Group, Investment Climate, 2003.pg 1

⁷⁹Bit agreement between France and Chad 1960, Bit between Switzerland and Tunisia,1961

⁸⁰Ibid; United Nations Conference on Trade and Development (UNCTAD) 2000b. Bilateral Investment Treaties: 1959-1999. New York: United Nations.Pg 1-2 for example BIT between India and Ghana, 2000

⁸¹Konoplyanik, Andrei, and Thomas Wälde."Energy Charter Treaty and its Role in International Energy."Journal of Energy & Natural Resources Law 24.4 (2006).Pg 31

⁸²UNCTAD, Bilateral Investment Treaties. "Treaties 1995-2006: Trends in Investment Rulemaking." United Nations (2007): 46.

3.2. The Protections

The features of a typical BIT/Multilateral agreements include: the preamble, the scope of application, admission and establishment of investment, investment promotion, general standards of treatment, expropriation, war and civil disturbance, transfer of funds, umbrella clause, other specific clauses, transparency, treaty exceptions and emerging issues and dispute resolution. This work will deal more on the terms that have to deal with mid and post establishment issues. It is reasoned that what happens at the operational stage of BOT mostly determines the profitability of the project. Hence, it is assumed that the selection and the construction stages were successful.

These features and their uses will be explained. The principles in the explained terms are general and they are applicable in all sectors and contracts. I considered the General standards of treatment and the transfer of funds.

3.3. General Standards of treatment

The general standards of treatment include: fair and equitable treatments (FET); most favored nation treatment (MFN); National Treatment; full protection and security; and expropriation. These standards can be found in BIT and multilateral treaties. Breach of any of these terms by the host state could be redressed in the dispute settlement process prescribed in the treaty.

3.3.1. Fair and equitable treatment (FET)

The meaning of what is fair and equitable treatment is a broad one.⁸³ Through decided cases, this treatment has been held to include: stability and the protection of the investor's legitimate expectations;⁸⁴ transparency on the part of the government;⁸⁵ compliance with contractual obligations; procedural propriety and due process;⁸⁶ good faith; and freedom from coercion and harassment.⁸⁷

⁸³Dolzer, Rudolf, and ChristophSchreuer. Principles of international investment law. Oxford University Press, 2012.Pg 139

⁸⁴Sempra v. Argentina, ICSID Case No. ARB/02/16, Award, 28 September 2007, paras.298, 300.

⁸⁵Tecmed v. Mexico, ICSID AF Award, 2003, para. 154.

⁸⁶Occidental Exploration and Production Company v.The Republic of Ecuador, LCIA Case No. UN3467, Award, 1 July 2004 para.183.

⁸⁷Dolzer, Rudolf, and ChristophSchreuer. Principles of international investment law. Oxford University Press, 2012.Pg 157 - 159

The standard of FET is an absolute minimum standard independent of how nationals of a third state or nationals of the host state are treated.⁸⁸ This principle in some treaties is equated with the customary international law of minimum standard of treatment.⁸⁹ Some scholars have argued that the customary international law minimum standard is a floor not a ceiling for threshold of FET.⁹⁰ The judgment of what is fair and equitable is done on case by case basis through the application of governing treaties to the facts available.⁹¹ When it is equated with the international minimum standard;⁹² it is to be interpreted as such. However, there is no uniform interpretation as to if FET is equivalent to minimum standard of treatment in international law, when it is not expressly stated in the treaty.

Recently, tribunals have concentrated more on the contents of FET than its relationship to the international minimum standard of treatment.⁹³ Any treatment from the host state which falls under this category can be a good reason to initiate arbitration against the host state. This standard can be used where there is no stabilization clause guaranteed by the host country. This is because one of its components is the stability and protection of legitimate expectation of the investor. For example, change in the legal frame work made to attract investment in renewable energy, is subject to arbitration. Especially if such change adversely affects the profitability of the project. A good illustration of this is the current arbitral case against Spain at the UNCITRAL.⁹⁴ However, arbitrators are more disposed to deciding the arbitration in favour of the investor when it is more explicit. More about legitimate expectation is discussed under section 3.5.1.

Not all treatments that are perceived to be bad constitute violation against this principle. In examining the conducts of the state, the tribunal is looking for acts that are arbitrary and irrational and not for error in policy or judgment. In *Saluka v. The Czech Republic's* case,⁹⁵ the Tribunal stated:

⁸⁸Fair & Equitable TreatmentBIICL, Investment Treaty Forum, 9 September 2005 by C. Schreuer

⁸⁹Article 1105(1) of NAFTA, Article 5(2) of US Model BITs 2004, 2005

⁹⁰Dolzer, Rudolf, and ChristophSchreuer. Principles of international investment law.Oxford University Press, 2012.Pg 137

⁹¹Mondev international limited V. United State of America, ICSID Case No. ARB(AF)/99/2. 2002

⁹²NAFTA Chapter 11, Article 1105

⁹³Fair and Equitable Treatment, UNCTAD Series on Issues in International Investment Agreements II, United Nations New York and Geneva, 2012

⁹⁴AES Solar and others v. Spain, UNCITRAL. The Spanish government gave a generous feed in tariff to boost investment in solar energy but had to change it when it could not cope with the cost. The change affected the viability of the sector. An arbitration has been initiated at UNCITRAL

⁹⁵ See UNCITRAL Arbitration, Partial Award, March 17, 2006; See also *Azurix Corp. v. Argentine Republic*,

“The Treaty cannot be interpreted so as to penalise each and every breach by the Government of the rules or regulations to which it is subject and for which the investor may normally seek redress before the courts of the host State. [...] something more than simple illegality or lack of authority under the domestic law of a State is necessary to render an act or measure inconsistent with the customary international law requirements”⁹⁶.

The investor seeking to invoke this standard must consider the wording of the clause. Despite the question that trails this standard and the fact that it still evolving in its use/interpretation; it is one of the main standards of protection in a BIT. The broad definition of this provision gives wide latitude of acts of host state that can be arbitrated. For a BOT investor, this provision is important. It constitutes a measure to mitigate political risk. It also serves as the backup mechanism to redress breach of contractual obligation, lack of due process and transparency, refusal to grant necessary consent or license.

3.3.2. Most Favored Nation Treatment (MFN)

This treatment required that a state should treat the investors of a state the way it will treat another investor from other states. It tends to prevent discrimination on basis of nationality. This principle can be invoked provided it is part of the treaty terms. It applies to matter within the scope of the treaty in relation to investment / investor. It is a relative standard which is applied to similar objective situations. It requires the finding of a less favorable treatment and is governed by the Eiusdem Generis principle.⁹⁷ The discrimination can be de jure⁹⁸ or de facto.⁹⁹ Some treaties are more explicit on the application of MFN treatment.¹⁰⁰ This principle can apply to both substantive and procedural matters. On the substantive matters, there has been little or no controversy in its application, provided the burden of prove is discharged as required. Standards of protection have been read into BITs via MFN.¹⁰¹ The application of

ICSID Case No. ARB/01/12, Award, July 14, 2006, available online at http://www.worldbank.org/icsid/cases/pdf/ARB0112_Azurix-Award-en.pdf

⁹⁶ibid

⁹⁷Eiusdem generis principle means that where specific words are followed by the addition of general words, the general words are to be confined in their application to the same kinds as is in the specific words

⁹⁸ It is de jure when the treatment is formally directed at the foreign investor

⁹⁹ It is de facto when the treatment is applied generally but it only affects the foreign investor.

¹⁰⁰Some on pre-establishment or on post-establishment stage, while some also specify if it will apply to the investment or investors or both. For example Art iv(2) of the Spain- Argentina BIT of 3 October, 1991, Article 3 Morocco-Senegal BIT (2006)

¹⁰¹BayindirInsaatTurizmTicaretVeSanayi AS v. Islamic Republic of Pakistan, ICSID Case No. ARB/03/29 Decision on Jurisdiction, 14 November 2005, paras. 227–235.

MFN principle to cover events that have occurred before the basic treaty came into place was rejected by the tribunal.¹⁰² This situation is seen in *Société Générale v. Dominican Republic*.¹⁰³ In the case, the tribunal rejected the attempt made by the claimant to qualify investments not covered by the basic treaty through the invocation of a third party treaty. It held that:

“Each treaty defines what it considers a protected investment and who is entitled to that protection, and definitions can change from treaty to treaty. In this situation, resort to the specific text of the MFN clause is unnecessary because it applies only to the treatment accorded to such defined investment, but not to the definition of ‘investment’ itself”

In essence, the basic treaty must be applied first through its definitions and clauses before invoking the third party treaty.¹⁰⁴ In finding a violation of MFN principle, the essential condition is the existence of a different treatment accorded to another foreign investor in a similar situation.

On the contrary, a lot of controversy has beguiled the application of MFN principle to dispute settlements especially in procedural matters. One opinion is based on literal interpretation which allows the application of MFN to procedural matters while the other opinion is against it. In *Emilio Agustín Maffezini V. The Kingdom of Spain*¹⁰⁵, the court held that MFN principle can be applied in order to benefit from favorable procedural conditions in a third party treaty. The tribunal qualified this benefit by laying out instances where MFN might not be applicable. An example is in the areas that might affect the public policy essential to the formation of the basic treaty. Nevertheless, some other tribunals have decided otherwise with regards to jurisdiction on the basis that the state’s consent to arbitration should be explicit and not inferred.¹⁰⁶ The need to prevent treaty shopping has also been one of the reasons canvassed against the use of MFN to broaden jurisdiction. The use of MFN will provide an

¹⁰²*TecnicasMediambientalesTecmed S.A. v. the United Mexican States*, ICSID Case no. ARB (AF)/00/02, Award, 29 May 2003.

¹⁰³*SociétéGénéralev.The Dominican Republic*, LCAI Case No. UN 7927, Award on Preliminary Objections to Jurisdiction.

¹⁰⁴ Most Favoured Nation Treatment, UNCTAD Series on Issues in International Investment Agreements II, United Nations, New York and Geneva, 2010

¹⁰⁵*Emilio AgustínMaffezini and The Kingdom of Spain*, ICSID Case No. ARB/97/7, Decision of the tribunal on the objections of jurisdiction, 25 January 2000.

¹⁰⁶*SaliniCostruttoriS.p.A. andItalstradeS.p.A.andTheHasemite Kingdom of Jordan*, ICSID Case No. ARB/02/13, Decision on Jurisdiction, 29 November 2004; *Plama Consortium Limited and Republic of Bulgaria*, ICSID Case No. ARB/03/04, Decision on Jurisdiction, 8 February 2005.

opportunity for a BOT investor to make use of favourable provisions available in other BITs in the host country. However, this must not be against the basic purpose of the main treaty.¹⁰⁷

3.3.3. National Treatment

The national treatment rule provides that the host state should accord to foreign investors and their investment treatment no less favourable to that which it accords to its own domestic investors.¹⁰⁸ This provision creates a level playing ground for the foreign investors and its local competitors. The scope of application of this provision depends on the sectors it covers in the treaty. Some BITs extends its application to admission and establishment, while some do not.¹⁰⁹ The bases of comparison are considered in finding a breach of this provision. Such bases includes: existence of differentiation, non-justification for differentiation and the relevance of discriminatory intent.¹¹⁰ This provision is relevant for investors in BOT in renewable energy.

New technology invention in renewable energy investment necessitates a level playing ground for all potential actors. States might be tempted to enact measures which might favour their domestic investors over the foreign ones. The implementation agreement contains rules against such measures.¹¹¹ In some agreements, it is only applicable to tax.¹¹² Other measures that affect only the foreign investor can be arbitrated under this provision. However, in treating the question of non-justification, it is widely accepted that differentiation are justifiable if rational grounds are shown.

3.3.4. Full Protection and Security

This is another standard of protection that requires the host state to provide protection against physical violence and harassment and also provides legal protection.¹¹³ The standard in some

¹⁰⁷Intention of the parties is essential in interpretation of treaties- Vienna convention- Vienna Convention on the Law of Treaties 1969 Article 31

¹⁰⁸Key Terms And Concepts In Iias:A Glossary Unctad Series on Issues in International Investment Agreementshttp://unctad.org/en/Docs/iteiit20042_en.pdfpg123

¹⁰⁹ Article 3 (3) of Austria's model BIT, Article II of the 1999 BIT between El Salvador and the United States,

¹¹⁰SD Meyers v.Canada, First Partial Award, 13 November 2000, paras 250,,254, 244-245

¹¹¹Model Implementation Agreement for SouthAsia.Article 5(10) <http://ppp.worldbank.org/public-private-partnership/agreements/concessions-bots-dbos>

¹¹² Model Implementation Agreement Africa, Article 8 http://ppp.worldbank.org/public-private-partnership/sites/ppp.worldbank.org/files/documents/energy%20implementation%203_0.pdf

¹¹³ National grid v. Argentina, Awarded, 3 November 2008, para 187

treaties appear as a single standard with fair and equitable treatment.¹¹⁴ However, it is a separate standard in others. The standard does not require the state to provide absolute protection from legal and physical infringement. It merely requires state to exercise due diligence and to take measures that will protect the foreign investment as is reasonable under a given circumstances.¹¹⁵ The duty to grant this protection may operate in relation to state organs, agency actions or private acts. In *AAPL v. Sri Lanka*,¹¹⁶ the tribunal held that the state has failed to carry out the necessary actions expected when there was an insurgent activity in the area where the company farm was situated. This view was upheld in *Biwater Gautiff v. Tanzania*, where it was held that the full protection does not only extend to states prevention of actions by third parties, but also to actions by state organs¹¹⁷. In *Azurix v. Argentina*,¹¹⁸

*“it was held that full protection is not only a matter of physical security; the stability afforded by a secure environment is as important from an investor’s point of view”*¹¹⁹

However, in these cases, the use of “full” protection was evident in the treaties. It remains to be seen if ordinary use of words “protection and security” will be interpreted as such. This protection is important for BOTs in renewable energy in developing countries. Some of these countries are insecure due to activities of insurgents. Actions or inactions of host state related to protection can be brought under this provision. However, it should be noted that due diligence and necessary measures reasonable in the circumstances are required from the state.

3.3.5. Transfer of funds

The condition for transfer of fund from and into the host state is of importance to the foreign investor. He needs to import funds into the state for the investment and also repatriate funds back to its home country. This concern is against the monetary policy of the host state whose concern is also to monitor and control the flow of currency in and out of the state as sudden inflow or outflow of funds could affect the economy of the host state. This area is mostly regulated in the BITs taking into considerations the concern of both sides. There are three issues arising from the use of this standard. First issue is whether the transfer should apply to

¹¹⁴ For example, Bahrain-United States BIT (1999),Article (2) (3)a, Rwanda-United States BIT (2008) Article 5

¹¹⁵ *AAPL v Sri Lanka*, Award, , 27 June 1990, para 53

¹¹⁶ *Ibid*, para 85

¹¹⁷ *BiwaterGautiff v. Tanzania*, Award 24 July, 2008,para 703

¹¹⁸ *Azurix v. Argentina*, Award, 14 July, 2006

¹¹⁹ *Ibid*, para 408

both inflow and outflow of fund? Second issue is whether the provisions in the treaty apply to all funds related to the investments or those specified in the treaty? Third issue is whether the transfer of funds should be regulated by the domestic laws and regulations?¹²⁰ Some treaty grants provision on the outflow of funds,¹²¹ while some focus on both inflow and outflow with exceptions.¹²² Some specify if the transfer of funds should be subject to the domestic laws of the parties or to international principles. There is no dominant pattern in this area. In considering the breach of this term, the tribunal in *Continental Casualty v. Argentina*,¹²³ considered if the transfer denied constituted an area covered by the investment protection under the treaty. There may be need for a host state to place restrictions on right to transfer during financial disorder. But these exceptions should have been specified in the treaty. This shows that the way the term is framed and its restrictions are important in interpretation of this term. The freedom to be able to transfer profits made is important to a BOT investor. Investors should note that it is their responsibility to follow all the procedure necessary to obtain authorization for transfer of funds. With this background, BOT investors can resort to dispute settlement when the condition guaranteed by the host state has been breached. The transfer in dispute should constitute the type of transfer covered by the treaty. More favourable terms for transfer of fund may be available in the implementation agreement. This can be arbitrated under the umbrella clause protection.

3.4. The Umbrella Clause

This clause guarantees the observance of obligations of the host state, in respect to the foreign investor. This includes the observance of contractual obligations and other commitments. The main issue of concern in applying this term is: if ordinary breach of contract term can amount to a breach of this clause? Tribunals in answering this question have come out with three different approaches. The first one, which connotes a restrictive application, indicates that an ordinary breach of contract terms will not amount to a breach of the treaty.¹²⁴ The second approach is a broad interpretation which connotes otherwise.¹²⁵ The third approach use the

¹²⁰UNCTAD, *Bilateral Investment Treaties. "Treaties 1995-2006: Trends in Investment Rulemaking."* United Nations (2007)

¹²¹The BIT between Belgium–Luxembourg and Hong Kong (China) (1996) art 6

¹²²The BIT between Japan and Vietnam (2003) art 12

¹²³*Continental Casualty Co.v. Argentine Republic*, ICSID CaseNo. ARB/03/9, Award(Sept. 5, 2008). Para 593

¹²⁴ *SGS v Pakistan*, decision on jurisdiction, 6 august 2003, *Joy Mining machinery limited v. The Arabic republic of Egypt*, Award on Jurisdiction, August 6,2004

¹²⁵ *Siemens v. Argentina*, award , 6 February 2007, paras196-206, *Plama v Bulgaria*, award, 27 August 2008

restrictive method but applied a distinction between acts of the state as sovereignty and acts of the state for commercial purposes.¹²⁶ In addition, Prof August Reinisch argued that breach of contract can constitute breach of treaty.¹²⁷ He reasoned that both claims can be treated separately as breach of treaty under the international tribunal; and breach of contractual terms under the domestic law.¹²⁸ However, the way the clause is framed in the treaty and its overall position in relation to the structure of the treaty determines the interpretation.¹²⁹ Treaties which adopt the use of the word observance of “any” obligation, with regards to investment, tends towards the broad interpretation than with other ones.¹³⁰ The second and the third approach provide a more favorable position for investors seeking protection in this area. In the developing country, the judiciary system is not entirely independent of the executive. This makes it difficult to get a fair judgment when there is dispute centered on breach of contract. The last two approaches provide a good ground for arbitration based on breach of treaty provision for a BOT investor who does not have confidence in the judiciary system of the host state. BOT investors should negotiate contractual terms in favour of international arbitration while the state is acting for commercial purposes. Breach of the obligations of government outlined in the implementation agreement can be arbitrated via this provision.

There are instances where contracts were made by persons other than the state and the investor. An example is a contract between a subdivision of the state and the subsidiary of the investor. This is usually applicable in the case of the power purchaser. The power purchaser is a legal entity different from the government. The principle of attribution can be applied in such cases.

3.4.1. The Principle of Attribution

The principle of attribution is a customary law principle. It depicts that a state is responsible for all its organs and at all levels.¹³¹ This principle is set out in Article four of the International

¹²⁶ *Sempra v. Argentina*, Award 28 September 2007, *Azurix v. Argentina* award 14 July 2006 para 315

¹²⁷ Seminar on international investment protection, Umbrella clauses, prof Dr August Reinisch, winter semester 2006/2007, Axel Weissenfels, reg no 0100220 pg 14

¹²⁸ *ibid*

¹²⁹ Paul Michael Blyschak, *Arbitrating Overseas Oil and Gas Disputes: Breaches of Contract Versus Breaches of Treaty*, *Journal of International Arbitration*, (Kluwer Law International 2010 Volume 27 Issue 6) pp. 579 - 629

¹³⁰ Yannaca-Small, Katia. *Interpretation of the umbrella clause in investment agreements*. No. 2006/3. OECD Publishing, 2006.

¹³¹ *Commentary to the international Law Commission's Articles on state responsibility*(2002) pg 95

Law Commission's (ILC) article on state's responsibility.¹³² It does not matter if such action was committed by the executive, judiciary or legislative arm of the government, neither does it matter if such acts were made ultra vires.¹³³ Generally, investors do not have direct contact with host state but its entities. The acts of these entities can be attributed to the state provided they are empowered by the state to exercise elements of governmental authority, and are acting in that capacity at that particular instance. Another scenario is if such entity is acting on the instructions of, or under the direct control of that state, in carrying out the function.¹³⁴ It must be noted that conduct with regards to state entities merely concern governmental activity and not other private or commercial activity.¹³⁵ In respect to state organ there is no such distinction.

The above test known as the structure, function and control test has been applied by different tribunals in attributing responsibility to state.¹³⁶ The tribunal in *Salini v. Morocco* used these tests to arrive at the conclusion that a Moroccan Company (ADM) which has the responsibility of constructing, maintaining and operation of high ways and major communication routes is a state entity. This is because it was de facto controlled by the state and it carried out functions which were state matters. The delegation of duty to state entities does not relieve a state from its responsibility for breach of treaty.¹³⁷

Another example of this is found in *Nycomb v. Latvia*.¹³⁸ In this case, the government gave a double price tariff for 8 years as incentive for investment in the power sector. Electricity generated by these investors is brought by a state entity named Latvernago. Contracts were signed based on the double tariff. The law was repealed after the investors have constructed their plants. Consequently, Latvernago refused to buy the electricity at the contractual price. Wandu, one of the foreign investors, initiated arbitration at the international level. It was held that Latvernago is a state entity because it was fully owned and control by the state - "clearly an instrument of the State in a highly regulated electricity market."¹³⁹ The power purchasers

¹³²Articles on Responsibility of states for Internationally Wrongful Acts adopted by the International law commission at its 53rd session in 2001

¹³³Ibid article 7

¹³⁴ Ibid Article 5&8

¹³⁵ Alpha v. Ukraine, Award, 8 November 2010, para 402

¹³⁶Feit, Michael. "Responsibility of the state under international law for the breach of contract committed by a state-owned entity." *Berkeley J. Int'l L.* 28 (2010): 142. pg 146

¹³⁷Schicho, Luca. "Attribution and State Entities: Diverging Approaches in Investment Arbitration." (2011). Pg 284

¹³⁸ Nycomb v. Latvia, Award, 16 December 2003 found at <http://www.encharter.org/index.php?id=213&L=0#Petrobart>

¹³⁹Ibid pg 31 section 4.2

in developing countries are principally state entities. This provision enables a BOT investor in renewable energy the opportunity to hold the host state responsible for actions of the ministries. The power purchasers and other governmental corporations can also be held responsible. However, it should be noted such act will only be attributed to the state when the entities are acting under the instruction of the state.

3.5. Expropriation

Protection against expropriation is another important provision in the BITs. The state has the right to expropriate. This is in line with the notion of sovereignty. However, for expropriation to be legal it must be for public purpose. It must not be arbitrary or discriminating and it must be accompanied with prompt, adequate and effective compensation. Most bilateral treaties acknowledge the right to expropriate with these reservations.¹⁴⁰ In recent years, some BITS mentioned both direct and indirect expropriation.¹⁴¹ Direct expropriation happens when the state takes over a foreign private investment. In indirect expropriation; the government makes it impossible to run the investment while ownership still resides with the investor. Expropriation can be interpreted to cover both direct and indirect expropriation where indirect expropriation is not expressly mentioned.¹⁴²

States rarely engage in direct expropriation¹⁴³ except in the times of emergency. This is because it does not portray such countries as being investment-friendly. However, there has been herald of cases before the tribunal on indirect expropriation. In indirect expropriation, the acts in question must have been attributed to the state.¹⁴⁴ There should be interference with property rights or other protected legal interests of such degree that the relevant rights or interests lose all or most of their value or the owner is deprived of control over the investment, even though the owner retains the legal title or remains in physical possession.”¹⁴⁵

For expropriation to occur, the measure or measures considered must have had a destructive and long lasting effect on the economic value of the investment and its benefits.¹⁴⁶ In addition,

¹⁴⁰Dolzer, Rudolf, and ChristophSchreuer. Principles of international investment law.Oxford University Press, 2012.pg 98.Uk-Ethiopia BIT 2009 Article 5

¹⁴¹Egypt-Germany BIT 2005 Article 4, Mexico-United Kingdom BIT, Article 7

¹⁴²Expropriation: A sequel ; UNCTAD Series on international investment Agreements ii pg8

¹⁴³Ibid (84)

¹⁴⁴Ibid pg 14

¹⁴⁵Ibid

¹⁴⁶Telenor v. Hungary award, 13 September 2006 para 64

the measures must have led to total or near-total destruction of the economic value of the investment. However, the mere fact that the measure has an adverse effect is not sufficient for the finding of an expropriation.¹⁴⁷ The character of the governmental measure and the extent with which it affected the reasonable investment backed expectation is also examined.¹⁴⁸

Another factor examined is the existence of expectation on the part of the investor that a certain measure will not be taken by the host state. This kind of expectation is called legitimate expectation. It is however important to note that host states change their policies from time to time to meet up with the changes in their economies and global world in general. It will therefore be unreasonable for an investor to think that a particular law or rule will not change especially if it is a long time investment.¹⁴⁹ The power of the state to make rules and regulation is called the police power. The relationship between police power and legitimate expectations is discussed below.

3.5.1. Police Powers versus Legitimate Expectations

The state has the power to make rules and regulations for itself.¹⁵⁰ Acts of states made in exercise of this power are contained in international law and are not subject to compensation in principle.¹⁵¹ The Restatement (third) of foreign relations of the United States, section 712, comment (g) captured this doctrine as follows;

“ a state is not responsible for the loss of property or other economic disadvantages resulting from bonafide taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of state, if it is not discriminatory, and is not designed to cause the alien to abandon the property to the state or sell at a distress price”

The principle is incorporated in some treaties as annexes or part of the main clause.¹⁵² It is also recognized by tribunals. For example in Methanex v. USA, the tribunal held that a non discriminating regulation for public purpose, enacted according to the due process and

¹⁴⁷Ibid (134) pg 58

¹⁴⁸United States Model BIT (2004)Annex B Expropriation

¹⁴⁹Pakerings v. Lithuania Award 2007 para 332

¹⁵⁰Newcombe, Andrew. "The boundaries of regulatory expropriation in international law." ICSID Review-Foreign Investment Law Journal 20.1 (2005).Pg 20

¹⁵¹Brownlie I. Principles of Public International Law. Seventh edition. Oxford University Press, Oxford (2008). Pg 532

¹⁵² Canada- Jordan BIT , 2009, canada- slovak republic BIT, 2010, Belgium/ Luxembourg- Colombia BIT (2009) Article IX(3)(C)

affecting a foreign investor's investment, is not due expropriatory excepts if the government has given a representation that such law will not be enacted.¹⁵³ This was also recognized in Feldman v. Mexico where the tribunal acknowledged that governments should be free to make law in public interest.¹⁵⁴

Tribunals have had the task to distinguish between non-compensable regulations and indirect expropriation. They have in their wisdom and through different cases, determined that these power is regulated by some conditions which if not fulfilled can make such measures become expropriatory and compensable. The first condition is if the host state has given a representation that such law will not be enacted or a particular law will not be changed.

Legitimate expectation consists of a representation from the host state that a particular law or regulation will not be enacted or will not be changed. Legitimate expectation is defined in Thunderbird v. Mexico¹⁵⁵ as follows;

“the concept of “legitimate expectations” relates, within the context of the NAFTA framework, to a situation where a Contracting Party’s conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honor those expectations could cause the investor (or investment) to suffer damages”

The legal frame work of the host state at the time of investment provides the basis for the legitimate expectations. Changes that remain within the normal boundaries of normal adjustments customary in the host state and accepted in other states will not constitute a violation of legitimate expectation.¹⁵⁶ In analyzing “legitimate expectations”, the basis for such expectations is very important.¹⁵⁷ If such expectation was created by an assurance given by the host state, change in such rule might lead to expropriation.¹⁵⁸ Such representation can be implicit or explicit.¹⁵⁹ The provisions of the stabilization clause in contract\concession or government guarantees are good example of an explicit representation for legitimate expectation. The reliance on such representation by an investor especially - while it is an inducement for the making of such investment (and when it affects the investment of such

¹⁵³ Methanex Corporation v. the United States, Final Award, 3 August 2005, part IV, chapter D, para. 7.

¹⁵⁴ Feldman v. Mexico, Award, 16 December 2002 para 83

¹⁵⁵ Ibid para.83

¹⁵⁶ Rudolf Dolzer and Christoph Schreuer: Principles of international investment law, 2nd edition 2012 pg 115

¹⁵⁷ Ibid (86), pg 75

¹⁵⁸ Methanex v. USA, Final Award, 3 August 2005, Part IV, Chapter D, para. 7.

¹⁵⁹ Azurix v. Argentina, Award, 14 July 2006,318

investor); made the enacted of such regulation tantamount to expropriation. In *Revere Copper & Brass, Inc. v. OPIC*,¹⁶⁰ the tribunal held that;

*“ We regard these principles as particularly applicable where the question is, as here, whether actions taken by a government contrary to and damaging to the economic interests of aliens are in conflict with undertakings and assurances given in good faith to such aliens as an inducement to their making the investments affected by the action.”*¹⁶¹

It is to be noted that specific or explicit commitment are more preferable than implicit ones as the latter will not provide a sufficient basis for legitimate expectation especially when they are unofficial.¹⁶² In *Mobil and Murphy v. Canada*,¹⁶³ the tribunal held that the burden is on the claimant to: establish a clear and specific representation given by the host state; its reliance on such representation; and its subsequent repudiation by the host state.¹⁶⁴ After considering the facts, the tribunal held that there was no specific assurance given by the host state.

In response to this principle, scholars have argued that investment law must strike a balance between “stability, security, predictability and fairness for the foreign investor with state regulation in the public interest.”¹⁶⁵ As much as investors prefer stability, such stability does not connote a regulatory stand still. States, especially developing states, should not be allowed to pay compensation in such instances especially where it is regulation in the public interest. As Dolzer noted:

*“reliance upon structures that reinforce underdevelopment does not deserve protection under modern international law; for arrangements falling into this category, the risks involved should probably be allocated to the investor.”*¹⁶⁶

The long duration of BOT contracts makes it vulnerable to change in regulatory framework. There is need for stabilization clause and government guarantees to ensure the stability of such regulation. The investor should not be left to bear such risks alone if the measure taken by the government totally destroys the viability of such investment.

¹⁶⁰ *Revere Copper & Brass, Inc. v. Overseas Private Invest. Corp.*, 56 ILR 258, 17 ILM 1321, 1331, cited in *Waste Management, Inc.* (2004)

¹⁶¹ *ibid*

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¹⁶³ *Mobil Investments Canada Inc. and Murphy Oil Corporation v. Canada*, ICSID Case no. ARB(AF)/07/4, Decision on Liability and on Principles of Quantum, May 12, 2012

¹⁶⁴ *Ibid* para 154

¹⁶⁵ Newcombe Andrew “the boundaries of regulatory expropriation in international law” *ICSID Review Foreign Investment Law Journal* 20.1 (2005)pg 35,

¹⁶⁶ R. Dolzer, “New Foundations of the Law of Expropriation of Alien Property” (1981) 75 A.J.I.L. 553 pg587

Secondly, the nature, purpose and character of such measure or regulation are necessary in ascertaining the difference. Some BITs explicitly introduced these criteria in their treaties.¹⁶⁷ Non-compensable exercise of police powers should be consistent with international minimum standards. Police powers exercise in violation of the minimum standard cannot be justified as this will be in violation of international customary law. When a regulation is made in a discriminatory manner, lacked due process and not for public purpose, such regulation is deemed expropriatory.¹⁶⁸ Moreover, when such regulations constitute an abuse of rights, abusive takings or are of economic benefit to the state¹⁶⁹, they are tantamount to expropriation which is compensable. In *Link- trading joint stock Company v. Moldova*, where the issue of consideration is a fiscal measure within the police power of the state, the tribunal noted as follows:

*“As a general matter, fiscal measures only become expropriatory when they are found to be an abusive taking. Abuse arises where it is demonstrated that the State has acted unfairly or inequitably towards the investment, where it has adopted measures that are arbitrary or discriminatory in character or in their manner of implementation, or where the measures taken violate an obligation undertaken by the State in regard to the investment.”*¹⁷⁰

The third instance is when there is lack of proportionality between the measure taken and the need in question. The issue of proportionality was first invoked in *Tecmed v. Mexico*¹⁷¹ and has been followed in other cases. Where state actions are disproportionate to the need being addressed, then there could be incurring of liability on the part of the state. This principle is equally used in the European human rights courts in determining the dispossession of property. In *Azurix v. Argentina*, the tribunal held that that proportionality will be lacking if the persons concerned bears an individual and excessive burden.¹⁷² However, it should be noted that international law gives states a wide margin of discretion with respect to questions on priority of public purpose and suitability of the measure.¹⁷³ The legal frame work for Renewable energy investment might be subject to changes as technology, capacity and

¹⁶⁷ Canada- Romania BIT (2009) Annex B, Colombia- India BIT (2009) article 6

¹⁶⁸ *Methanex v. United states*, Award, 3, August 2005

¹⁶⁹ Expropriation: A sequel ; UNCTAD Series on international investment Agreements ii

¹⁷⁰ *Link-Trading Joint Stock Company v. Department for Customs Control of the Republic of Moldova*, UNCITRAL, 18, April, 2002, at para 64

¹⁷¹ *Técnicas Medioambientales Tecmed, S.A. v. TheUnitedMexicanStates*, May 29,2003

¹⁷² *Azurix v. Argentina*, para 311

¹⁷³ Expropriation: A sequel ; UNCTAD Series on international investment Agreements ii p 98

technical know-how improves. However, such changes should not affect the economic viability of BOT investors substantially.

Tribunals have also considered if breach in contractual agreement is a measure tantamount to expropriation. In *Azurix Corp. v. the Argentine Republic*¹⁷⁴ it was held that;

“Whether contract rights may be expropriated is widely accepted by the case law and the doctrine.....contractual breaches by State party or one of its instrumentalities would not normally constitute expropriation. Whether one or series of such breaches can be considered to be measures tantamount to expropriation will depend on whether the State or its instrumentality has breached the contract in the exercise of its sovereign authority, or as a party to a contract. As already noted, a State or its instrumentalities may perform a contract badly, but this will not result in a breach of treaty provisions “unless it be proved that the state or its emanation has gone beyond its role as a mere party to the contract, and has exercised the specific functions of a sovereign.”¹⁷⁵

From above, it can be deduced that contractual rights can be expropriated. This occurs when the state is acting in his capacity as a sovereign through decree, exercise of legislative actor or executive power. In addition, such measures should have effects equivalent to expropriation. This principle is related to the notion deduced in umbrella clause while deciding when a breach in contract amounts to breach in treaty.

From the above, lots of factors are considered when an investment is deemed expropriated. For a BOT investor in renewable energy, it might be difficult to prove expropriation when the measures complained of came up when the investment is to be handed over. This is because one of the factors for expropriation is for the effect of the measure to have been substantial and last for a significant period of time. In addition, tribunals might be reluctant to find expropriation when the investor still has substantial control over the investment. However, such measures can still be brought under the fair and equitable provision.

In line with the principle of reparation, tribunals awards compensation to the investor when the host state is found guilty of indirect expropriation.¹⁷⁶ The fair market value is considered while deciding the value of the investment. The value of the investment at the time of the

¹⁷⁴ *Azurix Corp. v. The Argentine Republic*, Award, July 14, 2006

¹⁷⁵ *Ibid* paras 314&315

¹⁷⁶ International Law Commission, Articles on Responsibility of States for Internationally Wrongful Acts article 34 and 36

award is considered. This can have both positive and negative effect for the BOT investor. The viability of the investment could have appreciated or depreciated.

Another provision for protection for foreign investors, as earlier mentioned, is the opportunity to settle dispute via a neutral body other than the courts of the host state. This will be discussed in detail in chapter four.

3.6. Exemption Clauses (Non-precluded measures)

The IIL through its BITs also provides exemption from the application of its protection. The exemption are based on issues including: international agreements relating to taxation, customs, European union law for member states of the European Union, emergency situations such as war and social unrest, necessity, armed conflicts, force majeure, environmental matters and public health. A good example of this is in US Model BIT (2012) Article 12. This article guarantees the right of host state to make regulations in relation to environmental law. This entails protection of environment and prevention of danger to human, animal, plant life or health. Moreover, measures taken for reasons of public security, order and morality are not considered to be a breach of the provisions of such treaties. Another good example is the BIT Model of Canada, Article 9 and 10.¹⁷⁷ The non-precluded measure provision for environmental reasons also includes the measures made for curtailing the greenhouse emissions. It allows the host state to make new rules as necessary while it also prevents it from changing the existing rules arbitrarily. Some countries also include energy sector as part of their exception clauses. This might not be to the advantage of the BOT investor in renewable energy. The investor will not be able to rely on the protections explained above. However, the investors can still rely on these provisions if the host state is party to ECT.

All the provisions explained above are meant for the protection of the investments of the investor in the host country. Investors in BOT contract can rely on these protections in addition to the protection offered by the concession contract entered into at the onset of establishing such investment. Contractual breach can be brought under the auspices of the international forum via the umbrella clause or if the forum selection for settlement of dispute provides for such. Actions of government that were unfair and discriminating and not in good faith can be brought under the fair and equitable treatment.

¹⁷⁷ BIT Model Canada, 2004 found at <http://italaw.com/documents/Canadian2004-FIPA-model-en.pdf>

However, there are instances where there is a state of emergency in the host state which might demand the immediate change in the policy of the state or make the state to take actions which might negatively affect investment. State of emergency could be as a result of war, force majeure instances, civil unrest, natural or manmade disasters. Provisions are being made for such instances in the text of the treaty. How did tribunals treat emergency cases where the state of emergency in the treaty has been pleaded or where there is no provision for such emergency in the treaty? Who should bear the risk in such instances, the host state or the investor?

In recent times, the situation in Argentina provides a good example of such instance. The country had recently changed its law due to its economic crises. This change had negative effect on foreign investment. In the next section, I will discuss the case of Argentina and try to provide insight into what a BOT investor in renewable energy might expect in such instances.

3.6.1. Case Discussion (Argentina Cases) and application to BOT

Argentina faced some institutional crisis in the 1980s. In a bid to solve this crisis, the government enacted a legislation called convertibility law where she pegged its local currency to dollar. Furthermore, it carried out a series of privatization of the public sector via concession and licenses. Publicity which involves promises of legal guarantees, stable and secure environment was made to attract investors especially those interested in long term investment. However, in the next decade, the country was affected deeply by the world economic crises. In 2002, the country introduced a public emergence law in order to save its economy. This law terminated convertibility law and also issued some decrees and rules which affected the public utility sector. Investors whose investment was affected negatively by the new policy instituted case at the international level against Argentina. These cases were instituted for arbitration mostly at ICSID and a few at UNCITRAL.

Awards were issued in about twelve cases, some on jurisdiction bases, while some were argued and decided. In most of these cases (for those cases that got to argument on the main claims); Argentina pleaded the defense of necessity¹⁷⁸ as stipulated in some of its BITS¹⁷⁹ or as an international customary law when it is not stipulated in the concerned BIT.

¹⁷⁸http://www.iareporter.com/articles/20120717_2Ai reporter, investment arbitration reporter

The defence of necessity¹⁸⁰ is codified in Article 25 of Draft Articles on Responsibility of States for Internationally Wrongful Act. The necessity defense as a clause in BITs portrays exceptional instances where actions of the host state will not constitute a breach of the treaty. Necessity defence in ILC provides that a state will not be held to breach its international obligations if the action it takes is the only way to save an essential interest from imminent and grave peril, and it does not impair the essential interest of the state towards which such obligation exists. It also provides that a state cannot plead this law where the state has contributed to the state of necessity. In this paper, I would use the USA-Argentina BIT as an example.¹⁸¹ The exemption clause in this BIT provides that:

“This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the Protection of its own essential security interests”

Tribunals in deciding cases with this clause pleaded as defence, decides that this clause is not self judging.¹⁸² It needs to be analysed by a third party. In analysing this defence, three positions have been taken by the tribunals.

The first position was the total rejection of the defence of necessity based on their inability to satisfy the conditions outlined by necessity in customary international law as codified in the ILC. This was outlaid in CMS v. Argentina.¹⁸³ An investor in the TGN (an Argentinean gas transportation company) instituted arbitration against Argentina for exploitation without compensation, breach of fair and equitable treatment, arbitrary and discriminatory measures and umbrella clause. The tribunal found that Argentina has breached the fair and equitable treatment and the umbrella clause (failure to observe their obligations) and rejected the plea of defence of necessity in article XI of the US-Argentina BIT. The tribunal related the defence of necessity in Article XI to Customary international law of state of necessity and found Argentina cannot justify its actions based on both.

¹⁷⁹ For example article xi of treaty between United States of America and the Argentine republic concerning the reciprocal encouragement and protection of investment, 1991.

¹⁸⁰ Article 25 Draft articles on Responsibility of States for Internationally Wrongful Act

¹⁸¹ Several investors from USA were affected and they instituted arbitration through the USA-Argentina BIT.

¹⁸² El Paso Energy International Company v. The Argentine Republic, ICSID Case No. ARB/03/15, CMS Gas Transmission Company v. The Republic of Argentina, ICSID Case No. ARB/01/8 para 373, LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc. v. Argentine Republic, ICSID Case No. ARB/02/1, decision on liability, para 212

¹⁸³ CMS Gas Transmission Company v. The Republic of Argentina, ICSID Case No. ARB/01/8

A couple of cases have been decided in this manner¹⁸⁴ but some of the cases¹⁸⁵ have been subjected to review by the annulment tribunal and found wanting. The CMS case was also appealed. The award was not cancelled but the annulment committee criticized the way the defense of necessity was interpreted especially in relation to the customary international law on state of necessity.

The second position was outlined in *LG&E v. Argentina*¹⁸⁶ where the tribunal analysed the defence of necessity based on article XI of the US-Argentina exemption clause and the international customary law of defence of necessity. LG&E is a Kentucky based company that purchased interest in Three Gas Corporation in Argentina. It instituted action against the government for breach of treaty after the adjustment of the tariff. Argentina pleaded the same defence of necessity as found in the BIT and the international customary law. The tribunal analyse the defence based on both laws¹⁸⁷ and found that Argentina can be justified based on both laws. However, it differentiated the period of state of emergency in Argentina from the period that does not constitute an emergency period and held that Argentina is liable for the period that does not constitute a state where it is necessary to apply the emergency law.

The third position is found in *Continental Casualty & Co v. Argentina Award*¹⁸⁸ where an Illinois based company with investments in insurance company instituted arbitration against Argentina for damages based on loss incurred during her emergency measures. The tribunal in this case analysed the defence of necessity based on the Article XI. It held that the provision in The US- Argentina BIT is *les specialis*¹⁸⁹ and held that the standard required in the two laws are different. The standard in the international customary law is restrictive while that of the BIT is wider. It also absolved Argentina from liability based on article XI in almost all the claims except one.

In other cases where the BIT did not expressly preclude the state party from wrongfulness, just the international customary law on necessity was cited. Most probably, this defense might be used in all types of emergency. A lot of cases have been decided in this respect, not just in

¹⁸⁴Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic, ICSID Case No. ARB/01/3 (also known as: Enron Creditors Recovery Corp. and Ponderosa Assets, L.P. v. The Argentine Republic), *Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16,

¹⁸⁵ibid

¹⁸⁶*LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1

¹⁸⁷US- Argentina BIT Article XI and the defence of necessity in international customary law as codified in the ILC.

¹⁸⁸*Continental Casualty Company v. The Argentine Republic*, ICSID Case No. ARB/03/9

¹⁸⁹ Ibid, para 168

investment issues. The International court of Justice (ICJ) has held that the provision should be interpreted narrowly and the conditions to be provided should be met cumulatively.¹⁹⁰ In addition, the application of the state of necessity does not prevent the state relying on this provision from paying compensation where it is in line with the applicable law.¹⁹¹

From the above cases, it is a bit difficult to predict the position a tribunal might take when it comes to preclusion from wrongfulness (exemption clause) especially when it is treaty based. Taking of different positions despite similarities in facts and issues have been the bane of the ICSID as an institution for arbitration. This unsettling issue will be discussed in the next chapter. Nevertheless, from the decisions so far, the BOT investor might have to be responsible for the loss acquired during the period of emergency where the host state has been precluded from liability in the treaty. But the state can be held responsible where such measures were applied beyond the emergency period. When there is no provision for emergency in the treaty, the host state will have to meet the strict conditions outlined in the ILC and also pay compensation where it is necessary.¹⁹² From the above, the provision for emergency period in the BIT does not exactly favour the BOT investor in renewable energy.

4. WHEN IT GOES WRONG: CHALLENGES PRESENTED BY ICSID

The host state's court would normally adjudicate dispute between a foreign investor and the host state, where there is no agreement to the contrary. Foreign investors prefer to have an independent neutral body; because of fear of lack of impartiality and lack of independence between the judiciary and the executive arm of the host state. Even in developed countries where judiciary functions independent of the executive; the courts may tend to have sympathy towards its state policy. The IIA provides a neutral forum for settlement of dispute between the investor and the host state. This is done through reference to an arbitration forum in the investment Treaty.¹⁹³ Most treaties usually have ICSID as arbitration forum. The ICSID is a convention with 148 state members.¹⁹⁴ This chapter will consider the role of this body in investment dispute and its implication for BOT investors in renewable energy.

¹⁹⁰ International Court of Justice, Case Concerning The Gabčíkovo-Nagymaros Project (Hungary/Slovakia), Judgment of 25 September 1997 IC.J. Reports 1997,p 51

¹⁹¹Article 27Draft articles on Responsibility of States for Internationally Wrongful Acts, with commentaries 2001

¹⁹² Provided such host state is found to have breached the provisions in the treaty.

¹⁹³Reference could be made to any of the international arbitration fora eg ICC, PCA,LCIA, ICSID etc.

¹⁹⁴ Rudolf Dolzer and ChristophSchreuer; Principles of International Investment Law, second edition, oxford university press, 2012pg 238

The project company in the BOT renewable energy sector made many contractual agreements with different actors. Causes of action could be: refusal to grant approval or license to operate; change in policies guaranteed in implementation agreement; actions constituting breach of the general treatment terms; or breach of contractual obligation. Most of these contracts do contain arbitration clause for settlement of dispute. The arbitration body contained in the clause could be national or international. For protection under the investment treaty, the investor will need to seek the forum referred to by the treaty. Both the investor and the host state need to give consent to the arbitration. The host state consent can be given via a broad consent clause in a concession: through a standing offer in a treaty between the host state and the investor's nationality state or through a standing offer in the legislation of the host state.¹⁹⁵ The investor is deemed to have accepted the offer when it initiates arbitration. The clauses establishing arbitration differ in the wordings. Some provides jurisdiction on certain specified cause of action. A good example of this is found in Norway – Russia BIT, where it was stated that arbitration will be only on disputes which arises from implementation or non-implementation of the obligation in the agreement.¹⁹⁶ While in others there are no limitations on causes of action.¹⁹⁷ For a BOT investor in renewable energy, treaties with specified action might make it difficult to bring in contractual breach claim under a treaty obligation. Moreover, diverse decisions made by tribunals on application of umbrella clause, create difficulty in accessing the feasibility of a tribunal accepting to arbitrate a treaty claim. This particular issue creates more difficulty for renewable investor with investments in on-grid energy. This is because what he has is myriads of contracts with governmental entities that are separate legal entities. Arbitral decisions have shown that arbitrators are more willing to accept jurisdiction when such entity is the state itself than when it is a separate legal entity.¹⁹⁸ However, arbitrators are willing to adjudicate cases where the “contractual breach claim will constitute at the same time a violation of the bilateral treaty by the state”¹⁹⁹

¹⁹⁵ Goodman, Charity L. "Uncharted Waters: Financial Crisis and Enforcement of ICSID Awards in Argentina." U. Pa. J. Int'l Econ. L. 28 (2007): 449.

¹⁹⁶ Norway-Russia BIT(1995) Article 8, Energy Charter Treaty Article 26

¹⁹⁷ Norway-Peru BIT(1995) Article 9(1)

¹⁹⁸ SaliniCostruttori v. Morocco (Decision based on Jurisdiction, 2001) para 60-62, ConsortiumRfccc. Morocco (Decision on Jurisdiction, 2001) para 68-69

¹⁹⁹ SaliniCostruttori v. Morocco(Decision based on Jurisdiction, 2001) para 60, Impregilo v. Pakistan (decision on Jurisdiction, 2005) para 210

In some BITs, host states require that some conditions be met by the investors before initiating arbitration.²⁰⁰ Such conditions can be avoided through the MFN principle.²⁰¹ The center has jurisdiction on dispute that arises out of investment.²⁰²

ICSID also has an additional jurisdiction facility. This facility provides for cases where a party to a BIT is not a member state of the convention. It also takes cases that are not directly related to investment.

ICSID has indeed provided a neutral forum for settlement of dispute thereby boosting the confidence of investors in state that are signatory to it. This is evident in that most of the treaties contain clauses allowing the parties to make use of its provision.

However, the system is also clouded with its challenges and shortcomings. The challenges and the way out are enunciated below.

4.1. Lack of Consistency in ICSID Jurisprudence

In ICSID, tribunals are not bound by decisions made in other decided cases.²⁰³ This has been evident in a number of decided cases where tribunals have chosen to make decisions different from previous similar cases.²⁰⁴ Example is the application of non-precluded measure in the USA-Argentina treaty where different decision was reached by tribunals in two cases with similar facts.²⁰⁵ Another example is interpretation of umbrella clause²⁰⁶ and the extension of Most Favored Nation to dispute settlement.²⁰⁷ Consistency in jurisprudence is important to the legitimacy and growth of any legal regime. Inconsistency tends to reveal flaws in the structure of dispute resolution system (it shows that one decision is not legally correct);

²⁰⁰ For example , Argentina-Germany BIT Article 10 (2)

²⁰¹ Andrew Newcombe and Lluís Paradel; Law and Practise of investment treaties Standards of treatment, Wolters Kluwer Law& Business. 2009 pg229

²⁰² ICSID convention article 25(1), it has been decided that investment should be subject to these tests: existence of contributions in capital or otherwise; a certain duration; an element of risk and contribution to economic development of host state.

²⁰³ Article 53(1) ICSID Convention

²⁰⁴ SGS v. Philipines, Decision on jurisdiction, 29 January, 2004, 8 ICSID Reports 518, paras 125, 128

²⁰⁵ Decisions in CMS Gas Transmission Company v. The Republic of Argentina, ICSID Case No. ARB/01/8 and Continental Casualty Company v. The Argentine Republic, ICSID Case No. ARB/03/9

²⁰⁶ Decisions in SGS v. Pakistan, Decision on jurisdiction, 6 August 2003, 8 ICSID reports 383 paras 163-173, SGS v. Philipines, Decision on jurisdiction, 29 January, 2004, 8 ICSID Reports 518, paras 125, 128

²⁰⁷ Maffezini v. Spain, decision on jurisdiction, 25 January 2000, 5 ICSID reports 395, paras 38-64, siemens v. Argentina decisions on jurisdiction, 1 august 2004, 12 ICSID Reports 174, paras 32-110.

thereby reducing the public's confidence in such system.²⁰⁸ Legal theory stipulates that rule of law is rule of law if it is consistently applied to be predictable.²⁰⁹ Investment law is at the early stage of development hence the need for consistency. The BITs between the two countries is to show the private investors the desire of the host country to protect their investments. However, the value of winning the confidence of investors will be reduced when there is no uniform interpretation of the content of such treaty terms. Lack of uniformity may reduce the willingness of investors to invest for a long time, which is the bane for BOT investors especially in renewable energy sector. A predictable jurisprudence helps to analyse the risk of embarking on an expensive dispute settlement process like ICSID. It is good to note that tribunals at ICSID have not been inconsistent in all legal issues. There has been consistency in distinction between treaty and contract claims and the interpretation of fair and equitable treatment to include need for stable legal and business framework.²¹⁰

4.2. Enforcement of ICSID Award

Another major short coming of ICSID is the challenge being encountered by winning party in enforcing the award. ICSID convention provides that all states signatory to it should recognize a rendered award.²¹¹ However, it is not wise for the winning party to seek enforcement in the local courts. This is because the local courts are not independent enough to enforce awards against their state. Most states do not maintain large holdings outside their state and even when they do; it is via corporate instrumentality distinct from the state. In addition, where they had enough property, sovereignty immunity law might be a hindrance.²¹² The enforcement of an award is based on the law of execution of judgment in the state where execution is sought. Article 55 of the convention provides that the law of immunity in the contracting state holds when an award is sought to be enforced. In other words, if the law of such contracting state prevents the enforcement of judgment against state property or that of the property of foreign state, the winning party will not be able to enforce the award.

²⁰⁸ Franck, Susan D. "Nature and Enforcement of Investor Rights under Investment Treaties: Do Investment Treaties Have a Bright Future?" UC Davis J. Int'l L. & Pol'y 12 (2005): 47.

²⁰⁹ Kaufmann-Kohler, Gabrielle. "Is Consistency a Myth?" Precedence in International Arbitration 137 (2008)

²¹⁰ Kaufmann-Kohler, Gabrielle. "Is Consistency a Myth?" Precedence in International Arbitration (2008) 150 pg 141

²¹¹ Article 54 of the ICSID Convention

²¹² Foster, George K. "Collecting from Sovereigns: The Current Legal Framework for Enforcing Arbitral Awards and Court Judgments Against States and Their Instrumentalities, and Some Proposals for Its Reform." *Ariz. J. Int'l & Comp. L.* 25 (2008): 665.

Inability to enforce an award will definitely be a major disappointment to a BOT investor who has invested huge capital in renewable energy. This challenge almost negates the essence of BIT protection. It makes the BIT protection unreliable.

However, it is good to note that this usually occur at the execution stage after the award has been recognized. Investors can minimize this challenge by getting an explicit waiver of immunity from the execution clause in the investment contract.

Despite these challenges, ICSID still remain the most patronised international forum for dispute settlement.

5. CONCLUSION

IIL provides substantial measure of protection for BOT investor in renewable energy via the substantive obligation contained in the investment treaties. Non-performance of assurances made in the implementation agreement can be brought under the fair and equitable treatment. IIL protections found in the investment treaties might not shield BOT investors against tax increase. This sector is excluded from the areas protected by most treaties. But other unilateral changes can be adjudicated. Arbitrators adjudicate on contractual claims that constituting a treaty violation. Umbrella clauses provide an avenue to bring in contractual breaches under the treaty protection. Right to transfer to transfer profits in hard currency to home country is guaranteed. It also provides for investor- state arbitration of disputes. In case of emergency, changes due to necessity also demands that compensation be paid to the investors provided the IIA governing the investment did not make any provision otherwise. However, cases at the ICSID are adjudicated based on the fact of each case. This gives leverage to the investor in instances where precedent has not been in favour of his claim.

In times of emergency where changes are necessary, the customary law protection (necessity principle) is more favourable to a BOT investor. This is because where such instances are provided in the IIA; it is usually the investor who bears the liability. However, such changes can be arbitrated if they are applied beyond the emergency period. Investors should also note that the protections do not guarantee a risk free regime. Some of the protections are not absolute in themselves.

In conclusion, the fact that a host state is a party to an investment treaty (either bilateral or multilateral) gives a measure of assurance to renewable energy investor, because the latter can still recoup a measure of its capital via the award granted by arbitrators.

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