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# Evolution of Foreign Investment Law

## INTRODUCTION

The aim of this chapter is to provide an understanding as to how foreign investment law has evolved in response to the changing economic and political situation of the world. In doing so, it will also look at the impact the traditional developed—developing country tension has had on the evolution of international foreign investment law.

## THE EARLY YEARS

Since time immemorial people have gone abroad to invest and to engage in business. When European traders started to go to Asia, Africa and Latin America to trade with local communities, it was held that the local law could not be applied to them since they were already subject to the law of their home country. Early scholars such as Grotius[1] and Vattel[2] lent their support to such a position. This argument was based on the assumption that these businessmen carried the law of the country of their nationality with them wherever they went and were thus not subject to local law. Foreigners coming from European countries sought special and superior treatment from the local population in much of Asia, Africa and Latin America. The implication of this idea was that their assets could not be expropriated or nationalised through legislation enacted by the local population. Since the local law was inferior, it could not apply to the foreigners, who were subject to the superior body of law of their home country.

As noted by Sutton, many treaties concluded by European powers with Asian and African states provided that the Europeans remained under the jurisdiction of their home states and their consuls exercised jurisdiction over their fellow nationals.[3] For instance, the treaty concluded between the Sheikhdom of Bahrain and the British

[1] H Grotius, *De Jure Belli ac Pacis Tres* (rev edn, 1946), reprinted in (1925) 3(2) *The Classics of International Law*, 385 (F. Kelsey, trans), as cited in TM Franck, *Fairness in International Law and Institutions* (Oxford, Clarendon Press, 1995), 457, n 11.
[2] E de Vattel, *The Law of Nations* 174 (J Chitty ed, 1852), as cited in Franck, above n 1, 457.
[3] SD Sutton, '*Emilio Augustin Maffezini v Kingdom of Spain* and the ICSID Secretary-General's Screening Power' (2005) 21(1) *Arbitration International* 113–26, 119.

Government in 1861 stated in Article 4 that the British subjects and dependants in Bahrain shall receive the treatment and consideration of the most favoured people.

> All offences which they may commit or which may be committed against them, shall be reserved for the decision of the British Resident, provided the British agent of Bahrain shall fail to adjust them satisfactorily.[4]

Thus, in the early years of the development of foreign investment law it was understood that no state could expropriate or nationalise foreign assets. States could not invoke national laws as a reason for avoiding their international obligations arising from the notion of an international minimum standard. It was only in the next phase of development when the number of independent states grew that it came to be accepted that states could expropriate the assets of foreigners under narrowly defined conditions and against the payment of compensation.

Foreign investment law has its origins in the international law concerning the protection of aliens—a legal regime based both on international human rights law and the public international law principles of fairness, equity, justice and non-discrimination.

## NATIONAL TREATMENT VERSUS INTERNATIONAL MINIMUM STANDARD

When colonial territories began to gain independence they started to challenge the concept that foreigners residing and doing business in those countries could not be governed by the law enacted by the local population. Relying on the doctrine of sovereignty and sovereign equality, they asserted that every sovereign state had the right to expropriate or nationalise foreign assets provided that the foreign investor was provided with compensation. The very notion of sovereignty meant that foreigners residing within the national borders of the country were subject to the law of the land. For instance, Article 9 of the Convention on the Rights and Duties of States, one of the first international instruments to support the idea of national treatment, signed at the Seventh Pan-American Conference, provided that

> The jurisdiction of States within the limits of national territory applies to all the inhabitants. Nationals and foreigners are under the same protection of the law and the national authorities and the foreigners may not claim rights other or more extensive than those of the nationals.[5]

The Latin American countries were the first group of states to gain independence from their colonial rulers. These newly independent states began to assert that foreign investors were not entitled to any greater protection than those accorded to the nationals of the country under the law of the land. If the host states treated foreign investors on a par with the nationals of the country, the host states were acting within

[4] As quoted in Sutton, *ibid*.
[5] The Convention on the Rights and Duties of States (Montevideo Convention, 1933), text in (1976) 70 *AJIL* 445.



the norms of international law. Consequently, the right to expropriate the assets of foreign companies with compensation was accepted as an appropriate corollary to state sovereignty.

However, it was submitted that if the local law were considered inferior, not well developed or failed to meet the standards of justice and equity, the international minimum standard rather than national law would apply to foreign investors. The assertion was that international law provided for the international minimum standard and all states had to accept the international minimum standard by bringing their national laws up to this standard. Consequently, the focus was on interpreting what constituted the international minimum standard.[6]

One of the advocates of the application of an international minimum standard to the question of the treatment of aliens, including foreign investors, was Elihu Root, a leading American international lawyer, who argued in 1910 that there was a standard of justice which formed a part of international law. Any national law dealing with the treatment of aliens had to conform to this general international standard:

> If any country's system of law does not conform to that standard, although the people of the country may be content or compelled to live under it, no other country can be compelled to accept it as furnishing a satisfactory measure of treatment to its citizens.[7]

Schwarzenberger added his voice in support of this argument in the following words:

> [T]he national standard cannot be used as a means of evading international obligations under the minimum standard of international law. Even if the standard of national treatment is laid down in a treaty, the presumption is that it has been the intention of the parties to secure to their nationals in this manner additional advantages, but not to deprive them of such rights as, in any case, they would be entitled to enjoy under international customary law or the general principles of law recognised by civilised nations.[8]

Those scholars who articulated the notion of an international minimum standard drew on the doctrine of state responsibility, which provided protection against injury to aliens and alien property.[9] States were not legally bound to admit aliens into their territory but once admitted they had to be accorded a certain standard of decent treatment. The concept of national treatment would entitle foreign investors to the same rights and privileges as those enjoyed by the nationals of a country, but it would not provide adequate protection to foreign investors if the nationals and foreign investors were treated equally badly. As stated by Asante, according to the doctrine of state responsibility,

> host States are enjoined by international law to observe an international minimum standard in the treatment of aliens and alien property. The duty to observe this standard—objective international standard—is not necessarily discharged by according to aliens and alien property the same treatment available to nationals. Where international standards fall below the

[6] Sir R Jennings and Sir A Watts (eds), *Oppenheim's International Law* (9th edn, London, Longman, 1992) vol I, parts 2–4, 931–5.
[7] E Root, 'The Basis of Protection to Citizens Residing Abroad' (1910) 4 *AJIL* 517, 521–2. See also G Schwarzenberger, 'The Standard of Civilization in International Law' (1955) VII *Current Legal Problems* 220.
[8] G Schwarzenberger, *International Law as Applied by International Courts and Tribunals* (1957) 248.
[9] See generally EM Borchard, 'The Minimum International Standard in the Protection of Aliens' (1939) 33 *ASIL Proceedings*; AA Fatouros, 'Transnational Enterprises and in the Law of State Responsibility', in R Lillich (ed), *The International Law of State Responsibility for Injuries to Aliens* (1983) ch VIII.

> international minimum standard, the latter prevails. Breach of the minimum standard engages the responsibility of the host State, and provides a legitimate basis for the exercise by the home State of the right of diplomatic protection of the alien, a right predicated on the inherent right to protect nationals abroad.
>
> . . .
>
> The development of the law of State responsibility was inspired by Western *laissez-faire* ideas and liberal concepts of property. From the juristic standpoint, one of the underlying principles is the duty of the host State to display fair and equitable treatment or good faith in its conduct towards aliens.
>
> The Law of State Responsibility, which was originally conceived for the purpose of protecting individual aliens, was subsequently extended to foreign companies and other foreign business concerns.[10]

In the *Barcelona Traction Case*, the ICJ stated that

> When a State admits into its territory foreign investments of foreign nationals, whether natural or juristic persons, it is bound to extend to them the protection of the law and assumes obligations concerning the treatment to be afforded them.[11]

In the *Roberts* claim, the General Claims Commission held that

> Facts with respect to equality of treatment of aliens and nationals may be important in determining the merits of a complaint of mistreatment of an alien. But such equality is not the ultimate test of the propriety of the acts of authorities in the light of international law. That test is, broadly speaking, whether aliens are treated in accordance with ordinary standards of civilization.[12]

However, since there was no internationally negotiated treaty outlining the terms and conditions of protection of foreign investment, one had to look at other sources of international law, mainly customary international law, in order to ascertain what constituted international law on the subject matter or the international minimum standard. Thus, normally, the practice of investor countries had to be relied upon to determine what constituted customary international law. The same is true of the general principles of law or of the subsidiary sources of international law because whatever writing existed on international law or whatever case-law existed on the subject matter was based on the law hitherto in existence and the practice of investor countries. Furthermore, the law hitherto in existence was the law made by the investor countries designed to protect foreign investment abroad. Therefore, once it was agreed that international law or an international minimum standard would apply to foreign investment this meant, for all practical purposes, applying the law of investor countries. This is one reason why the classic doctrinal tension that existed with regard to foreign investment law was the tension between those who preferred to apply national law to regulate foreign investment and those who preferred to apply international law, meaning customary international law made by investor countries.

[10] SKB Asante, 'International Law and Foreign Investment: A Reappraisal' (1988) 37 *ICLQ* 588–628, 590.
[11] *Barcelona Traction, Light and Power Co Case (Belgium v Spain)*, ICJ Reports 1970, 3, para 33.
[12] The Roberts, Hopkins, and British Claims in the Spanish Zone of Morocco cases (1926), RIAA, iv.41; (1926) RIAA iv.411; and (1925), RIAA ii.617, respectively, as cited in JC Thomas, 'Reflections on Article 1105 of NAFTA: History, State Practice and Influence of Commentators' (2002) 17(1) *ICSID Review: Foreign Investment Law Journal* 21–101, 33.



When it was submitted that the international minimum standard[13] rather than national law was applicable to foreign investment, an attempt was made to define the international minimum standard not only in light of the general principles of justice and equity and the practice of states on the treatment of foreign investment, but also in light of the existing rules of both the conventional and customary international law of human rights. In other words, human rights principles, including the right to property, were also invoked to define what constituted the international minimum standard. Under the evolving principles of international human rights law, every individual, both physical and juridical and whether national or alien, residing within any country, was entitled to their basic human rights, including property rights, protected by law. Consequently, when it came to defining what constituted the international minimum standard not only foreign investment law, but also human rights law, including the property rights of the individuals, whether national or alien, had to be taken into account. Thus, in effect, the international human rights agenda, which supplemented and complemented foreign investment law, would extend the application of the national property law of investor countries to foreign investors doing business abroad. This meant that individual property belonging to either nationals or aliens could not be expropriated or nationalised by a state without compensation.[14]

Accordingly, the right of states to regulate foreign investment under their national law in exercise of their sovereign rights had to be balanced with the principles of international human rights law. Consequently, one of the benefits seen by many states in the promotion of the human rights agenda and in supporting the universality of human rights was the protection of the investment made by their nationals abroad. Thus, the cumulative effect of all customary and conventional rules of international law was that foreign investors were entitled to the protection accorded under the notion of international minimum standard which was based on both foreign investment law and international human rights law. Accordingly, one of the requirements of this international minimum standard was that the taking of private property by a state had to be non-discriminatory, for a public purpose, against the payment of appropriate compensation and in accordance with the due process of law. For instance, a provision in the Central American Free Trade Agreement (CAFTA) states that the provisions concerning expropriation and compensation in Article 10.7 are 'intended to reflect customary international law concerning the obligation of States with respect to expropriation':[15]

## THE ERA OF GUNBOAT DIPLOMACY

Prior to the introduction of diplomatic protection, particularly in the nineteenth century, influential individuals and corporations would persuade their governments

[13] E Borchard, 'The Minimum Standard of Treatment of Aliens' (1940) 38 *Mich LR* 445; A Roth, *The Minimum Standard of International Law as Applied to Aliens* (1949).
[14] CF Amerasinghe, *State Responsibility for Injuries to Aliens* (1964); C Eagleton, *The Responsibility of States in International Law* (1928); RB Lillich (ed), *International Law of State Responsibility for Injuries to Aliens* (1983).
[15] Annex 10-C on 'Expropriation' of CAFTA: www.ustr.gov/new/fta/cafta/text.

to send a small contingent of warships to moor off the coast of the host states until reparation was forthcoming. This was practised frequently by the major trading nations of Europe. For instance, in 1902 the governments of Great Britain, Germany and Italy sent warships to the Venezuelan coast to demand reparation for the losses incurred by their nationals by Venezuela defaulting on its sovereign debt.[16] However, the provision for the settlement of international disputes between states by peaceful means by the Second International Peace Conference of The Hague in 1907, which adopted the Convention on the Peaceful Resolution of International Disputes, opened the possibility of state-to-state arbitration on investment disputes.

## DIPLOMATIC PROTECTION AND THE TREATMENT OF ALIENS IN INTERNATIONAL LAW

Once it was established that foreign investors enjoyed the international minimum standard of protection under international law, the home states invoked the law to provide protection to their citizens doing business abroad and sought remedy for them under the notion know as 'diplomatic protection'. The state itself would intervene on behalf of its citizens abroad and demand protection and compensation from the host states alleged to have breached the international minimum standard of protection, which included the principles concerning the treatment of aliens in international law. The right of a state to protect its citizens abroad had been admitted as early as the middle of the eighteenth century by jurists such as Vattel. He wrote:

> Anyone who mistreats a citizen directly offends the State. The sovereign of that State must avenge its injury, and if it can, force the aggressor to make full reparation or punish him, since otherwise the citizen would simply not obtain the goal of civil association, namely security.[17]

Other scholars such as Borchard have since then endorsed and expounded on the notion of diplomatic protection. In a monograph published in 1915 Borchard stated that

> Diplomatic protection is in its nature an international proceeding, constituting an appeal by nation to nation for the performance of the obligations of the one to the other, growing out of their mutual rights and duties.[18]

The Permanent Court of International Justice (PCIJ) pronounced its justification for the right of states to resort to diplomatic protection in the following manner in the *Mavrommatis Palestine Concessions* case:

> It is an elementary principle of international law that a State is entitled to protect its subjects, when injured by acts contrary to international law committed by another State, from when they have been unable to obtain satisfaction through the ordinary channels. By taking up the case of one of its subjects and by resorting to diplomatic action or international judicial proceedings on his behalf, a State is in reality asserting its own rights—the right to ensure, in the person of its subjects, respect for the rules of international law.[19]

This ruling has since then found its expression and endorsement in other decisions of the PCIJ and its successor, the ICJ.[20] The doctrine of diplomatic protection finds its expression in different manifestations. The right of foreign investors to sue a state before an international tribunal under a BIT can, in fact, be regarded as an extension of diplomatic protection by states because it is states that have created this right for foreign investors through a BIT. For instance, in *The Republic of Ecuador v Occidental Exploration & Production Co* Aikens J of the English High Court of Justice stated that

> It is a long-standing principle of public international law that States owe duties to other States to protect their citizens. This is known as the 'doctrine of diplomatic protection'. Effectively, BITs are treaties that acknowledge this principle of public international law, apply it to particular circumstances between two States and develop the protection of investors by giving them 'standing' to pursue a State directly in 'investment disputes' between an investor and a State Party in ways that are set out in the BIT.[21]

Although the traditional form of diplomatic protection is no longer necessary in today's world where aggrieved foreign investors can resort to various international tribunals under BITs and regional trading agreements (RTAs), states can always avail them of this well-recognised tool of international law as and when it becomes necessary.[22] Many of the inter-state investment disputes referred either to the ICJ or to other international courts and tribunals are manifestations of the exercise of powers under the institution of diplomatic protection. Whether or not there is a BIT or some other treaty between the states concerned, a home state can always invoke the principles of public international law concerning the treatment of aliens and protect its citizens, both natural and juridical, abroad.[23] Thus, the protection available to foreign investors under the international law minimum standard of treatment of aliens is the foundation of modern foreign investment law. This level of treatment is part of customary international law and is thus binding on all states except for persistent and subsequent objectors under narrowly defined conditions. An attempt has been made in the recent past to expand this customary international law protection through a BIT or some other treaty of a similar nature.

16 A Redfern et al, *Law and Practice of International Commercial Arbitration* (4th edn, London, Sweet & Maxwell, 2004) 562–3.
17 E de Vattel, *Le droit des gens ou les principes de la loi naturelle* (vol 1, 1758) 309, as translated and cited in Z Douglas, 'The Hybrid Foundations of Investment Treaty Arbitration' (2003) 74 *BYIL* 151, 165.
18 E Borchard, *The Diplomatic Protection of Citizens Abroad or the Law of International Claims* (1915) 354.

19 PCIJ Rep Series (1924) A No 2.
20 Eg, *Reparation for Injuries Suffered in the Service of the United Nations* case (Advisory Opinion), ICJ Rep (1949) 181 and *Barcelona Traction, Light and Power Co (Belgium v Spain)*, ICJ Rep (1970) 3.
21 *The Republic of Ecuador v Occidental Exploration & Production Co*, High Court of Justice, Queen's Bench Division, Commercial Court, Case No 04/656 of 2 March 2006, para 8.
22 Eg, this issue arose recently in a case between *Sempra Energy v Argentina*, ICSID Case No ARB/02/16 of 11 May 2005, para 134.
23 I Seidl-Hohenveldern, *Corporations in and under International Law*, Hersch Lauterpacht Memorial Lectures (Cambridge, Grotius Publications, 1987).

## THE CALVO DOCTRINE

Those who were opposed to accepting the law of investor countries, in the name of the international minimum standards, were of the view that no state should be required to offer more protection to foreign investors than that accorded to its own nationals. There had to be equality of treatment. If the state in question was not discriminating against foreign investors, it was not violating any rules of customary international law. The argument was that it would be difficult for countries that are newly independent, have not attained the level of economic development required or have not acquired a developed legal system to accord a higher standard of treatment to foreign investors.

At the forefront of the argument in favour of national treatment of foreign investors and the right of states to expropriate the assets of foreign companies was a leading nineteenth-century Latin American jurist, Carlos Calvo of Argentina,[24] who articulated the position relying on the doctrine of economic sovereignty of states in the following terms:

> It is certain that aliens who establish themselves in a country have the same right to protection as nationals, but they ought not to lay claim to a protection more extended. If they suffer any wrong, they ought to count on the government of the country prosecuting the delinquents, and not claim from the state to which the authors of the violence belong any pecuniary indemnity.
>
> . . .
>
> The rule that in more than one case it has been attempted to impose on American States is that foreigners merit more regard and privileges more marked and extended than those accorded even to the nationals of the country where they reside.
>
> The principle is intrinsically contrary to the law of equality of nations.[25]

The central element of the Calvo doctrine was to require aliens to submit disputes arising in a country to that country's courts. In other words, it is about requiring foreign companies or other foreign investors to exhaust local remedies prior to resorting to international arbitration or international adjudication. According to Verwey and Schrijver, the Calvo doctrine basically stipulates that the principle of territorial sovereignty of the state entails:

> (a) the principle of absolute equality before the law between nationals and foreigners;
> (b) the exclusive subjection of foreigners and their property to the laws and juridical regimes of the State in which they reside or invest, and
> (c) strict abstention from interference by other governments, notably the governments of the States of which the foreigners are nationals, in disputes arising over the treatment of foreigners or their property (ie, abstention from diplomatic protection.)[26]

The essentials of the Calvo doctrine found their way into numerous Latin American

[24] K. Lipstein, 'The Place of the Calvo Clause in International Law' (1945) 24 *BYIL* 130; AV Freeman, 'Recent Aspects of the Calvo Doctrine and the Challenge to International Law' (1946) 40 *AJIL* 131.
[25] Translated and quoted from Calvo's work in Spanish by DR Shea, *The Calvo Clause* (1955) 17–9.
[26] WD Verwey and NJ Schrijver, 'The Taking of Foreign Property under International Law: A New Legal Perspective?' (1984) XV *Netherlands Yearbook of International Law* 3–96, 23.



constitutions (such as those of Peru,[27] Venezuela and Mexico), treaties (such as the Pact of Bogota[28]), and investment pacts (such as the Andean Foreign Investment Code[29]). In simple terms, according to the Calvo doctrine, land and other natural resources belong to the state by virtue of the doctrine of sovereignty and no foreign entity can permanently own land in the host states. After the Communist revolution in Russia in 1917 and the agrarian revolution in Mexico at around the same time, the governments of these countries proclaimed state ownership of land; and the assets of foreign companies were expropriated and nationalised without proper compensation, through invoking the sovereignty of states. This was an attempt to take the notion of national treatment to its extreme. The actions of the Soviet and Mexican governments were opposed by the Western states, who held the view that although sovereign states had the right to expropriate the assets of foreign companies, they could do so only under certain narrowly defined conditions stipulated in international law and the expropriation had to be coupled with prompt, adequate and effective compensation. Through several decrees issued after the Bolshevik revolution, the ownership of land and other natural resources was transferred to the state, all banks were nationalised, and the public debt was repudiated without any compensation. Since the decrees drew no distinction between property owned by Russian nationals and foreign-owned property, the Western countries protested against the Russian measures. After years of protests and counter-protests a form of claims settlement was reached between the US and the USSR in 1933 under the Litvinov Assignment.[30]

Similarly, Article 27 of the Mexican constitution promulgated in 1917 following a revolution, during which agrarian expropriations, including land owned by US nationals, were carried out, reads as follows:

> Ownership of the lands and materials included within the boundaries of national territory belongs to the Nation, which has had and continues to have the right to transmit ownership thereof to private parties, thereby constituting private property.
>
> Expropriations may only be made for reasons of public utility and by means of compensation.
>
> The Nation shall have at all times the right to impose on private property the modalities required by the public interest, as well as the right to regulate the exploitation of natural resources capable of expropriation in order to conserve them and to make equitable distribution of public wealth.[31]

[27] Art 17 of the 1939 Constitution of Peru provided that: 'Commercial companies, national or foreign, are subject, without restrictions, to the laws of the Republic. In every state contract with foreigners, or in the concessions which grant them in the latter's favour, it must be expressly stated that they will submit to the laws and courts of the Republic and renounce all diplomatic claims.'
[28] Art 7 of the American Treaty on Pacific Settlement (Pact of Bogota, 1948) reads: 'The High Contracting Parties bind themselves not to make diplomatic representations in order to protect their nationals, or to refer a controversy to a court of international jurisdiction for that purpose, when the said nationals have had available the means to place their case before competent domestic courts of the respective State.' 30 UNTS 55.
[29] Art 50 of the Andean Code of 1971 provided that 'Member countries shall not grant to foreign investors any treatment more favourable than that granted to national investors.' Text in (1972) XI *ILM* 126ff.
[30] See for the text of the Assignment contained in a letter to the US President by Litvinov, Soviet People's Commissar for Foreign Affairs, *United Sates v Pink*, 315 US 203 at 212 (1942). See also JW Garner, 'Recognition by the United States of the Government of Soviet Russia' (1935) 16 *BYIL* 171–3.
[31] The 1917 Constitution of Mexico together with Art 27 is still valid, but in its amended form as amended in 1992. See for the text of the amended Article, GH Flanz (ed), *Constitutions of the Countries of the World: Mexico* (Release 98–4, Issued June 1998) (Dobbs Ferry, NY, Oceana Publications) 17–21.

Unlike Russia, Mexico did not deny the duty to compensate foreigners against expropriation of the assets that they owned in Mexico, but the nature of compensation was not necessarily prompt, adequate and effective and depended on the ability of the state to pay compensation. After years of negotiations a binational claims commission was established in 1927 between the US and Mexico to consider claims of US foreign investors whose assets, mainly land, had been expropriated by Mexico. However, since not a single claim had been adjusted or paid by 1938, the US intensified its diplomatic efforts. The US Secretary of State, Cordell Hull, began a series of diplomatic exchanges with the Mexican Government and the content of these diplomatic exchanges in which Hull articulated the US views on compensation came to be known in international foreign investment law as the Hull formula.

## THE HULL FORMULA

Outlining the US position on the issue of expropriation and the nature of compensation under international law, Hull stated that

> The taking of property without compensation is not expropriation. It is confiscation. It is no less confiscation because there may be an expressed intent to pay at some time in the future. If it were permissible for a government to take the private property of the citizens of other countries and pay for it as and when, in the judgment of that government, its economic circumstances and local legislation may perhaps permit, the safeguards which the constitutions of most countries and established international law have sought to provide would be illusory. Governments would be free to take property far beyond their ability or willingness to pay, and the owners thereof would be without recourse. We cannot question the right of a foreign government to treat its own nationals in this fashion if it so desires. This is a matter of domestic concern. But we cannot admit that a foreign government may take the property of American nationals in disregard for the rule of compensation under international law. Nor can we admit that any government unilaterally and through its domestic legislation can, as in this instant case, nullify this universally accepted principle of international law, based as it is on reason, equity and justice.[32]

His letter goes on to outline the justifications for his position by drawing on the basic principles of international law governing international relations:

> The whole structure of friendly intercourse, of international trade and commerce, and many other vital and mutually desirable relations between nations indispensable to their progress rest upon the single and hitherto solid foundation of respect on the part of the governments and of peoples for each other's rights under international justice. The right of prompt and just compensation for expropriated property is a part of this structure. It is a principle to which the Government of the Untied States and most governments of the world have emphatically subscribed and which they have practiced and which must be maintained. It is not a principle which freezes the *status quo* and denies changes in property rights but a principle that permits any country to expropriate private property within its borders in

[32] Letter of the US Secretary of State to Mexican Ambassador to the United States, 21 July 1938, as cited in AF Lowenfeld, *International Economic Law* (Oxford University Press, 2002) 398.



> furtherance of public purposes. It enables orderly change without violating the legitimately acquired interests of citizens of other countries.[33]

However, the Mexican Foreign Minister disagreed with Hull's views of international law that was applicable to the subject matter. He replied by stating that there was in international law

> no rule universally accepted in theory nor carried out in practice, which makes obligatory the payment of immediate compensation nor even of deferred compensation, for expropriations of a general and impersonal character like those which Mexico has carried out for the purpose of redistribution of the land.[34]

The reply went on to assert that

> there does not exist in international law any principle universally accepted by countries, nor by the writers of treatises on this subject, that would render obligatory the giving of adequate compensation for expropriations of a general and impersonal character. Nevertheless, Mexico admits, in obedience to her own laws, that she is indeed under obligation to indemnify in an adequate manner; but the doctrine which she maintains on the subject, which is based on the most authoritative opinions of writers of treatises on international law, is that the time and manner of such payment must be determined by her own laws.[35]

Hull responded in the following terms:

> The Government of the United States merely adverts to a self-evident fact when it notes that the applicable precedents and recognized authorities on international law support its declaration that, under every rule of law and equity, no government is entitled to expropriate private property, for whatever purpose, without provision for prompt, adequate and effective payment therefor. In addition, clauses appearing in the constitutions of almost all nations today, and in particular in the constitutions of the American republics, embody the principle of just compensation. These, in themselves, are declaratory of the like principles in the law of nations.[36]

In his response the Mexican Foreign Minister rejected Hull's assertion and justified the Mexican expropriations as being a move designed to achieve social justice in the country. However, just before the Second World War spread to the Western Hemisphere, Mexico and the US reached an agreement to establish a commission to determine the compensation to be paid to the US nationals affected by the Mexican agrarian expropriations which took place after 30 August 1927. A deal was struck between the two countries designed to compensate the US investors. Moving from agrarian expropriations, the Mexican government issued a decree in March 1938 expropriating British- and American-owned oil companies. Another round of diplomatic exchanges took place between the two countries during which Hull reiterated his position that the US recognised the right of Mexico to expropriate foreign assets for public purposes, but that such expropriation had to be 'coupled with and conditioned on the obligation to make adequate, effective and prompt compensation'.[37] He

[33] *Ibid*, and also (1938) 32 *AJIL*, Suppl 181–207.
[34] Mexican Minister of Foreign Affairs to US Ambassador, 3 August 1938, as cited in Lowenfeld, above n 32, 399.
[35] *Ibid*.
[36] *Ibid*, 400.
[37] Secretary Hull to Mexican Ambassador, *ibid*, 402.

concluded: 'The legality of an expropriation is in fact dependent upon the observance of this requirement.'[38] In the same agreement that was concluded to settle the agrarian claims, the two countries agreed to settle the petroleum claims by each appointing an expert to establish just compensation 'on the basis of common rules of justice and equity'."[39]

Thus, throughout its dealings with the US, the Mexican government maintained the position that as a sovereign state it had the right to expropriate the assets of foreign investors in pursuance of a social policy. Thus, foreign investors had no special rights and privileges when it came to awarding compensation and any compensation had to be determined by applying the national laws of Mexico and the principles of justice and equity rather than those international law standards as claimed by Hull. Although the US and Mexico settled the claims relating to both agrarian and petroleum expropriations, there was no agreement on the law applicable to such expropriations. The report of the two experts appointed to establish just compensation for the American owners of the nationalized petroleum properties in Mexico acknowledged that expropriation and the rights of states to expropriate under the laws of the nations concerned were a recognised feature of the sovereignty of all modern states.

## CONCLUSION

As seen in the preceding sections, by the end of the 1940s the basic conditions under which the assets of foreign companies could be expropriated became clearer in state practice. During this time, foreign investment law started to take a shape as a distinct body of law. The Hull formula, advocated by developed countries in general and the US in particular, became a powerful norm sidelining much of the tenets of the Calvo doctrine favoured by developing countries. At the same time it also became acceptable in international law, as championed by developing countries, that states had a right to expropriate foreign assets under narrowly defined conditions; however, expropriations had to be accompanied by prompt, adequate and effective compensation.

[38] *Ibid.*
[39] Exchange of Notes of 1941 between Mexico and the US, para 9: *ibid.*

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# International Efforts to Regulate Foreign Investment

## INTRODUCTION

This chapter aims to look at the efforts made under the auspices of the UN, the Bretton Woods Institutions and other economic organisations such as the Organization of Economic Change and Development (OECD) to regulate investment. Although a Draft Convention on the Treatment of Foreign Investors was mooted in 1929 under the aegis of the League of Nations, it was rejected when some countries objected to some of its provisions. Thus, most of the attempts at international regulation of foreign investment have only been made since the inception of the UN.

## THE HAVANA CHARTER OF 1948

With the establishment of the UN, a new world order, both economic and political, was envisaged. While the UN was seen primarily as a political body, the World Bank and the International Monetary Fund (IMF) were established as financial and monetary institutions, respectively. Part of this grand vision for a new world order was the establishment of an international organisation dealing with international trade. Accordingly, a UN Conference on Trade and Employment was held at Havana, Cuba, between 21 November 1947 and 24 March 1948. However, the draft Havana Charter submitted to the Conference contained no provision on the regulation of foreign investment. One of the reasons for this deliberate omission seems to have been the fear on the part of the US that 'investment provisions negotiated at a multilateral conference might express the lowest common denominator of protection to which any of the participants would be willing to agree'.[1] Nevertheless, when a chapter on economic development was added to the initial draft Charter proposed by the US, a number of provisions making reference to foreign investment were included. Articles 11 and 12 of the Havana Charter[2] included the following provisions on investment:

[1] C Wilcox, *A Charter for World Trade* (1949, repr 1972) 145–6, as cited in AF Lowenfeld, *International Economic Law* (Oxford University Press, 2002) 404.
[2] Interim Commission for the International Trade Organization, Final Act and Related Documents of the United Nations Conference on Trade and Employment, Havana, Cuba: E Conf 2/78 of April 1948.

Article 11
Means of Promoting Economic Development and Reconstruction

Progressive industrial and general economic development, as well as reconstruction, requires among other things adequate supplies of capital funds, materials, modern equipment and technology and technical and managerial skills. Accordingly, in order to stimulate and assist in the provision and exchange of these facilities:

. . .

(b) no Member shall take unreasonable or unjustifiable action within its territory injurious to the rights or interests of nationals of other Members in the enterprise, skills, capital, arts or technology which they have supplied.

Article 12
International Investment for Economic Development and Reconstruction

1. The Members recognize that:
(a) international investment, both public and private, can be of great value in promoting economic development and reconstruction, and consequent social progress;
(b) the international flow of capital will be stimulated to the extent that members afford nationals of other countries opportunities for investment and security for existing and future investments;
(c) without prejudice to existing international agreements to which Members are parties, a Member has the right:
  (i) to take any appropriate safeguards necessary to ensure that foreign investment is not used as a basis for interference in its internal affairs or national policies;
  (ii) to determine whether and to what extent and upon what terms it will allow future foreign investment;
  (iii) to prescribe and give effect on just terms to requirements as to the ownership of existing and future investments;
  (iv) to prescribe and give effect to other reasonable requirements with respect to existing and future investments ...

2. Members therefore undertake:

. . .
  (i) to provide reasonable opportunities for investments acceptable to them and adequate security for existing and future investments, and
  (ii) to give due regard to the desirability of avoiding discrimination as between foreign investments . . .

According to Lowenfeld, a provision requiring Member States to make just compensation for property taken into public ownership, subject to various exceptions, was dropped from the final version as adopted at Havana.[3] At the end, the Charter itself never came into effect due, inter alia, to the US decision to abandon it in 1950. The states participating in the Havana Conference had decided, through Chapter VII of the Charter, to establish an International Trade Organization (ITO) whose functions could have included making recommendations for and promoting bilateral and multilateral agreements on measures designed 'to assure just and equitable treatment for the enterprise, skills, capital, arts and technology brought from one Member country to another'.[4] However, the ITO never came into existence and the Charter remained a document of merely historical interest.

[3] Lowenfeld, above n 1, 405.
[4] Art 11(2)(a) of the Havana Charter.



An attempt was made in 1959 by major capital-exporting countries to adopt an international instrument on foreign investment known as the Abs–Shawcross Draft Convention on Investment Abroad to protect the interests of foreign investors. Described as the 'Charter' or 'Magna Carta' of private investors, this Draft Convention included stronger standards for protection for foreign investors, including a broader definition of expropriation and an investor–state investment dispute settlement mechanism. However, in the face of strong opposition from the capital-importing countries this Draft Convention was not adopted. Although most of its provisions found their way once again into the 1967 Draft Convention on the Protection of Foreign Property proposed by the OECD, this too was not adopted and remained as a draft.[5]

## THE UN DECLARATION ON PERMANENT SOVEREIGNTY OVER NATURAL RESOURCES

One of the fundamental principles of the UN Charter is the sovereign equality of states, and it was the establishment of the UN that acted as a catalyst for independence movements in the colonial territories of Asia, Africa, the Caribbean and the South Pacific. As states gained political independence, their main priority was to assert economic independence. Gaining economic independence was a tricky task as many of the newly independent states had inherited an economic situation whereby their natural resources were controlled or exploited by foreign companies under concessions or other agreements concluded by the former colonial administration. Therefore, newly independent states sought to rely on the doctrine of economic sovereignty to claim permanent sovereignty over their natural resources; the goal being that once permanent sovereignty of states over their natural resources (PSNR) was acknowledged, sovereign states would be able to negotiate their way out of the old agreements and concessions.

While the well-established principles such as the sanctity of contracts and *pacta sunt servanda* of the law of treaties required states to respect the sanctity of the existing agreements, an equally powerful doctrine of international law was evolving to allow states to take back the control of their natural resources. To this end, the doctrine of PSNR was invoked by relying on one of the most powerful doctrines of international law: the sovereignty of states. This was not an attempt to rewrite the law completely, but an attempt to give a new direction to foreign investment law on the basis of certain rules of public international law, including economic sovereignty and the right to self-determination of states. Indeed, without achieving economic sovereignty, states would not be fully sovereign. Although the states could also invoke the right to expropriate the assets of foreign companies, this right was limited in scope, technical in character and subject to a number of conditions; it would not have allowed states to achieve full economic sovereignty vis-à-vis their natural resources. Rather, the idea was to strengthen and expand, inter alia, not only the right to

[5] See G van Harten, *Investment Treaty Arbitration and Public Law* (Oxford University Press, 2007) 20–21.

expropriate the assets of foreign investment but also other rights of states flowing from the doctrine of sovereignty through the principle of PSNR.[6]

Thus, the attempt to articulate the notion that states had permanent sovereignty over their respective natural resources began within the UN at the behest of developing states. Again, it was the Latin American countries, such as Uruguay and Chile, that led the way in introducing the idea of PSNR onto the UN agenda. The first of such initiatives was a General Assembly resolution (Resolution 626 (VII) of 21 December 1952) that supported the concept of economic self-determination. The notion was developed further when a draft article adopted by the Third Committee of the General Assembly in 1955 on the right of self-determination as part of the Human Rights Covenants sought to articulate the principle of PSNR in the second paragraph in the following words:

> The peoples may, for their own ends, freely dispose of their natural wealth and resources without prejudice to any obligations arising out of international economic co-operation, based upon the principle of mutual benefit, and international law. In no case may a people be deprived of its own means of subsistence.

In 1958, the Commission on Permanent Sovereignty over Natural Resources was established to consider the question of PSNR. As a result of the work done in this Commission, as well in the Economic and Social Council, the General Assembly adopted a resolution (Resolution 1803 (XVII)) on 14 December 1962 on the Permanent Sovereignty of States over their Natural Resources. The resolution provides, inter alia, that

1. The right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their national development and of the well-being of the people of the State concerned;
2. The exploration, development and disposition of such resources, as well as the import of the foreign capital required for these purposes, should be in conformity with the rules and conditions which the peoples and nations freely consider to be necessary or desirable with regard to the authorization, restriction or prohibition of such activities;
3. In cases where authorization is granted, the capital imported and the earnings on that capital shall be governed by the terms thereof, by the national legislation in force, and by international law. The profits derived must be shared in the proportions freely agreed upon, in each case, between the investors and the recipient State, due care being taken to ensure that there is no impairment, for any reason, of that State's sovereignty over its natural wealth and resources;
4. Nationalization, expropriation or requisitioning shall be based on grounds or reasons of public utility, security, or the national interest which are recognized as overriding purely individual or private interests, both domestic and foreign. In such cases the owner shall be paid appropriate compensation, in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law. In any case where the question of compensation gives rise to a controversy, the national jurisdiction of the State taking such measures shall be exhausted. However, upon agreement by sovereign States and other parties concerned, settlement of dispute should be made through arbitration or international adjudication.

[6] MS Rajan, *Sovereignty over Natural Resources* (1978); N Schrijver, *Sovereignty over Natural Resources: Balancing Rights and Duties* (Cambridge University Press, 1997).



Thus, this resolution of the General Assembly sought to strike a balance between the interests of both the host and the home countries by incorporating in one single instrument the issues of vital concern for both groups of states. For instance, when outlining principles applicable to the nationalisation or expropriation of foreign investment, the resolution conforms neither fully to the Hull formula nor the Calvo doctrine; rather it contains elements of both of these approaches. While it seeks to limit the conditions under which nationalisation or expropriation can take place, it lists enough conditions to enable a country to embark upon nationalisation and expropriation when necessary. It speaks of appropriate compensation rather than prompt, adequate and effective compensation[7] and in accordance not only with the laws of the country concerned but also with international law.

Although the principle of PSNR represented an attempt to develop certain new rules in favour of the developing countries on the basis of the extant and evolving rules of international economic law, it was accepted by the international community without much opposition from any quarters. Indeed, the UN General Assembly resolution to this effect has been regarded as a successful compromise between developed and developing countries and a statement of the law that is acceptable to both sides.

Thus, this UN General Assembly resolution enunciating the PSNR principle became the first international instrument to gain near-universal support for the notion that sovereign states had the right to expropriate the assets of foreign companies under certain conditions, which included appropriate compensation. While the PSNR resolution met the aspirations of the developing countries, it also embraced part of the Hull formula preferred by the developed countries. Consequently, this resolution remains to date the most widely accepted international instrument on foreign investment law and represents an articulation of customary international law principles on the subject matter.[8]

## ATTEMPTS TO DEVELOP THE LAW THROUGH THE NEW INTERNATIONAL ECONOMIC ORDER

When the developing countries gained a numerical majority in the UN, they sought to use the UN system to introduce fundamental reforms to the laws governing international economic relations among states. Encouraged and influenced by the oil crisis of the early 1970s, and disappointed at the lack of progress in addressing the issues of economic equality and prosperity for all, the developing countries introduced the agenda of a new international economic order (NIEO) within the UN; one of the

[7] Nevertheless, the US made it clear that it understood 'appropriate compensation' as incorporating the 'international minimum standard' of the Hull formula. UN Doc A/C.2/SR.835, para 10. On the other end of the spectrum the following amendment to para 4 proposed by the USSR was defeated: 'The question of compensation to the owners shall in such cases be decided in accordance with the national law of the country taking these measures in the exercise of its sovereignty.' UN Doc A/C.2/L670.

[8] In the *Texaco v Libya Case* the arbitrator held that the 1803 resolution reflects the state of customary international law existing in this field. (1977) 53 *ILR* 389, para 87. See for similar views the *Aminoil Case (Kuwait v American Independent Oil Co)*: (1976) 21 *ILM*, paras 143, 144 and *Topco/Calasiatic* case, (1978) 17 *ILM* 3.

items on the agenda was the regulation of foreign investment in a manner more favourable to developing countries.[9] Many developing countries were concerned about the rise of corporate power and the latter's ability and willingness to intervene in the internal affairs of developing countries, both in the pursuit of profit and to further the political agenda of their home countries during the Cold War.

For example, the alleged involvement of a US multinational corporation in the overthrow of the elected Allende government in Chile and the installation of the military dictatorship led by Pinochet had alarmed many developing countries. Consequently, there was a desire to go one step forward from the PSNR resolution and strengthen the hands of developing countries by rewriting foreign investment law. Accordingly, the UN General Assembly adopted a Declaration on the Establishment of a New International Economic Order on 1 May 1974 through Resolution 3201 (S-VI) and a Programme of Action on the Implementation of the Declaration through Resolution 3202 (S-VI).[10]

Article 4 of the Declaration listed the principles on which the NIEO had to be founded, and one of these, included in sub-Article (e), relates to the question of PSNR and the issue of expropriation and nationalisation. It recognised 'Full permanent sovereignty of every State over its natural resources and all economic activities', and went on to add that

> In order to safeguard these resources, each State is entitled to exercise effective control over them and their exploitation with means suitable to its own situation, including the right to nationalization or transfer of ownership to its nationals, this right being an expression of the full permanent sovereignty of the State. No State may be subjected to economic, political or any other type of coercion to prevent the free and full exercise of this inalienable right.

The Declaration stressed the need to regulate and supervise the activities of transnational corporations (TNCs) by taking measures in the interest of the host countries. The Programme of Action adopted by the General Assembly for the Implementation of the NIEO Declaration called for the formulation of an 'international code of conduct for the transfer of technology corresponding to needs and conditions prevalent in developing countries'.[11] Article V of the Programme of Action went on to speak of regulation and control over the activities of TNCs in the following terms:

> All efforts should be made to formulate, adopt and implement an international code of conduct for transnational corporations:
> (a) To prevent interference in the internal affairs of the countries where they operate and their collaboration with racist regimes and colonial administrations;
> (b) To regulate their activities in host countries, to eliminate restrictive business practices and to conform to the national development plans and objectives of developing countries, and in this context facilitate, as necessary, the review and revision of previously concluded agreements;

[9] K Hossain (ed), *Legal Aspects of a New International Economic Order* (London, Frances Pinter, 1980); SR Chowdhury et al (eds), *The Right to Development in International Law* (Dordrecht, Martinus Nijhoff, 1992).
[10] See generally, K Hossain (ed), *Legal Aspects of the New International Economic Order* (1980); N Schrijver, *Sovereignty of Natural Resources: Balancing Rights and Duties* (Cambridge University Press, 1997).
[11] Art IV (a) of the General Assembly Resolution 3202 (S-VI) of 1 May 1974. The terms 'TNC' and 'MNE' are used interchangeably in this book. However, the term 'TNC' is used in the context of the work of the UN in this area and the term 'MNE' elsewhere.



> (c) To bring about assistance, transfer of technology and management skills to developing countries on equitable and favourable terms;
> (d) To regulate the repatriation of the profits accruing from their operations, taking into account the legitimate interests of all parties concerned;
> (e) To promote reinvestment of their profits in developing countries.

As part of the drive to restructure the legal order for the world economy, the Charter of Economic Rights and Duties of States was adopted by the General Assembly on 12 December 1974, ie about six months after the adoption of the NIEO.

## THE 1974 CHARTER OF ECONOMIC RIGHTS AND DUTIES OF STATES

The Charter of Economic Rights and Duties of States is perhaps the most comprehensive international instrument outlining the economic rights and duties of states. However, it is not a 'hard law' instrument, as it was adopted through a resolution[12] of the General Assembly whose powers are limited to making recommendations under the Charter of the UN. Moreover, it was adopted by a vote of 120 in favour, 6 against,[13] and 10 abstentions.[14] Thus, it is an instrument of limited legal significance.[15] Nevertheless, it was seen as an instrument with far-reaching implications by the vast majority of states who voted in favour of the resolution and has had a measure of influence in the development of international legal order since its adoption. Although adopted as part of the NIEO agenda, it has had an independent status and existence; its significance has not been diminished by the passing into history of the ideas that lay behind the NIEO itself.

With regard to foreign investment law, the relevant provision can be found in Article 2 of the Charter, which reads as follows:

> Article 2
>
> Every State has and shall freely exercise full permanent sovereignty, including possession, use and disposal, over all its wealth, natural resources and economic activities.
>
> Each State has the right:
> (a) To regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities. No State shall be compelled to grant preferential treatment to foreign investment;

[12] Resolution 3281 (XXIX) of 12 December 1974.
[13] Belgium, Denmark, the German Federal Republic, Luxembourg, the United Kingdom and the United States voted against the resolution.
[14] Austria, Canada, France, Ireland, Israel, Italy, Japan, the Netherlands, Norway and Spain abstained from voting on the resolution.
[15] See B Weston, 'The Charter of Economic Rights and Duties of States and Deprivation of Foreign-Owned Wealth' (1981) 75 *AJIL* 437; CN Brouwer and JB Tape, 'The Charter of Economic Rights and Duties of States: A Reflection in Rejection of International Law' (1973) 9 *International Lawyer* 295; RCA White, 'A New International Economic Order' (1975) 24 *ICLQ* 542; SK Chatterjee, 'The Charter of Economic Rights and Duties of States: An Evaluation of After 15 Years' (1991) 40 *ICLQ* 669–84.

(b) To regulate and supervise the activities of transnational corporations within its national jurisdiction and take measures to ensure that such activities comply with its laws, rules and regulations and conform with its economic and social policies. Transnational corporations shall not intervene in the internal affairs of a host State. Every State should, with full regard for its sovereign rights, co-operate with other States in the exercise of the right set forth in this sub-paragraph;

(c) To nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely and mutually agreed by all States concerned that other peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principle of free choice of means.

These provisions are a reflection of the provisions of the NIEO resolution. Of particular note is that the provision makes no reference to international law, which is a break with the past and especially with the more balanced provisions of Resolution 1803 of 1962 on PSNR. In particular, the Charter does not require that any regulation of foreign investment, nationalisation or expropriation be in accordance with international law;[16] nor does it impose any conditions under which expropriation or nationalisation can take place.

The Charter takes the situation to a certain extent back to the era of the Calvo doctrine and rejects some of the core elements of the Hull formula. The emphasis is on the application of national law rather than on international law on issues concerning foreign investment and expropriation or nationalisation. This was one reason why many developed countries did not support the Charter.

Nevertheless, the provisions in the Charter are not as radical as the assertions made by the Russians after the 1917 revolution or by the Mexicans during the agrarian expropriations in which even the requirement to provide compensation to foreign investors affected by expropriations and nationalization was contested. The Charter does require, as does the 1962 PSNR Declaration, payment of appropriate compensation, albeit in accordance with national law rather than international law, to foreign investors affected by expropriation and nationalisation. However, the Charter departed to a certain extent from the 1962 PSNR declaration with regard to the standard of treatment of foreign investors and especially the provisions relating to expropriation and compensation.

[16] In the *Texaco v Libya Case* the arbitrator was not prepared to accept that this provision of CERD reflected customary international law: 'Article 2 of this Charter must be analyzed as a political rather than as a legal declaration concerned with the ideological strategy of development, as such, supported only by non-industrialized States. . . . The absence of any connection between the procedure of compensation and international law and subjection of this procedure solely to municipal law cannot be regarded by this Tribunal except as a *de lege ferenda* formulation, which even appears *contra legem* in the eyes of many developed countries. Similarly, several developing countries, although having voted favourably, on the Charter of Economic Rights and Duties of States as a whole, in explaining their votes regretted the absence of any reference to international law.' 52 ILR 389 (1977), para 88



## THE UN DRAFT CODE OF CONDUCT FOR TRANSNATIONAL CORPORATIONS

The NIEO resolutions had called for the adoption of two codes of conduct—one on the transfer of technology and another on the regulation of TNCs. One of the achievements of the NIEO process was the establishment of the UN Commission on Transnational Corporations (CTC) in 1974 by the Economic and Social Council to consider proposals for the regulation of multinational enterprises.[17] The decision to establish the CTC was taken in the aftermath of the alleged involvement of a US TNC in the overthrow of the elected government in Chile with the tacit support of the US; high-profile corruption scandals such as the Lockheed affair; and a wave of nationalisation and expropriation in the developing world in the 1960s and 1970s. The activities of the CTC were linked to the efforts to realise the objectives of the NIEO.

Much of the debate throughout the 1970s and 1980s focused on the content of a code of conduct for TNCs and whether this code should be voluntary or mandatory.[18] When the CTC finally formulated a draft code of conduct for TNCs in 1988 it became clear that there remained so many areas of major disagreement among states that the CTC itself seemed resigned to the impossibility of adopting an internationally agreed code. Consequently, through a letter of 31 May 1990 to the President of the ECOSOC,[19] the Chairman of the reconvened special session of the CTC forwarded a draft code of conduct, stating that there remained areas of disagreement among states.[20] With regard to the treatment of TNCs, the UN draft code provided that

> States have the right to regulate the entry and establishment of transnational corporations including determining the role that such corporations may play in economic and social development and prohibiting or limiting the extent of their presence in specific sectors.[21]

The draft code went on to state that TNCs 'shall receive fair and equitable treatment in the countries in which they operate',[22] and that they should be entitled, with some exceptions designed to maintain public order and to protect national security and other legitimate interests, 'to treatment no less favourable than that accorded to domestic enterprises in similar circumstances'.[23] The provision of the Draft Code on expropriation and nationalisation reads as follows:

> It is acknowledged that States have the right to nationalize or expropriate the assets of a transnational corporation operating in their territories, and that adequate compensation is to be paid by the State concerned, in accordance with the applicable legal rules and principles.[24]

[17] ECOSOC Resolutions 1908 (LVII) of 2 August 1974 and 1913 (LVII) of 5 December 1974.
[18] See generally N Horn (ed), *Legal Problems of Codes of Conduct for Multinational Enterprises* (Deventer, Kluwer, 1980); S Dell, 'The United Nations Code of Conduct on Transnational Corporations', in J Kaufmann (ed), *Effective Negotiation: Case Studies in Conference Diplomacy* (Dordrecht, Kluwer, 1989) 53–74.
[19] UN Doc E/1990/94 of 12 June 1990.
[20] *Ibid*. See also UN Doc E/1988/39/Add.1.
[21] *Ibid*, para 48.
[22] *Ibid*, para 49.
[23] *Ibid*, para 50.
[24] *Ibid*, para 55.

With regard to the settlement of disputes, the Draft Code provided that they must be submitted to competent national courts or authorities.[25] Similarly, it went on to state that government action on behalf of a TNC operating in another country would be subject to the principle of exhaustion of local remedies provided in such a country.[26]

## AN APPRAISAL OF THE EFFORTS MADE IN THE UN

The involvement of the UN in the codification and progressive development of foreign investment law and its attempts to adopt a code of conduct on TNCs came to an unsuccessful end in the early 1990s without the adoption of a comprehensive treaty on foreign investment law or a mandatory code of conduct for TNCs. After failing to come up with an internationally agreed code of conduct, the CTC was disbanded in 1993, which signalled the end of UN efforts in this area. As demonstrated in the preceding paragraphs, the UN did achieve a great deal during the 1950s–1980s in declaring and developing the norms applicable to foreign investment and the treatment of foreign investors. Throughout much of the 1970s, and until the mid-1980s, the debate continued within the UN on the ways and means of implementing the principles of the NIEO. However, nothing much could be achieved without the support of the leading developed countries who had opposed the adoption of the NIEO resolution. Since the UN was unable to come up with a final or definitive word on foreign investment law, the stage was left open for other actors. In particular, the World Bank, the OECD and the World Trade Organization (WTO) have recently tried to assert themselves as leaders in developing foreign investment law.

It was mainly the developing countries that, in an effort to assert economic self-determination and full economic sovereignty, sought to rewrite the law on foreign investment under the auspices of the UN in the 1950s and early 1960s. Their efforts did result in the adoption of certain fundamental and internationally accepted principles of international economic relations such as the PSNR. However, when the developing countries wanted to go beyond the 1962 PSNR Declaration, the consensus was broken within the UN and the policies such as the NIEO were pursued within the UN mainly by developing countries. In the 1980s much of the developing world went through a period of economic difficulty due to the failures of their—generally socialist—economic policies, and began to reverse their traditional attitude towards foreign investment, which was now seen as a solution to their economic problems. By the mid-1980s the developing countries were competing with each other to attract foreign investment and offering unprecedented incentives to foreign investors rather than seeking tighter regulation of foreign investment.

In the face of such competition for foreign investment, the disintegration of Third World solidarity, the chaos in the Communist world that followed the collapse of Communism in Europe and the fall of the Berlin Wall, there was no longer the

[25] *Ibid*, para 57.
[26] *Ibid*, para 65.



appetite within the UN to push ahead with the adoption of an international instrument to regulate or control the activities of foreign investors. Thus, by the late 1980s the pendulum had begun to swing in the opposite direction, rendering the NIEO and the idea of regulation of foreign investment in favour of host countries redundant. Now the idea was to offer TNCs as many concessions as possible in order to attract foreign direct investment. Encouraged by these developments, the TNCs began to demand greater protection for their overseas investments since they were now undertaking large-scale investments in countries with unstable political situations and needed as much protection as possible.

Traditional foreign investment law, referred to by some critics as 'Western' international foreign investment law,[27] came to be accepted as global law by the end of the 20th century. The law, developed to protect capital and vigorously defended by Western governments, was embraced by almost all states. Leading developing countries with socialist tendencies such as India and Zambia reversed their policies, as did former socialist states such as China and Vietnam. The Andean countries, known for their collective rigid position on foreign investment policies, also reversed their position in 1994. Those states that had in the past gone down the road to expropriation and nationalisation of foreign investment now accepted such provisions through BITs concluded with investor countries and through other regional and international treaties. It was now extremely difficult for any state to resort to traditional methods of outright expropriation or nationalisation without opting out of the entire international economic legal order developed around the WTO and foreign investment law.

Similar to other political and economic upheavals, the disintegration of the Soviet Union and the emergence of the Commonwealth of Independent States (CIS) had the potential to pose challenges to foreign investment law; however, the triumphant Western countries intervened in such a way that they actually succeeded in securing much better protection for foreign investment from these countries than available hitherto under international law. The conclusion of the Energy Charter Treaty of 1994 is an example of such Western success.[28] After the collapse of the Soviet Union, most developing countries came to embrace the idea that foreign investment was a necessity for economic development, and good incentives, including legal protection, had to be offered to attract such investment. Thus, the 1990s can be seen as a rosy decade for TNCs as foreign investment law was adjusted or modified to suit their needs and aspirations.

[27] Eg, Huan Xiang, a former Chairman of the Chinese Society of International Law, stated the following: 'Principles and rules of international law since Hugo Grotius' time (in general) reflected the interests and demands of the bourgeoisie, the colonialists and in particular the imperialists. The big and strong powers have long been bullying the small and weak nations, sometimes even resorting to armed aggression. International law has often been used by the imperialists and hegemonists as a means to carry out aggression, oppression and exploitation and to further their reactionary foreign policies. Apologies for aggression and oppression can often be found in the writings on international law.' H Xiang, 'Strive to Build up New China's Science of International Law', in *Selected Articles from the Chinese Yearbook of International Law* (Beijing, 1983) 3, as cited in K Qingjiang, 'Bilateral Investment Treaties: The Chinese Approach and Practice' (2003) 8 *Asian Yearbook of International Law* 108
[28] TW Waelde, 'International Investment under the 1994 Energy Charter Treaty' (1995) 29(5) *Journal of World Trade* 5–72.

## THE ROLE OF THE WORLD BANK

The World Bank, formally known as the International Bank for Reconstruction and Development, has had a long-standing interest in promoting foreign investment for economic development and has associated itself with a number of initiatives in this area.[29] Among them is the Convention for the Settlement of Investment Disputes of 1965, the Convention Establishing the Multilateral Investment Guarantee Agency of 1985 and the 1992 Guidelines on the Treatment of Foreign Direct Investment. It is proposed to examine each of them as follows.

## ICSID

Foreign investors wish to have legal certainty when making investment decisions. One of those certainties is to have a credible mechanism for the settlement of investment disputes. The perceived wisdom is that if foreign private investors are assured that in the event of a dispute between them and the state in question the dispute can be referred to an independent international tribunal, they will view that state as a relatively safe place for investment. Foreign investors would generally be unwilling to invest in countries where the judiciary is not fully independent and the political situation is unstable. However, if the state in question has agreed through an international agreement to settle an investment dispute with potential foreign investors, such investors would be encouraged to invest in such states. Accordingly, with a view to establishing an international centre for the settlement of investment disputes and to encourage states to refer investment disputes with foreign private investors to an international arbitration tribunal, the International Convention on the Settlement of Investment Disputes between States and Nationals of other States (ICSID)[30] was concluded in 1965.

The idea of creating such a vehicle for settling investment disputes between private investors and host states was mooted in 1961 by Aaron Broches, then the General Counsel of the World Bank. This was an attempt to advance a more general debate initiated by the OECD in the late 1950s to promote and protect foreign investment.[31] Under ICSID, the Bank is the host of the International Centre for the Settlement of Investment Disputes, which is similar in many respects to other international arbitration centres. The very idea of submitting investment disputes to the Centre ran counter to the ideas behind the Calvo doctrine, and the NIEO, yet no state was obliged to become a party to the Convention or to submit any particular dispute to

[29] IFI Shihata, *The World Bank in a Changing World: Selected Essays* (Dordrecht, Martinus Nijhoff, 1991).

[30] For a detailed commentary on the ICSID Convention, see CH Schreuer, *The ICSID Convention: A Commentary* (Cambridge University Press, 2001).

[31] This initiative of the OECD resulted in the preparation of a Draft Convention on the Protection of Foreign Property in 1962. However, this Draft Convention did not go much further because of differences of opinion as to the level or standard of compensation payable upon nationalisation or expropriation of foreign investments. See E Lauterpacht, 'Foreword' to Schreuer, *The ICSID Convention*, above n 30, xi.



the Centre or to any conciliation or arbitration body. What the Convention is designed to do is offer yet another platform for the settlement of investment disputes between a state party to the Convention and private foreign investors, should they wish to avail themselves of this opportunity.

Although an agreement to refer investment disputes to the Centre could be perceived as demonstrating a lack of confidence in the judiciary of the country concerned, the idea behind the Convention is to build confidence in private foreign investors and to provide a credible dispute settlement mechanism for such investors. Of course, states are free to agree to submit investment disputes to international commercial arbitration or other arbitration or conciliation centres, but by becoming a party to the Convention states would, as the perceived wisdom goes, stand a better chance of attracting foreign investment from those investors wary of losing their investment through expropriation, nationalisation or other government actions. Thus, ratification of ICSID would serve as some sort of insurance or an assurance to potential investors that they would always have recourse to this independent dispute settlement mechanism should the government of a state undermine the property rights of the foreign investors. Under Article 25 (1) the jurisdiction of the Centre would be as follows:

> The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.

According to Article 26, consent of the parties to arbitration under ICSID would normally be deemed consent to such arbitration as the sole remedy. Similarly, once a dispute is submitted to the ICSID Centre, diplomatic protection by a contracting state would also be ruled out. The provision in Article 42(1) is perhaps one of the most important ones because this Article stipulates the law applicable to a dispute submitted to the arbitration tribunal of the ICSID Centre:

> The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.

Thus, at a time when a vast majority of developing states were asserting within the UN that any dispute arising out of expropriation or nationalisation should be resolved by applying the national laws of the states concerned and by resorting to the local remedies provided for in the national laws and constitutions of the host states, it was quite a major departure from that position to agree to the provisions of ICSID just outlined. The adoption of ICSID under the auspices of the World Bank signalled that developments relating to foreign investment law could also take place outside of the UN framework.

## A 'SILENT REVOLUTION' IN INTERNATIONAL LAW?

The idea of allowing private companies, not subject to international law, direct access to an international dispute settlement mechanism created under ICSID was an innovative development in international law. It can be compared with the idea of individual petitions against human rights violations developed in the 1960s under the Optional Protocol to the International Covenant on Civil and Political Rights. Although host states can offer foreign investors the opportunity to take investment disputes to international tribunals under a domestic legislation, and some countries have done this, it is not common for national legislation to do so.

The investor–state dispute settlement mechanism of ICSID[32] became a catalyst for the conclusion of a large number of BITs. It heralded a new era of investment dispute settlement and was a sort of silent revolution in international foreign investment law. This momentum received further impetus when the Iran–US Claims Tribunal was established in the early 1980s to entertain cases submitted by US nationals, companies and businesses adversely affected by the Islamic revolution in Iran in the late 1970s. Following the massive political and economic changes that took place towards the end of the 1980s and the early 1990s, and the subsequent expansion of globalisation in the market place, new standards and values in international relations came to occupy centre stage in the conduct of international economic relations. Consequently, old values and dogmas gave way to new ones, and even countries traditionally opposed to the idea of allowing private companies direct access to international dispute settlement mechanisms, such as Argentina and Mexico, concluded BITs or joined RTAs providing for such access.

Prominent among the bundle of protections granted to foreign investors by host states is the provision for investor–state dispute settlement mechanisms through an independent international arbitration, whether it is under ICSID, the ICSID Additional Facility, the UNCITRAL Arbitration Rules or other comparable arrangements. As stated by an ICSID tribunal in the *Gas Natural SDG v the Argentine Republic*, such a provision

> offered to foreign investors assurances that disputes that might flow from their investments would not be subject to the perceived hazards of delays and political pressures of adjudication in national courts. Correspondingly, the prospect of international arbitration was designed to offer to host States freedom from political pressures by governments of the state of which the investor is a national.[33]

The ICSID tribunal went on to highlight the significance of international arbitration in the following words: 'We remain persuaded that assurance of independent international arbitration is an important—perhaps the most important—element in investor protection.'[34]

The silent revolution in foreign investment law that took place during the 1960s by way of ICSID and other BITs seems to have gained new momentum in the late 1990s and the early 2000s as foreign investors have made the most of the revolution with

[32] See Schreuer, above n 30.
[33] *Gas Natural SDG v the Argentine Republic*, ICSID Case No ARB/03/10 of 17 June 2005, para 29.
[34] *Ibid*, para 49.



the help of sophisticated lawyers, legal loopholes and lacunae in the BITs negotiated often under pressure from IMF and the World Bank; messy privatisation programmes managed by often incompetent and corrupt political leaders and government officials; unsound and faulty commercial contracts concluded by governments often under the influence of corrupt officials; innovative interpretations of BIT provisions by arbitrators mostly in favour of foreign investors and the demands placed on them by the globalisation of market forces. The silent revolution seems to be in full swing for the benefit of the foreign investor often at the expense of the host states and other societal values.

It is worth noting that when calling upon all Latin American countries to denounce ICSID, Bolivian President Evo Morales was reported to have said that '[We] emphatically reject the legal, media and diplomatic pressure of some multinationals that . . . resist the sovereign rulings of countries, making threats and initiating suits in international arbitration.'[35] This suggests that there is a growing unease with the manner in which this silent revolution is delivering results.

## MIGA

In addition to legal certainty, potential foreign investors wish to have some sort of additional guarantee of their investment when they invest in countries with a poor legal and physical infrastructure. Although many developed countries have their own internal system of investment guarantee for those investing in developing countries, and investment risks can also be covered through private insurance, it was thought desirable to have an international system of investment guarantee against non-commercial risks, such as expropriation, nationalisation and other political risks, in order to promote foreign investment in general and private foreign investment in particular in developing countries. Although protection under BITs, international law principles relating to the treatment of foreign investment, and diplomatic channels were available to foreign investors, it was considered desirable to have an additional mechanism designed to alleviate concerns related to non-commercial risks in order to promote the flow of foreign investment to developing countries. Therefore, as a measure complementary to already existing national and regional investment guarantee programs[36] and private insurers of non-commercial risks and supplementary to the activities of the World Bank Group, the Convention Establishing the Multilateral Investment Guarantee Agency (MIGA)[37] was adopted in 1985. Article 2 of the Convention outlines the objectives and purposes of the Agency in the following terms:

[35] As cited in the *Investment Treaty News*, 9 May 2007 (www.iisd.org/investment/itn), quoting a report published in the *Washington Post*.
[36] Many developed countries have their own agencies to provide insurance coverage to their nationals who wish to invest abroad. For a list of such schemes, see A Akinsanya, 'International Protection of Direct Foreign Investment in the Third World' (1987) 36 *ICLQ* 67.
[37] Secretary-General, International Centre for Settlement of Investment Disputes, *MIGA and Foreign Investment: Origins, Operations, Policies and Basic Documents of the Multilateral Investment Guarantee Agency* (Dordrecht, Martinus Nijhoff, 1988).