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BILATERAL TREATIES AND MULTILATERAL INSTRUMENTS ON INVESTMENT PROTECTION

by

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TABLE OF CONTENTS

Chapter I. Private foreign investments in the present international economic system: financial flows, economic function and legal regulation . 261

1. International private investments: recent trends and policy changes . 261
2. Economic data as to the evolution in foreign investment flows and patterns 265
   (a) The surge of private investments to developing countries 267
   (b) FDI and portfolio investments to developing countries 270
   (c) Private investment flows distribution among developing countries 272
3. The role of multinational companies and of small and medium enterprises in FDI 275
4. Economic evolution and legal status of foreign investment in an historical perspective 278
5. The globalization of the world economy and the new investment climate of the 1990s 282
6. Trade and foreign direct investment 284
7. The legal status of foreign investment in industrialized countries . . 288
8. The uncertainty of international standards for foreign investments in developing countries and the role of BITs 290
9. The negotiations at OECD of a Multilateral Agreement on Investment (MAI) (1995-1998) 292

Chapter II. The concept of foreign investment and the definition of the investor in recent BITs 298

1. The ever-growing network of BITs 298
2. The scope of application of BITs 302
3. Territorial coverage and duration 303
4. The definition of "investments" 305
5. Foreign-owned or controlled companies as protected investments . . 310
6. Nationality requirements as to the investor 315
7. Indirect investments 319

Chapter III. Market access by foreign investors 321

1. The admission of foreign investments: international law and States' policies 321
   (a) General international law 321
   (b) Policies and multilateral undertakings of industrialized countries 322
   (c) The evolution of the former centrally planned economies 325
   (d) The change in policies by developing countries 325
2. Admission of foreign investments in BITs: recent evolution 327
3. Regional and multilateral regulation of market access by foreign investors 331

Chapter IV. The standards of treatment of foreign investments: BITs and multilateral instruments 339

1. Standards of treatment of foreign investments in general 339
2. Standards of treatment in recent multilateral instruments 343

3. General standards of treatment in BITs: fair and equitable, full protection, international, national, most-favoured-nation treatment . . . 345
4. Exceptions and limitations . . . 350
(a) Regional integration . . . 350
(b) Taxation . . . 353
(c) Conclusions as to general treatment . . . 354
5. Specific rights granted to foreign investors in recent BITs . . . 355
(a) Entry and employment of personnel . . . 356
(b) Monetary transfers . . . 358
6. Preferential treatment, incentives and performance requirements . . . 363
7. Host and home countries' competence in the regulation of foreign investments . . . 368
(a) Legal régime applicable in the host State . . . 369
(b) Conflicts between home and host States . . . 371

Chapter V. Expropriation and compensation . . . 379

1. Expropriation and nationalization in international law . . . 379
2. Public purpose and non-discrimination . . . 386
3. The issue of compensation . . . 389
4. The standards of compensation and methods of evaluation of expropriated property in recent multilateral agreements and BITs . . . 394
5. "Prompt" and "effective" compensation . . . 401
6. Compensation for other damages in BITs . . . 405
7. Recognition of subrogation . . . 408

Chapter VI. The settlement of foreign investment disputes . . . 412

1. Introduction . . . 412
2. Recourse to international commercial arbitration . . . 415
3. ICSID arbitration . . . 418
4. Bilateral and multilateral investment dispute settlement mechanisms . . . 420
(a) The Iran-United States Claims Tribunal . . . 421
(b) The North American Free Trade Agreement (NAFTA) . . . 423
(c) The Energy Charter Treaty . . . 426
(d) The Mercosur Protocols . . . 426
5. Interstate dispute settlement in BITs . . . 428
(a) The appointment of arbitrators . . . 429
(b) The procedural rules . . . 431
(c) The law applicable to the merits . . . 432
(d) The time factor . . . 433
(e) The apportionment of costs . . . 434
(f) The relation between interstate and host State-foreign investor arbitration . . . 435
6. Host State-foreign investor dispute settlement in BITs: standard patterns and differences . . . 436
(a) Eligible disputes . . . 441
(b) The time factor . . . 442
(c) Consent of the contracting parties . . . 443
(d) Applicable law . . . 444
(e) Procedural applicable rules . . . 445
(f) Recognition and enforcement of awards . . . 448
(g) Effect of indemnity under investment insurance . . . 449

(h) Exercise of diplomatic protection 450
(i) Consent under Article 25 (2) *(b)* of the ICSID Convention . . . 450
7. Conclusions 452

Bibliography 455

BIOGRAPHICAL NOTE

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Italian Delegate at the OECD Working Group on Bribery in International Business Transactions since its establishment in 1989; Chairman of its Group of Experts on Criminalization (1996-1997).

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CHAPTER I

PRIVATE FOREIGN INVESTMENTS IN THE PRESENT INTERNATIONAL ECONOMIC SYSTEM : FINANCIAL FLOWS, ECONOMIC FUNCTION AND LEGAL REGULATION

Summary : 1. International private investments : recent trends and policy changes. 2. Economic data as to the evolution in foreign investment flows and patterns : (a) *The surge of private investments to developing countries ;* (b) *FDI and portfolio investments to developing countries ;* (c) *Private investment flows distribution among developing countries. 3. The role of multinational companies and of small and medium enterprises in FDI. 4. Economic evolution and legal status of foreign investment in an historical perspective. 5. The globalization of world economy and the new investment climate of the 1990s. 6. Trade and foreign direct investment. 7. The legal status of foreign investment in industrialized countries. 8. The uncertainty of international standards for foreign investments in developing countries and the role of BITs. 9. The negotiations at OECD of a Multilateral Agreement on Investment (1995-1998).*

1. International Private Investments : Recent Trends and Policy Changes

The subject matter of this course is the examination and assessment of developments in bilateral treaties and of recent initiatives as to multilateral instruments dealing with the promotion and protection of international investments.

The focus on the *recent* evolution of law and practice in this area is fully justified in view of the changes which have affected lately this basic feature of international economic intercourse. First of all there has been a tremendous revival in the flow of private investment to developing countries. Not only the total flow has increased markedly, but its pattern has changed both as to countries involved, economic sectors concerned and modalities of investment. The attitude towards such investments by developed and developing States, by home and host States alike, has also changed. A more favourable approach has emerged, on an almost universal basis, towards the

fundamental role of the private sector of the economy. The disappearance of the communist bloc of States and of its leading country, the Soviet Union, followed by the transition of these countries from a centrally planned system of economy to a market system has been a relevant element in this dramatic evolution.

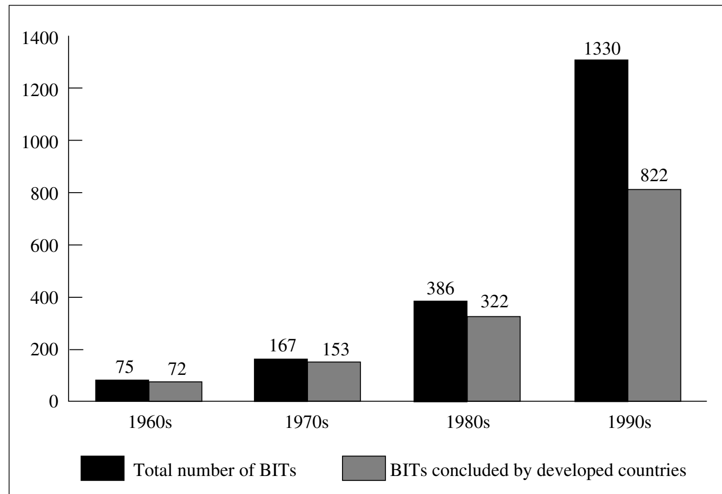
Add to this the successful conclusion of the Uruguay Round of GATT in 1993-1994, its transformation into the World Trade Organization (WTO), a fully fledged organization governing trade (but also related aspects of movement of persons and investments in the service sector), and the almost universal participation of States in it (China and Russia having applied for membership) [1]. A global economic order is emerging based on the market and on the progressive opening of most sectors of the domestic economy to international competition.

These developments have not yet brought about common multilaterally agreed rules on the treatment of foreign private investors. The end of the historical conflict as to their role and as to the treatment which should properly be accorded to them, both from an economic and a political point of view, seems however to be paving the road to the laying down of such rules on a universal basis. Principles and rules on freedom of investment and on non-discriminatory treatment have been laid down by regional organizations of industrialized market economy countries, such as the European Community and the OECD. They have been adopted in groupings made of both developed and developing countries, under the Fourth Lomé Convention and within NAFTA, and between developing countries (Andean Pact, Mercosur) [2].

Other recent developments include the 1992 initiative of the World Bank to "codify" principles in this area, and the rules on investments connected with trade of some of the WTO Agreements [3]. The General Agreement of Trade in Services (GATS) governs also direct investments by foreign service companies. The establishment of a commercial presence in a Member by a service provider of

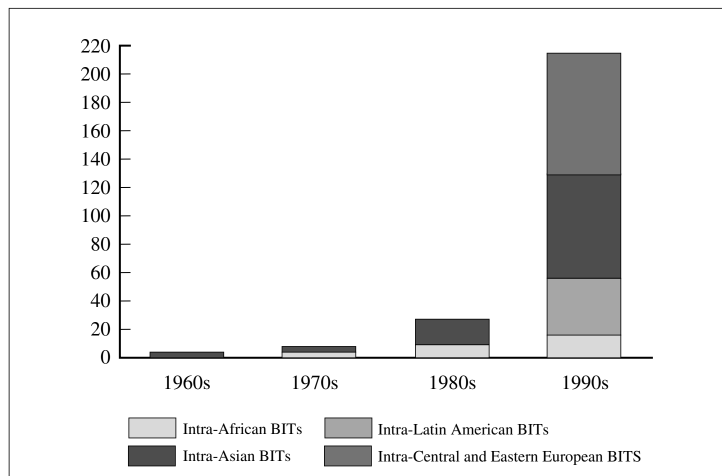
1. See generally P. Sauvé, "A First Look at Investment in the Final Act of the Uruguay Round", *J. World Trade*, 1994, 5, 5 *et seq*.
2. On the other hand Article 12 of the European Union-Mercosur Co-operation Agreement of 1995 dealing with investments is limited to the undertaking of promoting a favourable investment climate and of supporting the conclusion of bilateral investments protection treaties.
3. World Bank, *Legal Framework for the Treatment of Foreign Investment,* 1992, Vol. II, "Guidelines".

TABLE 1
Growth of BITs, 1959-1996
(Cumulative)



Source: United Nations, *World Development Report,* 1997 (UNCTAD, BITs database).

TABLE 2
Growth of Intra-Regional BITs in Developing Countries and Economies in Transition, 1960s through 1990s[a]
(Cumulative Number)



Source: United Nations, *World Development Report,* 1997 (UNCTAD, BITs database).
[a] Up to 1996.

another Member, is a covered mode of delivering a service when the host country has undertaken specific commitments in respect of this mode as to a given activity. The Agreement on Trade Related Investment Measures (TRIMS) is also part of the "single package" undertaking of the Uruguay Round. It binds all Members of the WTO not to maintain certain trade distorsive incentives or conditions as to the admission and carrying out of foreign investments. Based on the GATS framework the WTO achieved a landmark agreement on the liberalization of financial services in December 1997 providing for market-opening offers from 70 countries. Direct investment by means of commercial presence is an important element of this result, notably as to the right of foreign banks to obtain licences [4].

The Energy Charter Treaty, adopted in Lisbon on 17 December 1994 by the European Energy Charter Conference to which 50 States including major non-European countries and the European Communities participated, features a detailed chapter on investment promotion and protection. This is the first instance of a non-regional agreement (designed to promote East-West co-operation in the field) laying down multilateral rules on foreign investments [5].

Together with the current OECD initiative for a Multilateral Agreement on Investment (MAI), all these developments indicate a favourable outlook for the establishment of multilateral rules and the acceptance of liberalization commitments in the field of investments.

For the time being however, *ad hoc* bilateral investment treaties remain the principal instrument for agreeing on a bilateral basis specific rules for the legal protection of foreign investments [6]. The number of BITs has increased impressively, starting from the early 1980s, to reach well over 1,000 treaties [7]. More and more of such treaties are being currently negotiated, involving most of the countries of the world. They have thus become a standard feature of the framework of international economic relations, especially between

4. See WTO *Focus*, December 1997, for a general presentation.
5. For the text see 34 *ILM* 1995, 373 *et seq.* For comments see T. W. Waelde, (ed.), *The Energy Charter Treaty*, 1996, especially those at 251 *et seq.* ("The Investment Regime").
6. See B. Kishoiyian, "The Utility of Bilateral Investment Treaties in the Formulation of Customary International Law", *Northwestern J. Int. L. & Business*, 1994, 327 *et seq.*
7. See Tables 1 and 2 (source: United Nations, *World Investment Report*, 1997, 19) numbering 1,330 BITs at the end of 1996.

countries at different stages of development, but the number of BITs between developing countries has also increased.

BITs deal primarily with the treatment of foreign investments even if they may include obligations as to access, at the most in the form of stand-still commitments. Multilateral agreements on the other hand, regional, sectorial, or horizontal (as the MAI), have as their primary purpose liberalization of market access or entry, by means of an initial or periodic negotiation of reciprocal "concessions".

Although these agreements include also treatment obligations modelled after the typical BITs' relevant clauses thus binding the advantages mutually granted by the Parties, the difference in approach is substantial. Multilateral agreements tend to follow a trade model as they are the outcome of negotiations patterned after those of the multilateral GATT rounds. They include accordingly features which are alien to the BITs model such as: the positive or negative list approach followed to identify the scope of the liberalization and treatment obligations; providing for an ongoing process of further negotiations, multilateral surveillance and multilateral dispute settlement mechanisms; the presence of safeguard clauses allowing the taking back of binding offers subject to the granting of compensations.

2. Economic Data as to the Recent Evolution in Foreign Investment Flows and Patterns

In parallel the world has witnessed an impressive growth in the flow of private investments from one country to another in the 1990s. The boom that began in 1995 continued in 1996, with inflows setting a new record of around $350 billion, a 10 per cent increase over 1995. The total stock increased fourfold between 1982 and 1994; in 1996 the global FDI stock was valued at $3.2 trillion. Its rate of growth over the decade 1986-1995 was more than twice that of the gross fixed capital formation, indicating an increasing internationalization of domestic production systems. With an estimated $7 trillion in global sales in 1995 — the value of the goods produced by some 280,000 foreign affiliates — international production outweighs exports as the dominant mode of servicing foreign markets. Investments from abroad have diversified both as to type, sectors and countries involved. These changes have in particular affected the

role of developing countries as recipients of private foreign investments [8].

It is therefore appropriate to have a short look at relevant data as to the size and evolution of foreign private investments, with special attention to the situation of the developing world [9]. Statistics distinguish between various types of private capital invested abroad: foreign direct investment (FDI) and portfolio investment. FDI is made of medium- and long-term investment made by businessmen and companies in newly established ("greenfield investment") or existing enterprises based abroad in order to establish lasting economic ties. Portfolio investments, predominantly short term, are made for financial purposes: they include the subscribing and buying of equities, bonds and debentures of foreign private or public debtors issued in

TABLE 3

Net Long-Term Resource Flows to Developing Countries, 1990-1997

(Billions of US dollars)

Type of flow	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997* [a]
All developing countries	98.3	116.3	143.9	208.1	206.2	243.1	281.6	300.3
Official development finance	56.4	62.7	53.8	53.6	45.5	54.0	34.7	44.2
Grants	29.2	35.1	30.5	28.4	32.7	32.6	29.2	25.1
Loans	27.2	27.6	23.3	25.1	12.9	21.4	5.4	19.2
Bilateral	11.6	13.3	11.1	10.0	2.5	10.0	–7.2	1.8
Multilateral	15.6	14.4	12.2	15.2	10.4	11.3	12.6	17.4
Total private flows	41.9	53.6	90.1	154.6	160.6	189.1	246.9	256.0
Debt flows	15.0	13.5	33.8	44.0	41.1	55.1	82.2	103.2
Commercial bank loans	3.8	3.4	13.1	2.8	8.9	29.3	34.2	41.1
Bonds	0.1	7.4	8.3	31.8	27.5	23.8	45.7	53.8
Other	11.1	2.7	12.4	9.4	4.7	2.0	2.3	8.3
Foreign direct investment	23.7	32.9	45.3	65.6	86.9	101.5	119.0	120.4
Portfolio equity flows	3.2	7.2	11.0	45.0	32.6	32.5	45.8	32.5

Note: Developing countries are defined as low- and middle-income countries with 1995 per capita incomes of less than $765 (low) and $9,385 (middle).

[a] Preliminary.

Source: World Bank, *Global Development Finance*, 1998.

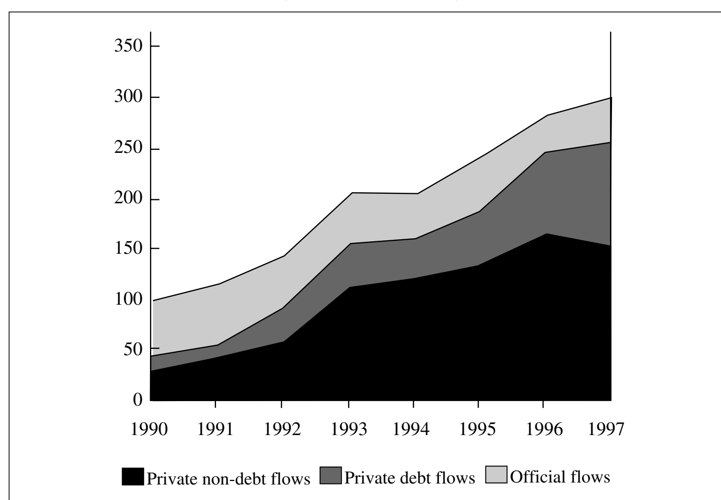
8. See generally S. Ostry, *Governments and Corporations in a Shrinking World*, Council of Foreign Relations, 1990; E. M. Graham and P. R. Drugman, "The Surge of Foreign Direct Investment in the 1980s", Froot (ed.), *Foreign Direct Investment*, 1993.

9. Except if otherwise indicated data and summing up concerning the period until the early 1990s are derived from the following sources: World Bank, *Global Economic Perspectives and the Developing Countries*, 1995; World Bank, *World Debt Tables. External Finance for the Developing Countries,* Vol. 1, 1994-1995; IMF, *Private Market Financing for Developing Countries*, 1995. Current data and evaluation (1995-1996) are taken from United Nations, *World Development Report*, 1997; World Bank, *Global Development Finance*, 1997 and 1998. For country by country breakdowns of in- and outflows see also OECD, *International Direct Investment Statistics Yearbook*, 1997.

TABLE 4

Private and Official Flows to Developing Countries, 1990-1997

(Billions of US dollars)



Source: World Bank data.

their countries or on international capital markets by individual or institutional foreign investors [10].

A preliminary *caveat* is necessary in this respect. Statistics of different sources are not always fully reconcilable while legal definitions, discussed in Chapter II, may not be identical to classifications used for statistical purposes. Moreover a significant portion of investments (10 per cent of the European Community FDI flows in 1992) are directed to offshore financial centres, from which they are redirected to various countries, making breakdowns according to countries of destination somehow uncertain.

(a) *The surge of private investments to developing countries*

Net long-term flows from private sources to developing countries were estimated at $256 billion for 1997, up slightly from $247 billion in 1996 (Table 3). Net FDI flows to these countries reached $120 billion in 1997, five times their level in 1990, but not much higher than 1996. Since 1990 an improved regulatory environment

10. For the legal aspects of this distinction see Chapter II, section 3.

and increased confidence by international investors (recurrent crisis notwithstanding) have helped many countries to gain greater access to international capital markets (Tables 3 and 4) [11].

Private flows account for more than three-quarters of all long-term flows to developing countries, 45 per cent of which took the form of FDI. This is also due to the fact that official development finance has recently declined to under $50 billion per year, 80 per cent of which is represented by aid flows (official grants and concessional loans) to low income, mostly severely indebted countries, which are as a rule unable to attract FDI (Table 4).

In comparison the yearly flow of FDI to developing countries averaged less than $10 billion per year in the 1970s and had declined to less than $20 billion per year in the mid 1980s after an upsurge at the beginning of the decade.

On average, flows more than doubled in nominal value between the periods 1987-1989 and 1990-1993. In real terms, net FDI flows to developing countries in the early 1990s were almost two and a half times their average level in the 1980s [12]. On the other hand, developing countries have generated substantial outflows in recent years, with the largest share coming from Brazil, Chile, China and Thailand, to reach a total of about $8 billion in 1995. Motivating these flows has been the search for a supply of key raw materials and for lower labour costs in less developed countries as domestic industries in those countries become more capital intensive [13].

Developing countries' share of global FDI flows rose in 1993 to 37 per cent, from 29 per cent in 1992 [14]. During 1995-1996 their share in global inflows was 34 per cent [15]. This indicates that while the share of developing countries in the total FDI is increasing markedly (the percentage was around 15 per cent in the years 1986-1990),

11. Declining returns in stock and bond markets in industrial countries also helped the growth of emerging markets. Equity flows accounted for 40 per cent of these investments in 1995. Figures for total portfolio investment flows refer to gross capital raised by developing countries through international bonds, certificates of deposit, and commercial paper issues. Portfolio equity refers to gross funds raised through international equity issues and net foreign investment in local equity markets.

12. Reinvested earnings are included in these data; they account for a large proportion of FDI capital flows, but since they do not appear in exchange statistics their reporting is uneven.

13. See World Bank, *Global Development Financing*, 1997, 30.

14. Developing countries' share in world exports also rose, from 25 per cent to 28 per cent of the total between 1985 and 1992.

15. See *World Development Report*, 1997, XVI.

most international investments, which come from private sources, flow among the industrialized countries.

Indeed, one-half of Japanese FDI has been directed to the United States market in 1992; the share of European Community private direct investment to third countries directed to the United States has varied between one-third and two-thirds of its total between 1986 and 1992. The United States, which is the largest source of FDI in the world, has become, from the 1980s on, also the major recipient. As a result its FDI flow balance was on the average negative in that decade. In 1996 inflows and outflows totalled about $85 billion each for the United States. Around two-thirds of the United States outflows go to the European Union and 30 per cent to developing countries.

As a result more attention has been given in the United States to inward investment issues. While for many years the United States has played a leadership role in promoting liberal, non-discriminatory treatment of foreign investors around the world and has kept an open and non-discriminatory investment régime in most areas of economic activity, the United States Government has become more concerned with promoting equal competitive opportunities for United States firms abroad through recourse to reciprocity and the negotiations of BITs.

Germany, France and the Netherlands were the largest recipients of FDI within the European Union in 1992[16]. These countries, together with Italy, totalled three-quarters of all FDI flows from the European Community to the rest of the world[17].

There has been also a certain "regionalization" of FDI flows in recent years, not restricted to economic integration areas in existence or in progress. It has been pointed out that the European Community has become the first source of foreign private investment for Central and East European countries; the United States is the largest investor in the American hemisphere, while Japanese investments exceed both European and United States investments in the Far East. The largest source of investments to low and middle income East Asian

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16. See EC, *European Union Direct Investment from 1984 to 1992*, 1994; cf. also OECD, *International Direct Investment, Policies and Trends in the 1980s*, OECD, 1992.

17. Five countries — the United Kingdom, Japan, the Netherlands, Canada and Germany — together accounted for 76.6 per cent of total FDI stocks in the United States in 1992.

countries from 1986 to 1992 (totalling almost half of the total FDI to those countries) were however not industrialized countries, but newly industrializing economies of the region (Taiwan, Korea and Hong Kong), which are usually included among the developing countries [18].

A certain decline of total private capital flows to the developing world was expected in 1998 as effect of the deterioration in confidence resulting from the East Asian crisis. Medium-term prospects for FDI were on the other hand considered to be favourable, as growth in developing countries was projected to be strong (at almost twice the rate in high-income economies), world trade buoyant, the liberalization of investment rules and the privatization process continued. The continuous increase in the share of non-debt-creating finance in total inflows should further provide a more favourable sharing of risk between recipients and investors than in the past, reducing the likelihood of renewed debt crisis of the type of those of the 1980s.

FDI flows should continue to rise with the further globalization of corporate production and distribution strategies induced by trade liberalization, technological change and deeper reforms in an increasing number of host countries. Thus OECD has estimated that at least 40 per cent of world trade is made of intragroup commerce. Privatizations have also relied on, and attracted, foreign investors: it was estimated that in 1997 foreigners had invested about $15 billion in the sell-offs (privatization) of State enterprises both as FDI and as portfolio investment [19].

(b) *FDI and portfolio investments to developing countries*

Foreign portfolio investment in the developing economies has been one of the most significant developments in the 1990s, increasing from negligible levels during the 1980s. This was prompted by the globalization of the capital markets, the emergence of local equity markets (stock exchanges) in the newly industrializing econo-

18. See World Bank, *East Asia's Trade and Investment*, 1994, 41 *et seq.*; IMF, *Capital Flows in the APEC Region*, 1995; P. Petri, "The Regional Clustering of Foreign Direct Investment and Trade", *Transnational Corporations*, 1994, 3, 1 *et seq.*

19. World Bank, *Global Economic Perspectives and the Developing Countries*, 1995, 13; IMF, *World Debt Tables 1994-1995*, Vol. 1, 15; World Bank, *Global Development Finance*, 1998, 4.

mies of the Far East and in Latin America, and by the diversification policies of investment funds managers (the institutional investors represent a high percentage of the portfolio sources), who have been attracted *inter alia* by the higher yields and possible capital gains offered by these new markets. In fact portfolio investments in developing counries increased by five times between 1989 and 1992 [20]. In the year 1993 alone foreign portfolio equity investment more than trebled, to $45 billion, from the previous year.

The Mexican crisis of 1994 has however suggested caution towards such investments. They declined in 1994 and 1995 but recovered in 1996. Also the East Asia financial crisis of the end of 1997 is bound to have long-term slowdown effects on them, underlining the financial risks associated with portfolio investments in the developing world. These flows are encouraged by the liberalization and globalization of financial markets and the growth of funds in the hands of institutional investors. Stability requires, however, functioning capital markets, adequate standards and efficient controls. The crisis of 1997 has shown that these conditions are often lacking in emerging markets.

In order to ensure the continued smooth and effective functioning of an open world financial market the emphasis has been put on structural reform to reduce inappropriate government interference in the market economy, restructuring financial systems, promoting integrity and transparency [21].

The volatility of portfolio investments, when balance of payments difficulties are encountered (as was the case of Mexico in 1994), has stressed the value of FDI capital flows as potentially providing a more stable form of financing for economic development as well as a substitute for reduced flows of commercial bank financing [22]. The nature of and motivation for FDI suggest that long-term considerations play a role in explaining their flow. As a result, direct invest-

20. See generally *Portfolio Investment in Developing Countries*, World Bank Discussion Paper 228, 1993. Emerging stock markets in Asia and Latin America represent about 12 per cent of the global equity market capitalization, see World Bank, *Global Development Finance*, 1998, Figure 1.5.

21. See the various contributions published in IMF *Survey,* 9 March 1998, and generally IMF, *International Capital Markets: Developments, Prospects and Key Policy Issues*, 1997.

22. Mexico was indeed disproportionately dependant on portfolio flows which accounted for 19 per cent of its stock exchange capitalization and for about one-quarter of all portfolio flows to developing countries in 1993.

ments are expected to exhibit greater stability than other types of private capital flows [23].

In addition to finance, FDI brings important supplementary benefits in technology and in export market development: equity portfolio capital does not bring with it the access to foreign technology, techniques and markets as FDI does. Moreover there are factors at work in the global economy, such as growing trade, greater market homogeneity and improved communication technology that provide impetus for increased flows of FDI.

(c) *Private investment flows distribution among developing countries*

The distribution of FDI among developing countries continues to be uneven. East Asia and Latin America still take the lion's share ($87 billion together, or 80 per cent in 1996). The surge has been concentrated in a score of countries, most of which are middle-income countries in those regions, with the exception of two large low-income countries, China and India. In the period 1990-1996 the largest recipients in the developing world have been, in order, China, Mexico, Singapore, Malaysia, Argentina, Brazil, Indonesia, Thailand, Hong Kong, Chile, ranging from more than $150 billion inflows over the period to at least $10 billion (Table 5) [24].

The geographical concentration is also observed when the flows are broken down by type. Argentina, Brazil and Mexico accounted for about 40 per cent of long-term bond financing flows (gross) to all developing countries in recent years. Similarly, more than half of portfolio equity flows to developing countries in 1989-1993 went to three countries: Brazil, Mexico and Korea. Five countries (Argentina, China, Malaysia, Mexico and Thailand) accounted for more than half of the total FDI flows to all developing countries in 1989-1993. China with inflows of $42 billion in 1996 ($26 billion in 1993) was the largest developing recipient of FDI, the second in the world, after the United States [25]. African non-oil-producing countries

23. See IMF, *Private Market Financing for Developing Countries*, 1995, pp. 35 *et seq.* The stability of FDI capital flows during crisis periods appears to be largely confirmed by a review of balance of payments data reported to the IMF.

24. For these and other data see United Nations, *World Investment Report*, 1997, at 5.

25. In comparison, no other individual recipient reached $7 billion of FDI inflows.

TABLE 5

Total FDI Inflows 1990-1996

(Billions of US dollars)

Range	Country
Over 150	United States
	China
100-150	United Kingdom
	France
50-100	Belgium-Luxembourg
	Spain
	Netherlands
40-50	Mexico
	Canada
	Singapore
	Australia
30-40	Sweden
	Malaysia
20-30	Italy
	Argentina
	Brazil
	Germany
	Indonesia
15-20	Denmark
	New Zealand
	Switzerland
10-15	Thailand
	Hungary
	Poland
	Hong Kong
	Portugal
	Norway
	Chile
5-10	Colombia
	Peru
	Nigeria
	Austria
	Chinese Taipei
	Korea
	Greece
	Japan
	Philippines
	Venezuela
	Russia
	Czech Republic
	Turkey
	Israel
	India
	Finland

Source: OECD, 1998.

receive on the other hand only about 1 per cent of total FDI. However in 1996 even the 48 least developed countries experienced an increase in flows of 56 per cent, to $1.6 billion.

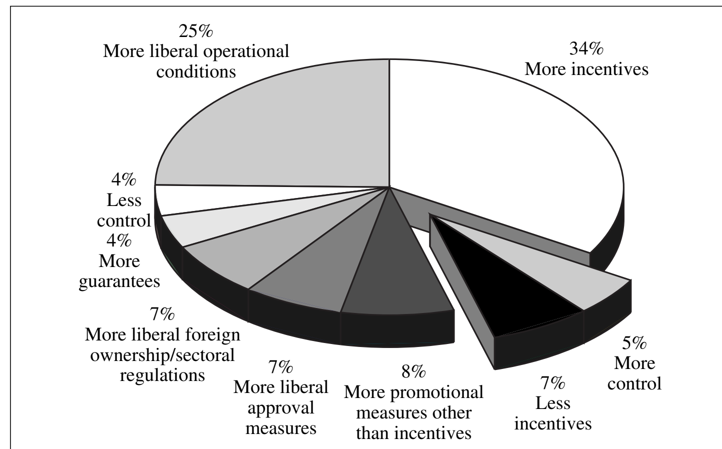
The recipients of capital flows within developing countries are also changing. Unlike the late 1970s, when private capital to developing countries flowed mainly to sovereign and parastatal borrowers, the 1990s have seen a sharp rise in net resources flows to the private sector in recipient countries. Aggregate private-to-private flows — debt (bond and loan), FDI, and portfolio equity investment — accounted for about 70 per cent of the net long-term flows to developing countries in 1993, up from 45 per cent in 1990[26].

Notwithstanding recent regulatory changes and the opening of many sectors to foreign investment in developing countries, existing restrictions play an important role and are relevant, from a legal

26. See OECD, *Foreign Direct Investments, OECD Countries and Dynamic Economies of Asia and Latin America*, 1995.

TABLE 6

Types of Changes in FDI Laws and Regulations, 1996 [a]



Source: United Nations, *World Investment Report,* 1997.
[a] There were 138 changes in 114 measures that were implemented in 65 countries.

point of view, when assessing the benefits of BITs as to market access (Tables 6 and 7)[27].

It must also be stressed that after the fall of communism developing countries must compete for foreign capital also with the economies of Eastern Europe and Central Asia in transition to the market. Eastern Europe is a preferred destination for many foreign investors also in view of their proximity to the Western European markets which facilitates production integration. Inflows into these economies rose

TABLE 7

Regulatory Changes, 1991-1996

(Number)

Item	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*
Number of countries that introduced changes in their investment régimes	35	43	57	49	64	65
Number of régimes	82	79	102	110	112	114
Of which:						
In the direction of liberalization or promoting [a]	80	79	101	108	106	98
In the direction of control [b]	2	—	1	2	6	16

Source: UNCTAD, based on national sources; United Nations, *World Investment Report,* 1997.
[a] Including measures aimed at strengthening market supervision, as well as incentives.
[b] Including measures aimed at reducing incentives.

27. See S. Gootpu, "Portfolio Investment Flows to Emerging Markets", *Portfolio Investment in Developing Countries, op. cit.*, 45 *et seq.*

sharply after 1993, amounting to 10 per cent of total foreign direct investment inflows to developing countries more than in recent years [28].

The sectoral distribution of foreign direct investment in developing countries is not well documented, but it seems that in recent years services (financial, trade, construction, tourism) have increased their share to more than one-third. Manufacturing has declined to less that one-half, with the remainder accounted for by agriculture and mining [29].

3. The Role of Multinational Companies and of Small and Medium Enterprises in FDI

The recent evolution of FDI concerns also qualitative and not only quantitative aspects. Ten or fifteen years ago it was common, in economic literature, to point out the concentration of the source of international investments in the hands of large multinational companies, hinting at a progressive concentration in fewer and larger such corporations, often of a conglomerate type [30].

This trend has not materialized although multinational enterprises lead the internationalization of production and distribution on a global scale [31]. The largest 100 multinationals ranked on the basis of the

28. See *A Global "Capital Shortage" ?*, World Bank, *Global Economic Perspectives*, 1997, 11 ; OECD, *Future Global Capital Shortage — Real Threat or Pure Fiction ?*, 1996. Russia has become a major destination for foreign investments by the mid-1990s (3.9 billion FDI in 1997 on a total flow of funds from abroad of 10.4 up from 6.5 in 1996).

29. See World Bank, *Global Development Finance*, 1997, 28 ; 1998, 22.

30. For the legal aspects see D. F. Vagts, "The Multinational Enterprise : A New Challenge for Transnational Law", 83 *Harvard LJ*, 1970, 739 *et seq.* ; C. D. Wallace, *Legal Controls of the MNE*, 1982 ; *L'entreprise multinationale face au droit*, 1977 ; OECD, *Responsibility of Parent Companies for Their Subsidiaries*, 1980 ; D. Sugarman and G. Teubner, *Regulating Corporate Groups in Europe*, 1990 ; C. Schmitthoff and F. Wooldridge, *Group of Companies*, 1991 ; A. F. Lowenfeld, "Liability of Multinational Corporations for Obligations of Their Subsidiaries", *Annuaire IDI*, 65, 1993, I, 244 *et seq.* ; J. Antunes, *Liability of Corporate Groups*, 1994. For a comparative view and national reports in various languages see *I gruppi di società*, Proceedings of the Venice Conference of 1995, 3 vols., 1996.

31. As to the change in the policies of multinational enterprises see J. Dunning, "Re-evaluating the Benefits of Foreign Direct Investment", *Transnational Corporations*, 1994, I, 23 *et seq.* As to recent developments in the theory of multinational enterprises in the context of globalization see S. Chan, *Foreign Direct Investment in a Changing Political Economy*, 1995 ; J. R. Markusen, "The Boundaries of Multinational Enterprises and the Theory of International Trade", 9 *J. of Economic Perspectives*, 1995, 169 ; E. M. Graham, "The (Not Wholly Satisfactory) State of the Theory of Foreign Direct Investment and the Multinational Enterprise", 20 *J. Int. Comp. Economics*, 1996, 183 *et seq.*

size of foreign assets controlled an estimated one-fifth of global foreign assets [32]. Multinational enterprises in industrial countries, led by those in the United States and Japan, remain the largest source of FDI, accounting for more than 90 per cent of recent flows and 95 per cent of the stock of FDI [33].

Medium-size and even small companies have started entering foreign markets not only through exports and independent distribution channels, such as agents and distributors, but also through direct investment. Industrialized home countries have generally favoured this development by assisting these companies through financial and other instruments to establish themselves in foreign markets. The European Community (EC) is especially active in this respect, within its institutional policy in favour of these actors, reflected in Article 130 of the Rome Treaty as amended by the Maastricht Treaty [34].

Small and medium-size enterprises often lack adequate financial resources to expand abroad: their most important asset is rather reputation and technical and commercial know-how. These enterprises have looked increasingly to local partners in order to enter foreign markets; they have been more open therefore than large multinational companies in joining forces with local entrepreneurs through the establishment of joint ventures, sometimes being satisfied with a minority share in the local company being thus created. In this context they rely moreover on various types of side agreements of a commercial type. In some industries, such as hotel and distribution of consumer products, companies have been able to enter foreign markets by having recourse exclusively to these "new" types of agreements. They include franchising, granting manufacturing and trading licences, or the right to use the company and product (brand) name to local partners, extending to them appropriate technical and marketing assistance without any direct capital investment [35].

Joint ventures had often been favoured in the past by host countries for other reasons. In centrally planned economies, where business activity was reserved to State enterprises, minority shareholding

32. United Nations, *World Development Report*, 1997, at XVII.
33. World Bank, *Global Development Finance*, 1997, 30.
34. For a list of the specific European Community programmes see footnote 62.
35. See e.g. OECD, *International Subcontracting, a New Form of Investment*, 1980; United Nations (UNCTAD Programme on TNCs), *Small and Medium-sized Transnational Corporations*, 1993.

by the foreign partner had been for some time the only admissible form of investment by companies from abroad. Also Governments of developing countries with tight controls on economic activity and foreign investments had insisted on joint ventures with foreign multinational companies when establishing or expanding their State-owned industries. The underlying theory was that the local economy could profit more if control was kept in local hands while the foreign partner would act basically as a source of technical and managerial know-how.

The very distinction between investments and commercial agreements becomes less clear in case of turn-key or "product in hand" industrial co-operation arrangements for the supply of factories and the establishment of new productions. These schemes may include the requirement that the foreign partner take a minority stake in the local company, in order to guarantee its long-term commitment to the success of the enterprise.

Sometimes the foreign partner undertakes to buy a share of the output and to market it abroad as a part of the overall scheme (buy-back arrangements). Joint ventures may thus be favoured by foreign investors that do not consider full ownership or even majority control essential.

These developments are in part the result of policy choices by host States' Governments, some of which have been abandoned since, especially when they were based on protectionism and extensive regulation of the economy. On the other hand these "new types" of investment, relying less on capital transfers and on foreign ownership of local companies thereby being established, reflect a change in the economic business environment and new strategies by companies wishing to expand abroad [36].

Special tax, custom and other advantages have been and are often being granted, conditioned upon the use of local resources or the exporting of a certain share of the output of the enterprises being thereby created [37].

36. See generally United Nations, *World Investment Report*, 1993, *Transnational Corporations and Integrated International Production*, 61 *et seq.*

37. See OECD, *Investment Incentives and Disincentives and the International Investment Process*, 1983. Many of these policies have been criticized from an economic point of view as distorting international trade, and have been outlawed by the Uruguay Round "TRIM" Agreement. The subjecting of foreign investment to local content or export requirements is also excluded under some recent BITs, see Chapter IV, section 6.

4. Economic Evolution and Legal Status of Foreign Investment in an Historical Perspective

Let us now turn to the interrelation of these trends with the legal status of foreign investment generally.

Investment of private capital in a foreign country has been a traditional feature in international economic intercourse. According to classical theories, factors of production, especially capital, tend to flow where their use is more productive (i.e. where the return is higher), and from economies where it is abundant, such as developed countries and financial centres, towards countries where capital is scarce and where the capabilities associated with private entrepreneurship are lacking. The higher demand and therefore remuneration for such factors in these economies would give rise to an investment capital inflow, provided that the economic and legal situation of the host country makes the investment abroad look profitable. This explains the initial flow of investments from Europe to the United States, to the Russian empire, and to new countries overseas in the second half of the nineteenth century. Acquisition of control over natural resources necessary to advanced economies but scarce therein, principally raw materials, have been another reason for investing abroad, including in the colonies of the European powers.

Around the end of the nineteenth century the beneficial influence of foreign investment based on liberal economic principles was universally acknowledged by the countries which had then a say in international affairs. Hence the consolidation of principles and rules of customary international law guaranteeing full security to it (non-discriminatory, national, international treatment), both during an investment's productive life and in case of expropriation, as an essential part of the obligations of States as to the treatment of aliens.

Things changed, as is well known, with the Soviet Revolution in Russia, whereby the private ownership of property was abolished and the economy was centrally planned and run by the State. Expropriations and nationalizations without compensation followed, together with their consequences, namely interstate conflicts and disputes, in which the very existence and content of customary rules in the area became an issue. The most contentious point has been ever since that of the obligation, if any, of the expropriating State to compensate the States whose nationals, including companies, had been

affected. The expansion of communism and of centrally planned economies in Central Europe after World War II increased those conflicts [38].

Later on, many newly independent countries of the developing world, while not following the Soviet model, aimed first at eliminating or reducing the dominance of investors of the former colonial powers in their economies. Thereafter they often inspired their economic policy to the principle of State intervention, close control of the economy and protectionism, limiting the freedom and role of foreign entrepreneurs, with the aim of speeding the process of their endogenous development and economic independence.

Most capital importing countries took the view that defining the standards of admission, treatment and compensation (in case of nationalization) of foreign investors was a matter purely within domestic law and jurisdiction. As a group in the international arena they advocated the principle of permanent national economic sovereignty over natural resources and economic activities. International obligations would only exist, according to these views, where treaties governing the subject matter had been freely entered into with foreign States [39].

The massive increase in the price of certain raw materials on which the industrialized West heavily relied, especially oil, as a result of the concerted action by the producers of the developing world in the early 1970s, gave weight and credibility to these strategies. Serious doubts were cast on the existence of generally accepted principles as to the treatment of the economic property of aliens, except in the most blatant instances of discriminatory and unfair measures.

A crisis naturally followed in the flow of foreign direct investment towards the productive sectors of most developing countries, as evidenced by the data mentioned above, especially since stagnation

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38. See generally I. Foighel, *Nationalisation and Compensation in International Law*, 1964; R. B. Lillich, *The Protection of Foreign Investment*, 1965; G. Schwarzenberger, *Foreign Investments and International Law*, 1969.

39. See Article 2 of the Charter of Economic Rights and Duties of States, United Nations Gen. Ass. res. 3281 (XXIX) of 1974 adopted against the opposition of industrialized States; M. Bedjaoui, *Pour un nouvel ordre économique international*, 1978; I. Brownlie, "Legal Status of National Resources in International Law", *Recueil des cours*, Vol. 162 (1979), 245 *et seq.*; G. Elian, *The Principle of Sovereignty over Natural Resources*, 1979; K. Hossain (ed.), *Legal Aspects of the New International Economic Order*, 1980; A. Lowenfeld, *International Private Investment*, 2nd ed., 1982.

in many industrialized countries reduced the availability of funds to be employed outside the developed economies.

The increased political risk facing foreign investment in the developing world could be and was covered in part by a variety of alternative measures — among them, the financial and insurance support of the home countries, the reliance on the terms and assurances provided in several host countries' legislations (foreign investment codes) or through contractual arrangements between the host States and the largest investors, namely the emerging category of the multinational enterprises (MNEs) or transnational corporations (TNCs).

In order to protect their investments, these big investors, and they only, could negotiate with host Governments *ad hoc* favourable terms and legal devices (such as stabilization, internationalization and transnational arbitration clauses). However the protection under international law of the stability of these arrangements in case of unilateral modifications or straightforward cancellation by a new Government or of requests for renegotiation has remained until now an open question [40].

A new approach emerged, on the other hand, based on the co-operation of all countries, regardless of their economic system and level of development, in order to fight underdevelopment and the connected social plights affecting a majority of the population of the Earth and destabilizing North-South relations [41]. Multilateral and bilateral funding of economic assistance was viewed as, and became a basic source of, resources geared to assisting developing countries in search of scarce external financing for their economic programmes. The latter turned also to private commercial banks loans, ultimately financed by the funds placed in the major financial centres

40. See A. A. Fatouros, *Government Guarantees to Foreign Investors*, 1962; P. Weil, "Problèmes relatifs aux contrats passés entre un Etat et un particulier", *Recueil des cours*, Vol. 128 (1969), 181 *et seq.*; K. Böckstiegel, *Der Staat als Vertragspartner ausländischer Privatunternehmen*, 1971; G. Sacerdoti, *I contratti tra Stati e stranieri nel diritto internazionale*, 1972; *Le contrat économique international, Stabilité et évolution*, 1975; J. Cherian, *Investment Contracts and Arbitration*, 1975; N. Horn (ed.), *Adaptation and Renegotiation of Contracts in International Trade and Finance*, 1985; D. Bettems, *Les contrats entre Etats et personnes privées étrangères. Droit applicable et responsabilité internationale*, 1988.

41. See M. Flory, *Droit International du développement*, 1977; Soc. fr. droit int., *Les Nations Unies et le droit international économique*, 1986; C. De Wart, P. Peters and E. Denters (eds.), *International Law and Development*, 1988; M. Bulajic, *Principles of International Development Law*, 1993.

by oil exporting countries. With the increase of the interest rates in the late 1970s, however, and the failure of the economic policies of receiving countries based on a protectionist approach and import substitution policies, most of the latter found themselves unable to service the debt and repay the loans [42]. Capital inflows by private investors and the transfer of technology, including management know-how usually associated with them, looked again as an interesting alternative [43]. Multinational companies became courted as engines for and partners in development.

The recent upsurge of FDI flows was not the result of an increased legal security due in turn to some positive change in the general international legal framework. It is rather the general change of attitude towards economic co-operation and the value of private investment and of the factors connected with it in an increasingly integrated world that is at the root of this evolution. This has been reflected in the many regulatory changes undertaken by developing countries in the 1990s, aimed at liberalizing the régime applicable to foreign investment (see Tables 6 and 7).

Multilateral efforts with a view to agreeing on common principles in the North-South context by way of non-binding codes of conduct (on transnational corporations and on transfer of technology as a separate item) did not succeed. The gap between the search for protection for the investments on one hand and the upholding of the freedom of the receiving countries to manage their policies as freely as possible proved itself impossible to bridge [44].

More modest efforts, though in important areas for improving the investment climate between home and host countries, met with more success. The ICSID Convention of 1965 provided for an interna-

42. On the legal aspects of the debt crisis see : D. C. Dicke (ed.), *Foreign Debt in the Present and a New International Economic Order*, 2nd ed., 1987 ; K. M. Meessen (ed.), *Internationale Versicherung und Wirtschaftliche Entwicklung*, 1988.

43. S. K. B. Asante, "International Law and Foreign Investment ; A Reappraisal", *ICLQ*, 1988, 588 *et seq.* ; C. D. Wallace, *Direct Foreign Investment in the 1990s. A New Climate in the Third World*, 1989.

44. The works on these codes came to a halt in the mid-1980s : see UN/TNC doc. E/1983/17 with the Draft Code of Conduct on TNCs and UNCTAD doc. TD/Code Tot/47 of 1985 with the text of the Draft Code on Transfer of Technology. See generally N. Horn (ed.), *Legal Problems of Codes of Conduct for Multinational Enterprises*, 1980 ; S. Rubin and G. Hufbauer (eds.), *Emerging Standards of International Trade and Investments*, 1984 ; G. Sacerdoti, "Les codes de conduite sur les entreprises multinationales, mise en œuvre et effets juridiques", *Etudes Ago*, 1987, IV, 263 *et seq.*

tional neutral forum within the World Bank for the arbitral settlement of investment disputes directly between investors and host countries on the basis of a mutual agreement. The *a priori* security that once this means of settlement had been agreed it could be pursued in all cases, should a dispute arise, is conducive to a better relationship between the parties and helped to "depoliticize" these disputes, avoiding State to State disputes [45].

The MIGA Convention of 1985, also promoted by the World Bank, the leading multilateral organization in the field of economic assistance and advice to developing countries, created a multilateral scheme of insurance of foreign investment against non-commercial risks, thereby further enhancing legal security and avoidance of political clashes in the area [46].

5. The Globalization of the World Economy and the New Investment Climate of the 1990s

The revival in the investment flow in recent years was basically due to the dramatic changes in domestic economic policies pursued by most developing countries as a different answer to their unresolved economic problems and to the widening gap with the industrialized countries, starting with the end of the 1980s. Reduction of the direct involvement of Governments in the management of the economy, deregulation, privatization of inefficient State enterprises have been the result of a new approach relying on market forces and private enterprise also in developing countries. Progressive opening of the local markets to international competition, including through investment of foreign capital (both FDI and portfolio investments), as well as liberalization of foreign exchange regulations have been an integral element of these new policies. While these reforms have been connected in many countries with democratization and the ousting of military régimes, they have been adopted also by countries where this welcome political evolution has not taken place.

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45. See generally A. Broches, "The Convention on the Settlement of Investment Disputes", *Recueil des cours*, Vol. 136 (1972), 330 *et seq.* ; M. Hirsch, *The Arbitration Mechanism of ICSID*, 1993.

46. See generally T. Meron, *Investment Insurance in International Law*, 1976 ; I. Shihata, *Towards a Greater Depoliticization of Investment Disputes : The Role of ICSID and MIGA*, ICSID Rev., 1985, 1 ; I. Shihata, "The MIGA and the Legal Treatment of Foreign Investments", *Recueil des cours*, Vol. 203 (1987), 95 *et seq.*

The internationalization of world economy, the easiness with which production can be shifted abroad and products exported worldwide, the progress in communication networks and the advance in information technology has brought about an increased interdependence and integration between nations. Economic sovereignty has lost a great part of its nationalistic overtones. On the other hand most countries are objectively unable to control fully their economy by the use of traditional regulatory instruments, including border protection, in view of the worldwide freedom of movement of input factors and their dependence on private actors and market forces that operate globally [47].

By opening their markets many developing countries have been able to enter into advanced, capital intensive sectors where they are able to compete with industrialized countries, thereby increasing their rate of growth. In the current less conflictual climate, foreign direct investment is considered the prime form of transnational industrial co-operation and as a complement, rather than as an alternative, to trade [48].

While in the 1970s the main worry was that voiced by developing countries as to the risk of being economically dominated by industrialized countries and their multinational corporations, a popular fear in developed countries is now that of deindustrialization and of excessive imports from developing countries, which avail themselves of low wages (hence the accusations of "social dumping") coupled with increasing efficient production capability. The resistance against lowering domestic standards (for example, as to environmental protection) in order to compete with foreign goods, often produced by delocalized plants of multinational companies investing worldwide, may motivate new forms of protectionism [49].

The service sectors (banking, insurance, telecommunications, advisory services) and public procurement, henceforth among the most protected sectors, have been influenced by liberalization too

47. See generally as to globalization from different angles R. B. Reich, *The Work of Nations,* 1991 ; C. Philip and P. Soldatos (eds.), *Au-delà et en-deçà de l'Etat-nation*, Brussels, 1996 ; M. Svetlicic, H. M. Singer, *The World Economy, Challenges of Globalization and Regionalization*, London, 1996 ; J. N. Baghwati and R. Hudec, *Fair Trade and Harmonization*, 1996. For a warning see M. Mahmoud, "Mondialisation et souveraineté de l'Etat", *JDI*, 1996, 648 *et seq.*

48. See E. Graham, "Investment and the New Multilateral Trade Context", OECD, *Market Access after the Uruguay Round,* 1996, 35 *et seq.*

49. As to the role of multinational companies see OECD, *Trade and Investment Transplants*, 1994.

and have started to be open to international competition, also by way of local establishment of foreign companies. The benefits of innovation and reduction in price stemming from the competition by and the entrance of new more efficient foreign suppliers are being considered as more than offsetting any negative effect associated with the decrease in national control of these sectors. The first general multilateral agreement on trade in services, namely the GATS concluded in 1994 as an outcome of the Uruguay Round of GATT, reflects and gives legal shape to this new attitude.

The very distinction between developing and developed countries, as the basis of a duality reflecting itself also in international legal régimes, has lost some of its importance. This duality is not viewed anymore as a structural feature of the world economy, as it was in the Tokyo Round agreements and decisions of the GATT in 1979, but rather as a justification for temporary relief as evidenced by the Uruguay Round approach [50]. From an economic point of view, and therefore for the purpose of international aid, countries are being distinguished in various groups according to the average individual income, while "least developing countries" have been singled out. Countries such as Mexico and the Republic of Korea have joined OECD, up to now considered as the "rich countries club", and are accepting its stringent standards as to foreign investment. The qualification of China as a developing country is debated in the context of its admission into the WTO, in view of its booming economy, the investment flow it is attracting, and of its export performance.

6. Trade and Foreign Direct Investment

The growing importance of FDI, coupled with the absence of binding multilateral rules on national policies towards FDI, has created what in many quarters is viewed as an obstacle that could slow down the pace of the further integration of the world economy. Renewed interest in FDI within the trade community has been stimulated by the perception that trade and FDI are basically two ways, sometimes alternative, but increasingly complementary, of servicing foreign markets, and that they are already interlinked in a variety of ways.

A brief examination of the links between FDI and trade is justi-

50. See generally M. Flory, "Mondialisation et droit international du développement", *RGDIP*, 1997, 609 *et seq.*

fied in a legal analysis first of all because the prevailing favourable consideration of foreign investment is often based on its perceived positive role on the development of international trade and specifically of exports from the host countries. Legal regulations often reflect this approach in particular in the area of conditions of admission and incentives. On the other hand tariffs and in general trade policies may be and are in fact used to induce foreign investments in certain sectors and/or discourage them in others (for example in the production of capital goods instead of in that of consumer products or vice versa). Regional trade agreements may also have an impact on the flow of foreign investment by inducing establishment in the area as a consequence of the enlargement of the regional market and in view of its trade policy towards third countries.

In more general terms, a liberalized multilateral trading system and an open régime for foreign investments are mutually supportive. The need to integrate rules on investment and international trade as well as on competition policy was recognized already in the Havana Charter after World War II, although that comprehensive effort failed. The aim of a liberal international trading system, that to favour a mutually beneficial division of labour, is facilitated by FDI which takes advantage of international trade opportunities. Linkage does not mean causation; the focus of empirical economic research is rather on exploring the correlations, that is testing whether trade and FDI are substitutes or complements.

The existence of these multiple links is one of the reasons for the WTO researching thoroughly the issue and addressing it as a special feature in its Annual Report for 1996 [51]. The report addresses first the question of the motivations for internationalization by the individual firm in this context. The answer is that in service industries in order to be competitive a service provider must usually have a physical presence in the market, hence the inclusion of commercial presence (establishment) in the GATS. As to producers of goods, vertical FDI, where a firm locates different stages of production in different countries, is the result of differences in input costs across countries. Horizontal FDI, where similar types of production activities take

51. See WTO, *Annual Report 1996,* Vol. I, Chap. 4, *Trade and Foreign Direct Investment*, which includes also a survey of international legal instruments and a bibliography. See also the WTO's Director-General's contribution: R. Ruggiero, "Foreign Direct Investment and the Multilateral Trading System", *Transnational Corporations*, 1996, 1, 1 *et seq.*

place in different countries, are motivated by transport costs or consumers' proximity, but may be driven also by trade barriers.

Trade barriers have a variety of effects on the localization of FDI, depending on the nature of the barrier and the type of investment. A sufficiently high tariff may induce FDI motivated by "tariff jumping" to establish in a protected market to serve it better. On the other hand the evidence supports the view that protected markets do not favour integration and export by foreign investors. Export oriented FDI has been attracted more by the relatively open markets of certain Asian countries, while local market oriented FDI have been attracted rather by the until recently protected Latin America markets. Low tariffs are thus the preferred strategy for countries wishing to integrate themselves into the global economy also through the inflow of FDI.

If trade policies, including regional agreements, affect FDI flows, FDI has in turn an impact on trade. The effects on the home versus that on the host countries' trade position have been distinguished and debated at length. It is widely held today that the traditional view that FDI and home country exports are substitutes ignores the complexity of the relationship in the contemporary global economy. On the contrary the gain in competitive position of the internationalized firm may well induce additional exports of intermediate goods and services to the subsidiaries, besides generating profits remittances. Analysis has shown that United States and Swedish exports, among others, were positively influenced by their foreign investments.

Detailed studies have confirmed the expected strong positive correlation between FDI and host countries' exports in many sectors. Foreign-owned firms tend to export a greater proportion of their output than do their locally owned counterparts[52]. This correlation is strengthened by appropriate incentives or policies providing for export processing zones (EPZ) or similar schemes, though these on the other hand may distort trade flows. Competition for FDI may induce the introduction of subsidies to investing that transfer a part of the value of FDI-related slipovers from the host country to the multinational investor.

Among the areas where different benefits and costs of FDI are perceived are those relating to balance of payments effects, domestic market structure, national economic policy and sovereignty espe-

52. WTO, *Annual Report 1996, op. cit.*, at 54.

cially in relation to the host country. A variety of factors, not predominantly trade-related, including policy choices (a qualitative element), are to be taken into account in order to draw a balance between costs associated with related concerns and benefits deriving from FDI.

The impact of FDI on technology transfers are another relevant issue. Recent studies tend to provide evidence that FDI exerts a positive effect on the productivity of local firms, on the introduction of new technologies and on economic growth in general [53]. The abandonment of national policies adopted in developing countries in the 1970s with a view to subjecting these transfers and related payments to tight controls is the result of fresh economic thinking in this direction, without understating the effect of the opposition of investors and of home countries to those measures and to related international initiatives by LDCs.

It should not be a surprise therefore that the WTO Report concludes that FDI and the trade of home and host countries are generally complementary, and that liberal trade and investment policies boost FDI and strengthen the positive relationship between FDI and trade. While protectionism can create strong incentives to substitute investments for trade, a country's trade policy is only one of the factors that determine FDI inflows. Generally speaking a liberal investment régime, including stability, predictability and transparency, allows a country to participate more fully in the open trade relationships established under the umbrella of the WTO. A reason therefore is the marked orientation to the global market and hence to international trade that characterize most multinational enterprises.

These conclusions are also a case for a more direct involvement of the WTO as an organization and as a negotiating forum in the multilateral regulation and liberalization of investments, at least as they relate to trade [54].

53. See United Nations, *World Investment Report,* 1997, *op. cit.*, at 20, for indications and data on trends in technology and related payments flows.

54. In fact the WTO Ministerial Declaration of Singapore in December 1996 established a Working Group to examine the relationship between trade and investment alongside another group on trade and competition. According to the Declaration, paragraph 20,

> "The General Council will keep the work of each body under review, and will determine after two years how the work of each body should proceed. It is clearly understood that future negotiations, if any, regarding multilateral disciplines in these areas, will take place only after an explicit *consensus* decision is taken among WTO Members regarding such negotiations."

7. The Legal Status of Foreign Investment in Industrialized Countries

The lack of an explicit coherent legal framework as to the treatment of foreign investment has never been a problem in the relationships between industrialized countries. Common principles of protection of private property and freedom of private economic initiative are enshrined in constitutional law, while the various forms of corporate entities and capital market organization are well established.

Investments from abroad are channelled through these instruments, compete with local investors and enjoy by and large equality of treatment and equal protection under the law, including recourse to courts. Foreign investors can establish branch offices, which are legally an integral part of the parent company without separate legal personality, though enjoying for some purposes (taxation, corporate accounting) a limited autonomy. As a preferred alternative they can establish or acquire local companies (subsidiaries) with separate legal personality under local law. The parent company, as their controlling shareholder, can fill the positions in their corporate organs and appoint their management thereby determining their policies. The foreign investor is usually free to be the sole shareholder of the subsidiary, or it can look for foreign or local partners (as a rule in market economies a private entrepreneur, a company, or individual investors), in order to establish a joint venture. A foreign investor may be able to sell minority shares of its company to individual or institutional investors, especially where there is a local market on which these shares can be issued and traded.

International law is of course not irrelevant. First of all industrialized countries have consistently shared the view that there exist customary rules as to the protection of foreign private property, guaranteeing fair treatment and ensuring "prompt, adequate and effective" compensation in case of expropriation. Second, many treaties between developed countries deal with the protection of foreign investment, or more generally of foreign property. These treaties are not generally in the form of specific agreements such as BITs. Relevant provisions are rather found in more general, often rather old treaties of friendship, commerce and navigation, of establishment, or governing generally the parties' mutual relations. Their relevance can be defined as residual. The need to invoke them has emerged

occasionally, mostly when the Government of the host country has changed its economic policies, thereby affecting the acquired position of foreign investors, depriving them of their assets, or affecting the rights of subsidiaries abroad[55].

The relevance of such treaties has been tested recently in various instances concerning different countries. The United States invoked against Italy in the *ELSI* case before the International Court of Justice (ICJ) in 1986-1989 certain provisions of the FCN treaty of 1948 protecting foreign investments[56]. On the other hand, Italy has successfully exercised diplomatic protection against Switzerland in 1991-1992 in favour of Italian citizens faced with confiscation of immovable property because of alleged violations of Swiss legislation restricting acquisition of land by foreigners. Italy relied on the treaty of establishment of 1868, still in force, which guarantees to the nationals of either country an unlimited right to acquire such property[57]. In another instance the Italian Supreme Court has ruled that the FCN Treaty between Italy and Germany of 1957 guarantees to German citizens in Italy full indemnification in case of expropriation, even when this is not provided for in Italian law[58]. The United States-Germany FNC Treaty of 1954 has been invoked by the United States in order to ensure to United States companies non-discriminatory access to public procurements in Germany on the same footing as companies of other EC countries[59].

Multilateral rules both of a binding and non-binding character have been developed within OECD, with a view to encouraging member States to open more fully their economy to foreign capital and to accept more widely standards of treatment which are already recognized in principle in their domestic systems[60]. The negotiations

55. As to the international aspects of the French nationalizations of the early 1980s see I. Seidl-Hohenveldern, *Corporations in and under International Law*, 1987, 42 *et seq.*

56. See Chap. II, section 5.

57. See the statement of the Swiss Ministry of Foreign Affairs upholding the application of the 1868 Treaty, *Neue Zürcher Zeitung*, 25-26 April 1992, at 24.

58. Cassazione 28.7.1986 n. 4811, *Riv. dir. int. priv. proc.*, 1997, 788.

59. See F. Abbott, "Crosscurrents in the EU External Commercial Relations: The Controversy over the German-United States Treaty of Friendship", *Zaörv*, 1994, 756 *et seq.*

60. See the OECD Capital Movement Liberalization Code of 1961, as periodically amended, the 1976 Declaration on International Investment and Multinational Enterprises, and the 1991 Decision on National Treatment; OECD, *National Treatment for Foreign Controlled Enterprises*, 1993, featuring the member States' lists of exceptions.

for a Multilateral Agreement on Investment has been aimed at giving a fully binding status to these kinds of undertakings and at rolling back existing barriers to entry and other restrictions.

8. The Uncertainty of International Standards for Foreign Investments in Developing Countries and the Role of BITs

Matters have been traditionally different as concerns developing countries. Many of them had a limited private sector and had enacted only scant legislation governing private business activities. While this situation may offer in some cases more freedom to private initiative than in industrialized countries (for example as to the protection of the consumer and respect of environmental standards), it has been usually viewed by investors as reducing the legal security that local law offers in case of large investments.

State intervention has been traditionally widespread and independent judicial control on it is often inadequate. The political (non-commercial) risks facing long-term investments in the productive sector of the economy has been considered high in countries affected by political instability. Foreign capital avoids these countries, even if welcome by the current Government and protected by domestic *ad hoc* legislation, except if the short-term expected returns would be exceptionally high, something which would not be beneficial to the local economy.

The added uncertainty in international customary law principles applicable to foreign investment mentioned above, coupled with the lack of compulsory dispute settlement procedures, is an argument for the bilateral laying down of rules and obligations, as a device of legal protection for the investors and an inducement of investments from the developed country party to such agreement. The role of bilateral agreements should be enhanced by the fact that they are negotiated between countries which have, or should have, a specific reciprocal interest in their conclusion, be it because of traditional ties, business opportunities in the host country, availability of capital in the developed country entering into them. Their content can moreover be patterned to take care of specific needs, although this is rarely evidenced in actual texts.

The very large number of BITs being concluded by all sorts of countries as a matter of general policy, the standardization of their clauses, the inclusion in them of a most-favoured-nation (mfn) clause, as well as the lack, on the other hand, both of specific mar-

ket access commitments by host countries and of specific investment undertakings by home countries tend however to reduce the relevance of any individual treaty as an instrument of specific promotion of investments. Indeed the argument has been made that some large developing economies, such as Brazil, Argentina, India and Algeria, have been recipients of substantial amounts of foreign investment in the past, notwithstanding the fact that they were rejecting at the time the practice of concluding BITs[61]. While an impressive number of developing countries have liberalized their regulations on foreign investment in recent years (see Tables 6 and 7) unilateral changes lack of course the legal stability and binding character of treaty provisions.

Several industrialized countries, within their policy of establishing economic co-operation ties with developing countries and with the former centralized economies, have recently concluded at the same time BITs and bilateral treaties against double taxation with a number of these countries. The latter are considered by prospective investors as having an immediate relevance, while BITs are rather viewed by most businessmen as a confirmation of the existing legal framework, of an eventual use in case of major political upheavals.

The above-mentioned international co-operation policies include often also the establishment of financial and technical assistance schemes by the home country of the investor (as well as by regional and international organizations) in order to support such investments, especially joint ventures by small and medium enterprises. These schemes supplement national (public) insurance and guarantee programmes for investments made in developing countries in order to protect them against political risks, which were considered from the 1970s on a major hindrance to their promotion[62].

61. See United Nations Centre on TNCs, *Bilateral Investment Treaties*, 1988, 10.

62. See IFC-MIGA, *Programs in Industrial Countries to Promote Foreign Direct Investment in Developing Countries*, 1992; OECD, *Promoting Foreign Direct Investment in Developing Countries*, 1993. The European Community (EC) has put in place a number of financial schemes in order to support medium and small companies' investments (specifically joint-ventures) in developing countries: see the EC Investment Partners programme, Reg. 319/92 of 3.2.1992; the AL-Invest programme for Latin America, Reg. 443/92 of 25.2.1992; the Med-Invest programme for Associated Mediterranean Countries, Reg. 1762/92 of 29.6.1992; the TACIS and JOPP financing of joint-ventures in the CIS and central European countries respectively. The International Financial Corporation of the World Bank group has the purpose to support and finance private foreign investment and specifically joint-ventures in developing countries through loans and equity participation. See IFC, *Lessons of Experience: Foreign Direct Investment*, 1997, summarizing IFC's approach and including extensive analysis of the policy environment necessary to attract investment.

9. The Negotiations at OECD of a Multilateral Agreement on Investment (MAI) (1995-1998)

After extensive preliminary studies the OECD Council decided in 1995 that the time was ripe to negotiate a multilateral agreement on investment within this Organization whose member countries are among the most open and secure for foreign investments. The OECD had moreover a positive record in the development of (predominantly non-binding) instruments to promote liberalization of capital flows and multilateral standards of treatment by member States and directed to multinational enterprises [63].

Negotiations were launched with a view to reaching an agreement by the OECD Ministerial Meeting of May 1997. In twelve negotiation sessions between delegations of the members a preliminary draft text had been formulated, but several issues were still unresolved. In 1997 it was therefore agreed to extend negotiations until the Ministerial Council of May 1998. At the end of 1997 disagreement subsisting on several key issues, notably concerning exceptions and restrictions to the applicability of the instrument and to the level of initial liberalization that could be accomplished, led to increased uncertainties as to the achieving of the aim. From the outside, critical views have started to be voiced rather forcefully by certain sectors of public opinion, hinting at the risk that far-reaching obligations as to the unqualified admission and non-contingent standards of treatment of foreign investors would unduly limit the members' sovereignty in the conduct of their policies in areas such as the protection of the environment, labour standards, promotion of new industrial and service sectors, protection of cultural industries. It was also alleged that the text contains provisions granting *de facto* or *de jure* a preferential treatment to multinational enterprises based abroad, for instance as to dispute settlement. These criticisms reflect a political dislike against the entering into multilateral commitments in the area, since taken piece by piece the MAI does not seem to add much to fair treatment obligations in force. They are enrishrined in

63. For an overview see OECD, *OECD Instruments for Promoting the Liberalization of Foreign Direct Investment,* Doc. GD(95)36, 1995. Several studies are collected in OECD, *Towards Multlateral Investment Rules*, 1996. The European Commission had favoured the opening of the MAI negotiations in its Communication of 14 December 1995, *A Level Playing Field for Direct Investment Worldwide,* OJ C 17, 22.1.1996, 175.

laws and national constitutions, found in existing multilateral agreements and bind already bilaterally OECD members between themselves and especially towards third countries as a result of their numerous BITs.

These criticisms have been expressed in a European Parliament resolution of 11 March 1998[64]. They echo similar criticisms by various sectors of the society in the industrialized countries against policies favouring the ongoing trend towards globalization in trade, finance and competition, attacked as a demise from the responsibility that national Governments have towards their constituencies. This has further jeopardized the prompt conclusion of the MAI as originally envisaged and has given fresh impulse to the views of those who question OECD (rather than the WTO) as the most appropriate forum to deal with the subject[65]. An additional obstacle which may have been solved since (thanks to a political agreement reached at the G-7 Summit at Birmingham in May 1998) has been represented by the European Union-United States conflict on the extraterritorial application of the United States Helms-Burton Act and of other statutes mandating or authorizing boycotts and other sanctions against non-United States companies trading with or investing in countries blacklisted for political reasons by the United States. The idea to deal generally with this kind of recurring issue in the context of the MAI negotiations has added further difficulties[66].

The main features of the MAI, based on the text of the draft as developed until early 1998 can only be highlighted here in general terms[67]. The indications that follow may serve as a guide and a reminder when dealing in the next chapters with corresponding provisions of BITs from which the MAI text has been basically derived.

The aim of the negotiations was to achieve a broad and comprehensive agreement for international investment that would set high standards concerning three areas of FDI rule-making: investment

64. See European Parliament, *Resolution containing Parliament's Recommendation to the Commission on Negotiations in the Framework of the OECD on a Multilateral Agreement on Investments.*

65. As to the relation between various multilateral instruments covering in part the same matters see, from a legal point of view, A. Wimmer, "The Impact of the GATS on the OECD Multilateral Agreement on Investment", 19 *World Competition*, 1996, 4, 100 *et seq.*

66. Cf. the comments "The Sinking of the MAI", *The Economist*, 14 March 1998, at 16, 85.

67. The negotiating text as of 14 February 1998 with a Commentary has been made available on Internet at the OECD site, www.oecd.org.

protection, investment liberalization and dispute settlement. Specifically one of the objectives was to go beyond existing commitments to achieve a high standard of liberalization covering both standstill, roll-back, non-discrimination/mfn, and transparency, and apply disciplines to areas of liberalization not satisfactorily covered by existing OECD instruments. It was noted that the rapid growth of investment flows in recent years and the wide trend towards more liberal régimes had taken place despite the absence of multilateral rules. However, while investment régimes in many countries have become more open and welcoming there is no assurance that they will remain so in the years to come. The risks of backsliding were considered to be significant and even in the OECD countries foreign investors still encounter barriers, discriminatory treatment and legal and regulatory uncertainties.

The MAI would be a free-standing international treaty open to all OECD members, the European Community and non-OECD countries which would be willing and able to live by its rules. High-level contacts were maintained accordingly during the negotiations with some large non-OECD countries with a view to their later accession to the MAI, once concluded, although participation in the negotiations was limited to members.

As to the definition of investments, there was consensus that the Agreement should have a single broad definition, going beyond the traditional notion of FDI to cover virtually all tangible and intangible assets, and which would apply to both pre- and post-establishment. The definition would cover portfolio investments but would not be so wide as to cover trade operations. It is not clear however in what exact terms the contentious fundamental issue of the coverage of local companies which are investments of a foreign investor has been adequately dealt with, since the question was still open at the beginning of 1998.

As to protection, investors would be entitled to fair and equitable treatment in the host country as well to full and constant protection and security. They would enjoy national and mfn treatment, whichever is more favourable, both in the pre-establishment (access) phase and once established. Non-contingent standards, that is directly laid down in the Agreement, and appropriate obligations would apply as to key personnel employment, performance requirements, privatizations, monopolies and State enterprises, and investment incentives. On some of these "special topics" achieving common positions has

been a difficult process, not yet concluded. The explicit coverage of environmental, labour and health matters as far as national regulation in these areas of general interest may limit an investor's guaranteed freedom has also proved to be contentious.

Expropriation and other measures having comparable effects would be permitted only if in the public interest, on a non-discriminatory basis, against payment of prompt, adequate and effective compensation, and in accordance with due process of law. Inward and outward transfers of capital related to an investment would be freely transferable, while possible limitations in case of balance of payments difficulties have been the subject of different views.

Other areas of disagreement are found as to the general exceptions, temporary derogations and country-specific reservations which have to be dealt with in MAI as a progressive liberalization undertaking. It is enough to recall here the questions of the "cultural exception", which is especially relevant as to the audio-visual industry, and of the protection of linguistic and other features of national cultures. The scope of application of the regional integration organization exception is evidently another delicate matter. General limitations in either area could substantially limit the scope of application of the obligations in a given country or group of countries, thus upsetting the balance of advantages as to investors of different geographic origin. The same can be said in respect of any limited application of the Agreement to measures taken by subnational authorities. Should this be the case the balance would be upset between federal and non-federal countries.

It has been accepted that non-conforming measures would need to be covered by country-specific reservations by participants, and preliminary lists (in part inspired by the idea of listing existing measures extensively for "precautionary" reasons) have already been circulated. The "negative lists" (or "top down") approach would be followed, whereby only listed measures conflicting with the Agreement would remain unaffected[68]. To these reservations a stand-still obligation would apply. Listed measures would be subject to rollback, that is progressive reduction and elimination through a phase-out process of mutual negotiations, or based on the temporary validity of a reservation.

68. In GATT and GATS the positive list approach is followed, whereby commitments apply only to products and services listed by each country, under the terms indicated therein.

The MAI would include both interstate and investor-State mechanisms of dispute settlement. State to State disputes related to the MAI would be subject to mandatory arbitration by *ad hoc* MAI panels. Direct arbitration of investor-State disputes would be subject at the option of the foreign investor to international commercial arbitration or to ICSID arbitration under an advance consent clause inserted in the MAI itself. Direct arbitration organized within the MAI would also be available at the option of the foreign investor, who could of course have recourse to the tribunals of the other party instead. This is an issue which appears to be still under consideration, among others, especially as to the types of disputes covered in either type of mechanism.

Finally the MAI could be the occasion and the forum to enhance the status of other OECD instruments, such as those on the national treatment of foreign-owned companies, on conflicting requirements to which companies might find themselves subject in different countries, and the OECD Guidelines for multinational enterprises[69]. The Guidelines might be annexed to the treaty as a "good practice" model recommended to enterprises and all others concerned.

An evaluation of the current status of the draft from a legal point of view should, in our opinion, underline the fact that the negotiating text has become in the course of the sessions far-reaching and complicated. The draft has been overburdened with details in order to accommodate specific requests of the various delegations on this or that narrow point, at the risk of endangering its overall logic and balance. On the other hand, the text has entered into general matters, such as the power of States to regulate their domestic economy generally, which are a prerequisite of any foreign investment regulation but not necessarily a proper object of an international agreement on FDI.

Mixing two different approaches, the legalistic one, typical of norm-setting treaties, and the trade approach, based on a dynamic process of negotiations of reciprocal concessions has added complexity. These two models are traditionally different also as to legal implications within the domestic systems of participating countries. While treatment obligations, such as those found in BITs, are naturally self-executing, i.e. meant to be directly applicable and enforceable before national courts for the benefit of private parties including

69. Available on Internet: www.oecd.org/daf/cmis/cime/mneguide.htm

foreign protected investors, trade commitments usually bind only States and dispute mechanisms are open only to Governments.

From the trade negotiating point of view, one wonders about the prospects of success of such a process on a worldwide scale, i.e. involving countries maintaining substantial restrictions, when it has proved so difficult to reach agreement among OECD countries, the historical champions of investment liberalization.

The legal implications of the MAI have to be fully evaluated also in respect of the position of third countries and their investors in OECD markets. Based on BITs, third parties would be entitled to mfn and national treatment in respect of the MAI obligations, as well as to specific treatment granted therein. The relationship between the MAI and other relevant multilateral treaties, such as the Energy Charter and the GATS, needs also to be elucidated further. Finally from a trade policy perspective the MAI as a liberalization device raises typical issues concerning unconditional mfn treatment, reciprocity and "free riding" by third parties which should be taken into account.

CHAPTER II

THE CONCEPT OF FOREIGN INVESTMENT AND THE DEFINITION OF THE INVESTOR IN RECENT BITS

Summary: 1. The ever-growing network of BITs. 2. The scope of application of BITs. 3. Territorial coverage and duration. 4. The definition of "investments". 5. Foreign-owned or controlled companies as protected investments. 6. Nationality requirements as to the investor. 7. Indirect investments.

1. The Ever-Growing Network of BITs

Before examining the historical pattern and the content of BITs, it must be emphasized that the legal framework governing foreign direct investment at the national level in home countries consists mostly of domestic legislation regulating business activity and business entities in general, or regulating specific lines of business. Besides special legislation concerning foreign investment and regulating the ownership of local assets and business entities, such as a*d hoc* investment laws or codes, relevant provisions may be scattered in financial, tax and other legislation.

Bilateral treaties have been promoted since the 1960s by developed market economy countries in order to lay down guarantees for the protection of the investments of their nationals (individuals and corporations) in developing countries. BITs were viewed as an answer to the uncertain legal framework of many newly independent States, thanks to the standards of treatment provided therein, and as a protection against political risk (change of domestic legislation, expropriation) through the procedural and substantial requirements laid down in them.

These standards enshrine the element of "protection" which appears in the title of all such treaties. All current treaties are "reciprocal", in that the investments of nationals of either of the contracting States in the other are protected, even if the flow tends obviously to run essentially from the industrialized country to the developing

one[70]. This structure is dictated by the respect to sovereign equality of States. It is justified moreover by the fact that the treaties do not guarantee the carrying out of any specific investment. Their "promotion" is viewed rather as an eventual outcome of their mere conclusion, evidencing the existence of a "favourable investment climate" in the contracting States. Their conclusion is however advocated by the developed party, when there is such a party, with a view to protecting its prospective and actual investors in the territory of the other party, thus supplementing local law by international norms.

Nowadays investments flow both ways. It is therefore wrong to view BITs from the point of view of the industrialized partners only. Thus developed countries, when insisting on direct arbitration between the foreign investor and the host country in case of dispute, may have overlooked that this implies the setting aside of their own judicial system, should an investor of the otherwise predominantly host country find itself in the reciprocal case discriminated against in the developed country market and decide to use the treaty mechanism[71].

The agreement between the Federal Republic of Germany and Pakistan of 1959 is considered as the prototype of BITs. It was followed by more than 90 such treaties concluded by Germany up to now and the pattern was followed by all major industrialized countries of Western Europe[72].

The United States relied for a long time instead on its traditional

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70. This was not the case of all earlier BITs until the 1970s, such as those concluded by France which protected French investments only. See for instance France-Indonesia (1973); France-Yugoslavia (1974); France-Korea (1975).

71. Cf. the following examples concerning Italy: the economic press reported at the end of 1994 that a private Indian steel company was participating together with Italian investors in the privatization of the Italian State-owned steel industry. In the first case of judicial application of a BIT in Italy, the Tribunal of Como (judgment of 5.4.1994, *Rivista di diritto internazionale privato e processuale*, 1994, 638) ruled that the creation of a company by Chinese nationals in Italy was not subject to the reciprocity requirement of the civil code, since their right to do so was unconditionally recognized by the BIT between Italy and China of 1985.

72. The EC Council of Ministers recognized in 1980 (EC OJ 11/1980, para. 2.2.21) that the competence to enter into BITs had remained with EC member States. The Council has periodically authorized under the common commercial policy the maintenance into force of trade and FCN agreements with third countries predating the EEC Treaty, some of which include clauses on investments; see the Council Decision 95/133 of 19.4.1995 (EC OJ L89/30 of 21.4.1995).

Investment protection provisions were inserted however in the Fourth Lomé Convention of 1990 with the ACP associated countries (Art. 258-274 and Annex LIII) which have been clarified by the statement of "Principles of Protection of

Friendship, Navigation and Commerce (FNC) treaties, entered into especially with other industrialized market economy countries, which include provisions on the protection of investments. The post World War II FNC treaties of the United States included *inter alia* provisions granting national and mfn treatment to individual and corporate investors of either party engaging in various types of commercial and non-commercial activities, as well as prompt, adequate and effective compensation in case of expropriation of their property [73].

The United States changed its policy at the end of the 1970s, also in view of the difficulties encountered in entering into such complex treaties with developing countries; it concluded its first BIT in 1982 with Egypt. The United States had signed 34 BITs by the beginning of 1995 and was negotiating another 13 with various developing countries and economies in transition.

Most industrialized countries have drafted model treaties which they use in their negotiations and which are being improved through time, also in view of the texts being adopted by other capital exporting countries. The actual treaties tend to follow the models, though

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Investments in ACP Countries" (ACP-EEC doc. 2172/92), adopted by the EC Council on 4.10.1992.

The Court of Justice in its Opinion 2/92, handed down in 1995, has ruled that the Community and its member States share joint competence to participate in the revised OECD Decision on National Treatment. This should prompt the re-examination of the exclusive competence of member States to enter into BITs, also in view of the fact that entry and exercise of banking and insurance activities by third countries' enterprises is exclusively governed by the terms of the relevant EC Directives. The Amsterdam Treaty of 1997 amending the Maastricht Treaty provides for the possibility that negotiations and agreements on services and intellectual property (but not investments as such) be added to the common commercial policy (new paragraph 5 of Article 113 of the EC Treaty).

BITs of EC member States may however be replaced at least in part by the provisions on establishment and capital movements of the partnership and co-operation agreements "entered into by the EC and its members with former USSR countries"; see, for example, the agreement with Russia of 1994, approved by the EC in 1997, text in OJ L 327 of 28.11.1997 (Arts. 28-34, 52).

73. See R. Preiswerk, *La protection des investissements privés dans les traités bilatéraux*, 1963; J.-P. Laviec, *Protection et promotion des investissements*, 1985; M. N. Leich, "International Economic Law: Bilateral Investment Treaties", *AJIL*, 1986, 948 *et seq.*; I. Cheyne, "Investment Promotion and Protection Agreements", *ICLQ*, 1987, 929 *et seq.*; L. Migliorino, *Gli accordi internazionali sugli investimenti*, 1989; J. W. Salacuse, "BIT by BIT: the Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries", *Int. Lawyer*, 1990, 655 *et seq.*; M. Khalil, "Treatment of Foreign Investment in Bilateral Investment Treaties", *ICSID Rev.*, 1992, 339 *et seq.*; M. Sornarajah, *The International Law on Foreign Investment*, 1994, 225 *et seq.* For the evolution and the current US practice, see "The Development and Expansion of BITs", *ASIL Proceedings*, 1992, 532 *et seq.*; K. J. Vandevelde, *US Investment Treaties, Policy and Practice*, 1992.

differences appear between BITs entered into by a given country in the same period of time; specific needs tend to be covered by protocols or other annexes to the individual treaty, especially in the practice of the United States [74].

The network of BITs include by now more than 1,000 treaties and new agreements are being added to the list every year [75].

Bilateral treaties have been concluded also by newly industrialized countries, by the countries of the former Soviet bloc including the USSR and subsequently Russia, by countries in Latin America (including Cuba) that used to oppose international commitments in this area under the "Calvo doctrine", and between developing countries.

Even those few major developing countries which had remained until recently out of this network, such as Algeria, Mexico, Brazil and India, though they did welcome foreign investment as evidenced by domestic encouraging legislation and recent multilateral undertakings (Mexico within Nafta and Brazil within Mercosur), started negotiating BITs after 1990.

Not only has each major industrialized country a network of BITs in place, but this is the case with other countries as well. China for

74. The practice of individual countries has been examined in detail. See H. Z. Hashem on Egypt, 40 *Rev. égypt. dr. int.*, 1984, 133; K. Kraichitti on Thailand, *Thailand YB Int. Comp. L.*, 1986, 76; D. C. Dicke (ed.), *Foreign Investment in the Present and a New International Economic Order*, 1987, featuring reports on Austria by H. H. Haschek and on Switzerland by M.-C. Kraft (as to Switzerland see also H. Gattiker, *Ann. suisse dr. int.*, 1981, 25); E. Denza and S. Brooks on the United Kingdom, *ICLQ*, 1987, 908; P. T. B. Kohona on Australia, *J. World Trade*, 1987, 79; Li Shi on China, C. De Waart, P. Peters and E. Denters, *International Law and Development*, 1988, 163; P. Juillard on France, "Chronique de droit international économique — Investissements", *AFDI* (every year since 1983); M. Banz on Germany, *Völkerrechtlicher Eigentumschutz durch Investitionsschutzabkommen*, 1988; Matsui on Japan, *Ann. Int. L.*, 1989, 1; M. Van de Voorde on Belgium, *Studia Diplomatica*, 1991, 87; M. Paterson on Canada, *Can. YB Int. L.*, 1991, 373; Reading on Asia, *Duke LJ*, 1992, 679; J. Karl on Germany, *ICSID Rev*., 1996, 1 (see the 1991 German Model Treaty at 221); A. Escobar on BITs of Latin American Countries, *ICSID Rev*., 1996, 86.

75. For recent lists see United Nations, *Bilateral Investment Treaties*, 1988, 86 *et seq.*; United Nations, *Bilateral Investment Treaties 1959-91*, 1992, 15 *et seq.*; "Status of Investment Treaties", 31 *ILM*, 1992, 491, and 32 *ILM*, 1993, 929; R. Dolzer and M. Stevens, *Bilateral Investment Treaties*, 1995, 267 *et seq.* These lists are never accurate, especially as to recent treaties not yet in force, due to the lack of centralized up-to-date reporting. For some samples of model BITs (not all up-to-date any more) see United Nations, *Bilateral Investment Treaties*, 1988, 111 *et seq.*; R. Dolzer and M. Stevens, *op. cit.*, 165 *et seq.*; United Nations (UNCTAD), *International Investment Instruments: A Compendium*, 1996, III, 115 *et seq.* ICSID has been publishing the full text of BITs in its series.

instance has concluded almost 60 such treaties, not only with industrialized nations and neighbouring States but also with countries widely apart such as Ghana, Malaysia, Papua New Guinea, Slovenia and Uruguay.

2. *The Scope of Application of BITs*

A comparative survey of investment treaty provisions can be based on the examination of a number of treaties in force that have been signed recently, which can be considered significant because of the importance and variety of the contracting States involved. Older BITs retain of course their interest as long as they remain applicable; disputes and therefore case law tend indeed to involve those treaties that have been in force a longer time.

In view of their standardized pattern the following major points are being examined, taking into account the status of general international law and multilateral instruments, where existing and relevant, in the area:

— scope of application, namely definition of investment covered and of individual and corporate investors eligible, also in relation to nationality requirements (Chap. II);
— admission of investments, i.e. establishment, access to the market (Chap. III);
— general standards of treatment and specific commitments such as to repatriation of profits, divestments, currency transfers, related activities, protection of contractual undertakings (Chap. IV);
— expropriation and compensation including subrogation (Chap. V);
— settlement of disputes between the investors and the host State and between contracting parties (Chap. VI).

Their standardized pattern and the fact that they *reflect* liberalization of access for foreign investments in the contracting parties (especially in the country which can be viewed as the predominantly host country) rather than *promote* them explain certain shortcomings of their content, which are apparent on close examination. Certain issues, which have been shown to be delicate and contentious in multilateral negotiations (including the MAI) are covered superficially or not at all in BITs. This is the case *inter alia* for balance of payment restrictions in case of financial strains (which are hardly mentioned), the scope of regional exceptions, the exact class of dis-

pute amenable to arbitration and its relation with the host country jurisdiction [76].

3. Territorial Coverage and Duration

As to the *territorial coverage* of BITs, the most common indication found is that the BIT applies to investments made in each party's territory without any further specification. Some recent BITs are more specific, taking into account also the contracting States' rights as to maritime areas.

Some BITs just refer to sea and seabed subject to the sovereignty of either contracting party under international law [77]. A few refer to either contracting parties' exclusive economic zone and continental shelf [78]. Others are more detailed. Article I (1) *(f)* of the BIT between the United States and Argentina of 1991, for instance, includes a clause which runs as follows

> "including the territorial sea established in accordance with international law as reflected in the 1982 United Nations Convention on the Law of the Sea. This Treaty also applies in the seas and seabed adjacent to the territorial sea in which either Contracting Party has sovereign rights or jurisdiction in accordance with international law as reflected in the 1982 United Nations Convention on the Law of the Sea." [79]

As to the *duration* one must distinguish between the standard

76. The BITs of the United States and those of Canada appear to be the most attentive to specific issues and to the foreign investment regulations and limitations in force in these countries themselves as a constraint for the content of their BITs. The same can be said of the European Union-Russia.

77. See Switzerland-Poland (1989), Art. 1 (3); Canada-Poland (1990), Art. 1 *(a)*; Italy-Argentina (1990), Art. 1 (4); France-Argentina (1991), Art. 1 (4); Australia-Viet Nam (1991), Art. 1 (1) *(f)*; Switzerland-Peru (1991), Art. 1 (3); Argentina-Egypt (1992), Art. I (5); Netherlands-Poland (1992), Art. 1 *(c)*; France-Viet Nam (1992), Art. 1 (5); Argentina-Venezuela (1993), Art. 1 (4); Australia-Romania (1993), Art. 1 (1) *(g)*; Italy-Cuba (1993), Art. 1 (6); Canada-UAE (1993), Art. 1 (7); Netherlands-Lithuania (1994), Art. 1 *(c)*; Colombia-Spain (1995), Art. I (4); Italy-Ukraine (1995), Art. 1 (6); United Kingdom-Turkmenistan (1995), Art. 1 *(e)*; Italy-Russia (1996), Art. 1 (4). It is surprising to find specific mention of maritime areas in BITs to which a landlocked State is a party.

78. See Germany-Poland (1989), Art. 1 (2); France-Mongolia (1991), Art. 1 (5); Israel-Estonia (1994), Art. 1 (5); Israel-Ukraine (1994), Art. 1 (5); Israel-India (1996), Art. 1 *(f)*.

79. See also United States-Nicaragua (1995), Art. I (1) *(i)*; Italy-Brazil (1995), Art. I (1) (IV).

clause regarding the duration of the treaty itself and the duration of the protection afforded by the treaty. As to the first point BITs are usually concluded for 10 years [80]; thereafter automatic renewal for the same period of time is often provided, subject to unilateral termination at any time [81].

BITs usually provide that the protection obligations established by the treaty survive to its termination for a period whose length is set forth in the BIT; this period varies from a minimum of 10 years to a maximum as long as 20 years [82].

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80. As an exception China-Slovenia (1993), Article 12 (1), provides that "the Agreement shall remain in force for a period of five years". Australia-Viet Nam (1991), Article 15 (1), provides that the Agreement "shall remain in force for a period of fifteen years and thereafter shall remain in force indefinitely, unless terminated". See also Australia-Romania (1993), Art. 11 (2); Norway-Peru (1995), Art. 14.

81. Netherlands-Lithuania (1994), Article 15 (2), provides typically that

> "unless notice of termination has been given by either Contracting Party at least six months before the date of the expiry of its validity, the present Agreement shall be extended tacitly for periods of ten years, each Contracting Party reserving the right to terminate the Agreement upon notice of at least six months before the date of expiry of the current period of validity".

Sweden-Poland (1989), Art. 11 (2); Switzerland-Poland (1989), Art. 12; Switzerland-Peru (1991), Article 12 differs only as to the time-limits prescribed.

German BITs provide that

> "this Treaty shall remain in force for a period of ten years and shall be extended thereafter for an unlimited period unless denounced in writing by either Contracting Party twelve months before its expiration. After the expiry of the period of ten years this Treaty may be denounced at any time by either Contracting Party giving twelve months' notice."

See Germany-Poland (1989), Art. 14 (2); Canada-Poland (1990), Art. XIV; German-Barbados (1994), Art. 13 (2). According to Canada-Trinidad and Tobago (1995), Art. XVIII (2), "The Agreement shall remain in force unless either Contracting Party notifies the other Contracting Party in writing of its intention to terminate it".

Canada-UAE (1993), Article 15, instead provides that

> "(1) This Agreement shall remain in force for a period of ten years. Thereafter, it shall remain in force until the expiration of twelve months from the date that either Contracting State in writing notifies the other Contracting State of its intention to terminate this Agreement."

82. Germany-Barbados (1994), Article 13 (3), provides that "in respect of investments made prior to the date of termination of this Treaty, the provisions of articles 1 to 12 shall continue to be effective for a further period of twenty years from the date of termination of this Treaty". Twenty years are also provided in Germany-Poland (1989), Art. 14 (3); Sweden-Poland (1989), Art. 11 (3); France-Mongolia (1991), Art. 12; France-Viet Nam (1992), Art. 12; United Kingdom-Honduras (1993), Art. 14; United Kingdom-Turkmenistan (1995), Art. 14. Fifteen years after termination are instead provided in China-Japan (1988), Art. 15 (3); Australia-Viet Nam (1991), Art. 15 (3); Australia-Romania (1993), Art. 11 (3); Netherlands-Lithuania (1994), Art. 15 (3); United King-

The clauses on duration are meant to afford the maximum security to existing [83] and to future investments even after the BIT should cease or has ceased to be in force. The provisions found in some BITs, according to which suspension or interruption of consular or diplomatic relations shall not affect their application, are also intended to secure investors as to the future stability of the protection granted by the treaty [84].

4. The Definition of "Investments"

In the absence of a generally accepted international legal definition of the term "investment", national laws define it differently depending upon the relevant purpose. In many countries the term "investment" is not even legally defined; the terms "property", "assets" or *"biens"* are defined as an established concept in civil and constitutional law. The well-known civil law distinction between absolute ownership of things *(in rem)* and rights or claims stemming from contractual or non-contractual obligations *(in personam)* is relevant, though constitutional protection against deprival of ownership covers to some extent also the second category [85].

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dom-India (1994), Art. 15; Canada-Trinidad and Tobago (1995), Art. XVIII (2); Norway-Peru (1995), Art. 14; Israel-India (1996), Art. 15 (2). Finally ten years are provided in United States-Argentina (1991), Art. XIV (3); Argentina-Egypt (1992), Art. XI (2); United States-Russia (1992), Art. XIII (3); Argentina-Venezuela (1993), Art. 12 (2); Czech Republic-Hungary (1993), Art. 12 (3); China-Uruguay (1993), Art. 13 (4); China-Slovenia (1993), Art. 12 (4); UAE-Poland (1993), Art. 15 (2); Israel-Ukraine (1994), Art. 15; Israel-Estonia (1994), Art. 14 (both these Israel BITs add "without prejudice to the application thereafter of the rules of general international law"). The same provision is also included in United Kingdom-Honduras (1993), Art. 14; United Kingdom-India (1994), Art. 15; United Kingdom-Turkmenistan (1995), Art. 14; Colombia-Spain (1995), Art. XII (2); United States-Nicaragua (1995), Art. XVI (3); Israel-Turkey (1996), Art. 14; Italy-Russia (1996), Art. 14 (2). Only five years are provided in Italy-Argentina (1990), Art. 13 (2); Bolivia-Peru (1993), Art. 14 (2); Italy-Cuba (1993), Art. 15 (2); Italy-Ukraine (1995), Art. 14 (2).

83. Investments are protected in most BITs regardless of the date when they were made, thus including existing investments at the time of the BITs signature or entry into force as some of them specify. Some BITs, however, indicate a specific earlier date in connection with the history of the parties' relations. See China-Japan (1988), Art. 9 (from 29.9.1972); Italy-USSR (1989), Art. 12 (from 10.2.1947); Italy-Russia (1996), Art. 11 (from the same date).

84. See China-Japan (1988), Art. 10; Italy-USSR (1989), Art. 11. Such a provision appears however to be superfluous in view of Article 63 of the Vienna Convention on the Law of Treaties, which lays down the same rule when diplomatic or consular relations are not indispensible for the application of a treaty.

85. See the judgment of the ECHR in the case *Greek Refineries Stran and Stratis Andreadis* v. *Greece* of 9 December 1994. The Court held that legislative

One of the few generally accepted concepts is the distinction between *direct* and *portfolio* investments, which reflects a difference in scope, in the nature of the investor and in the related activities which must be allowed in order to manage the investment[86]. Though based on economic criteria this distinction may be the basis of differences in treatment both domestically and internationally.

Foreign direct investments (FDI) are, according to the OECD definition adopted also by the European Community, those made by non-residents for the purpose of establishing lasting economic ties with an enterprise, such as, specifically, those which allow the investor to exercise an effective influence in the management of such enterprise. FDI covers the creation or extension of an enterprise, branch or subsidiary ; the acquisition of a share in an existing enterprise or a long-term loan (more than five years duration), provided that the share of ownership or the ties established create the above situation[87].

Such an investment is usually made by an individual entrepreneur or a company within a policy of expanding abroad. It entails the exercise of management rights and is often associated with contractual ties between the investor and the enterprise abroad. FDI is the typical expression of the internationalization of business activity, both if the investor is a large multinational company or a small business.

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annulment of an arbitral award between the claimants and Greece, awarding damages to the claimant for breach of contract, was an unlawful interference with property in violation of Article 1 of the Additional Protocol to the European Convention on Human Rights.

86. As to the economic underpinnings see Chapter 1, section 2. For a general discussion of definitions see D. Carreau, T. Flory and P. Juillard, *Droit international économique*, 1990, 559 *et seq.*

87. See OECD, *Capital Movement Liberalisation Code*, Annex A ; EC Directive 88/361 for the application of Article 67 of the EC Treaty, Annex I. The percentage of participation can vary. For balance of payment statistical purposes the IMF considers that a 10 per cent participation represents a direct investment, but in specific cases a smaller shareholding may entitle to a representation in the board of a company and a say in its management. This is the case of some recent privatization in Western Europe where lower ceilings of shareholding were imposed by law. Not all FDI implies therefore full ownership or majority control by a parent company over a subsidiary. It usually requires at least a "qualified participation" which allows a "significant influence" on the conduct of the foreign company. For a legal definition of control see EC Seventh Directive 83/349 on consolidated accounts of 13.6.1983.

According to the definition contained in Article XXVIII *(n)* (ii) a juridical person is controlled by persons of another Member "if such persons have the power to name a majority of its directors or otherwise to legally direct its actions".

"Establishment" encompasses the most significant form of FDI, with an emphasis on the initial entering into the foreign market. A foreign investor establishes itself therein by creating or expanding a commercial office, a branch or a subsidiary under local law, which will then operate in that market [88].

Portfolio investment on the other hand consists in the placement of funds in foreign markets for financial purposes, such as the buying of stocks, bonds, treasury bills and the making of loans there, without the possibility or intent of influencing the management of any local company. It includes the subscription and buying of stock, bonds or debentures issued by foreign entities, both public and private, on international capital markets.

From a macroeconomics point of view, the qualitative features of FDI are its stability, the additional resources connected to it (such as technical, managerial and marketing know-how) and the beneficial side-effects associated with the increase of business (such as employment opportunities and exports) which it entails. As mentioned in Chapter I, most developing countries did not provide a reliable domestic market for portfolio financial investments until recently, so that this kind of investment is a new feature in the general picture of private capital flows to developing countries.

FDI is accordingly the main objective of BITs, as well of the liberalization efforts of capital movements by and within industrialized countries which was initiated by the OECD in the 1950s. Portfolio investment and other personal investments from abroad, such as ownership of real estate, are however not excluded as a rule from a BIT's coverage. The undertaking to respect contractual obligations found in many recent BITs may be relevant also as to equities and debentures issued by a contracting State or by its companies abroad

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88. See the definitions of the right of establishment in Article 52 of the EC Treaty. Since the right of establishment in the EC is a freedom guaranteed by the Treaty, separate from the freedom of capital movements, these movements when incidental to establishment are liberalized in accordance with the provisions concerning the right of establishment. For a similar approach under GATS see Article XVI on market access, footnote 8, according to which if a member allows commercial presence of a foreign service provider it must also allow cross-border movement of capital if it is an essential part of the service itself.

The EC partnership agreement with Russia of 1994 (OJ L 327 of 28.11.1997) at Article 52 distinguishes between movement of capital representing direct investment which is liberalized and other movements which may be subject to unilateral restrictions. Russia is moreover free to apply restrictions to capital outflows (Art. 52 (3)).

and underwritten or bought by financial investors of the other country [89].

The lack of an accepted terminology and the multifaceted forms (contractual besides proprietary) through which investments are currently carried out explain the care with which recent BITs define investments, with a view to cover all types of transfers of, and ownership in, financial, tangible and intangible rights and claims of an economic value which represent or are connected with an investment in the economic sense.

The United States treaties include, after a general definition (which is common in all BITs), a detailed non-exclusive list of what may constitute an investment. Thus the BIT between the United States and Russia of 1992 is worded as follows in Article 1 *(c)*:

> " 'investment' means every kind of investment in the territory of one Party, owned or controlled by nationals or companies of the other Party, such as equity, debt, service and investment contracts, and includes, without limitation:
>
> (i) any kind of property including movable and immovable property, tangible and intangible property, and including property rights such as mortgages, liens and pledges;
> (ii) any interest in a company including shares of stock, management and operating rights, or interests in the assets of a company;
> (iii) a claim to money or a claim to performance having economic value, and associated with an investment;
> (iv) intellectual property which includes, *inter alia*, rights relating to:
>
> literary and artistic works, including sound recordings,
> intervention in all fields of human endeavour, industrial designs, integrated circuit layout designs,
> know-how, trade secrets, and confidential business information, and trademarks, service marks, and trade names; and
>
> (v) any right conferred by law or contract relating to an investment, or by virtue of any licenses and permits pursuant to law."

89. The requirement found in most BITs that covered investments must be made in the other country's territory would however exclude such investments from the purview of the treaty, *ratione loci*.

Most BITs of other States include instead in the definition of investment a rather shorter, non-limitative list. The list mentions movable and immovable property, stocks in companies (sometimes mentioning explicitly that also minority or indirect participation in a company are included), monetary or other (contractual) claims having an economic value, intellectual and industrial property rights. Financial or portfolio investments are covered under these definitions and listings. Licences and permits are sometimes explicitly mentioned as well.

As to multilateral instruments, a detailed definition of investment similar to the one of the BIT between United States and Russia is found in Article 1 (6) of the Energy Charter Treaty of 1994:

> " 'Investment' means every kind of asset, owned or controlled directly or indirectly by an Investor and includes:
>
> tangible and intangible, and movable and immovable, property and any property rights such as leases, mortgages, liens, and pledges;
>
> a company or business enterprise, or shares, stock, or other forms of equity participation in a company or business enterprise, and bonds and other debt of a company or business enterprise;
>
> claims in money and claims to performance pursuant to contract having an economic value and associated with an Investment;
>
> Intellectual Property;
>
> Returns;
>
> any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.
>
> A change in the form in which assets are invested does not affect their character as investments and the term 'investment' includes all investments, whether existing at or made after the date of entry into force of this Treaty for the Contracting Party of the Investor making the investment and that for the Contracting Party in the areas in which the investment is made (hereinafter referred to as the 'Effective Date') provided that the Treaty shall only apply to matters affecting such investments after the Effective Date.
>
> 'Investment' refers to any investment associated with an Economic Activity in the Energy Sector and to investments or

classes of investments designated by a Contracting Party in its Area as 'Character efficiency projects' and so notified to the Secretariat."

Some BITs mention explicitly that any lawful modification of the form of an investment does not affect its status as such under the treaty (cf. Article 1 (1) of the BIT between France and Argentina of 1991), though this should result from the definition even in absence of such a clause [90].

Two questions are relevant in respect of the definition. The first one is whether also foreign property which cannot be defined as an investment (for instance real property acquired by inheritance) is covered by the treaty as is the case under typical FCN treaties.

The answer depends on the wording of the relevant provisions: such a right would be covered by the France-Mongolia BIT which defines investment as including all kind of property. It would be excluded under the BIT between China and Japan of 1988 according to which "'investment' comprises every kind of asset, used as investment". The answer is doubtful under the BIT between the United States and Russia. The doubt is not solved by looking at the purpose of the treaty as stated in the unusually long preamble, since it refers to the desire of the parties to promote investments. The preamble also states, however, the belief of the parties that "economic freedom for the individual includes the right freely to own, buy, sell, and otherwise use property", a sentence which hints at a wide coverage [91].

5. Foreign-owned or Controlled Companies as Protected Investments

Another more weighty question is whether companies organized under the law of one of the parties, owned or controlled by nationals

90. This is also provided for in Article 1 (6) of the European Energy Treaty. Reinvestments, which may represent a substantial part of FDI, are sometimes explicitly mentioned (cf. Italy-Argentina (1990), Art. 1 (1)), but they are generally covered by the definition also in absence of specific mention. The requirement that the assets or funds be imported from abroad is rarely found in recent BITs. For such an approach see Cartagena Commission Decision N. 291 of 21.3.1991 on the common treatment of foreign capital in the Andean Pact countries (30 *ILM*, 1991, 1283 *et seq.*).

91. See also A. Newburg, "US-Soviet Trade Agreement and Investment Protection Treaties", 11 *NYL Sch. J. Int. and Comp. L.*, 1987, 117 *et seq.*, as to the 1990 BIT.

of the other, are to be considered as investments under the treaty. If so, they would enjoy its protection, whereas if the investment consists only in the ownership by the foreign investor in their capital stock, the latter would be protected only insofar as the specific rights pertaining thereto were mistreated in violation of the treaty.

The question has been discussed in general international law and has been dealt with by the International Court of Justice in the *Barcelona Traction* case of 1970, though the point was not decisive for rendering the decision.

As is well known, the Court held that, in view of the fact that corporations enjoy in municipal law an independent corporate personality (whose veil can be pierced only in exceptional cases) from that of its shareholders, the "distinction between injury in respect of a right and injury to a simple interest" must be upheld. Therefore "an act directed against, and infringing only the company's rights does not involve responsibility towards the shareholders, even if their interests are affected". The Court acknowledged that "a theory has been developed to the effect that the State of the shareholders has a right of diplomatic protection when the State whose responsibility is invoked is the national State of the company". However the Court had not to pass upon the validity of this theory, since Spain, the defendant in the case, was not the national State of the *Barcelona Traction* company, a Canadian company, for the protection of whose Belgian shareholders Belgium had initiated the case [92].

The question is open in general international law as to what kind of deprivation of rights or discrimination against a foreign-owned company affects the shareholders in such a way as to prejudice their rights (as opposed to their economic interests). According to some views, it is enough that the subsidiary legally exists and can protect judicially its rights, to bar any diplomatic intervention of the home country of the investor. In any case this uncertain situation warrants more specific provisions in BITs, as well as multilateral efforts aimed at avoiding discrimination against such companies.

The question came up again before a Chamber of the Court in the

92. *ICJ Reports 1970*, paras. 40-41, 46, 56 *et seq.*, 92. As to the recent literature on the issue, see G. Sacerdoti, "The *Barcelona Traction* Revisited*:* Foreign-Owned and Controlled Companies in International Law", *Essays Rosenne. International Law at a Time of Perplexity*, 1989, 699 *et seq.*; C. Staker, "Diplomatic Protection of Private Business Companies", *BYIL*, 1990, 155 *et seq.*; M. Sornarajah, *op. cit.*, 286 *et seq.*

ELSI case decided in 1989, where the United States claimed against Italy that a decree of requisition by the mayor of Palermo against the assets of ELSI, an Italian subsidiary of a United States corporation, was in violation of Article III (2) of the FNC Treaty between United States and Italy of 1948. This provision grants *inter alia* the right to nationals and corporations of either party "to organize, control and manage corporations" established under the law of the other party, which shall be entitled to national treatment.

The rights of the United States shareholder in the assets of the subsidiary were found to be protected by the Treaty in the instance at issue not because the subsidiary was an "investment", but rather thanks to the provision granting to the United States investors the right to "control and manage" Italian corporations. This right had been affected in Italy, although for factual reasons no damage was found [93].

The definition of "investment" in BITs, as to subsidiaries organized under the law of one of the contracting States and "owned or controlled" by nationals, including companies, of the other, has therefore to be viewed in the light of both the general and specific obligations undertaken by the parties as to such investments [94].

Some treaties, such as the BIT between Italy and Argentina of 1990, explicitly mention also minority participations among protected investments. The Protocol to the United States-Russia of 1992 states that control depends on factual circumstances, considering *inter alia* the extent of equity, the ability to exercise substantial influence over the management and operation of the investment and

93. *ICJ Reports 1989*, 15 *et seq.*; but see Judge Oda's dissenting opinion according to whom the Italian measures affecting the subsidiary could not violate the rights of the US parent as a shareholder of the same. On the *ELSI* case see the extensive comments by P. Juillard, "L'arrêt de la Cour internationale de Justice (chambre) du 20 juillet 1989 dans l'affaire de l'Elettronica Sicula (Etats-Unis c. Italie) : procès sur un traité, ou procès d'un traité ?", *AFDI*, 1989, 276 *et seq.*; B. Stern, "La protection diplomatique des investissements internationaux : de *Barcelona Traction* à *Elettronica Sicula* ou les glissements progressifs de l'analyse", *JDI*, 1990, 897 *et seq.*; I. Seidl-Hohenveldern, "*Elsi* and *Badger*, the Two Raytheon Cases", *Rivista di diritto internazionale privato e processuale*, 1990, 261 *et seq.*; F. A. Mann, "Foreign Investment in the International Court of Justice : the *ELSI* Case", 86 *AJIL*, 1992, 92 *et seq.*

94. The definition of investment in Article 1 (6) *(b)* of the Energy Charter Treaty, by including "a company or business enterprise" owned or controlled directly or indirectly by a protected investor, appears to have covered the issue in the most far-reaching way from a definitional point of view. It must be stressed however that the Charter does not provide in Article 10 for binding standards of treatment.

over the composition of the board of directors or any other managing board[95]. According to Article I (3) of the BIT between Australia and Viet Nam of 1991, control means having a substantial interest; any question arising in this respect "shall be resolved at the satisfaction of the Contracting Parties".

It is clear that, in view of the prevailing practice to carry out investments abroad by means of locally organized subsidiary companies, the general standards of fair, national and mfn treatment provided for foreign investments in BITs would be meaningless, contrary to their purpose, should the separate legal personality and different nationality of the subsidiary bar the application of those standards to foreign-owned or controlled companies[96], i.e. to FDI operations.

This matter has been extensively dealt with within OECD, but even its members, which include all industrialized countries, could not agree to legally commit themselves to the unconditional granting of national treatment to companies owned or controlled by nationals of other members.

The process started in 1976, when the OECD member States adopted a Declaration on International Investment and Multinational Enterprises, recommending to multinational enterprises operating in their territories the Guidelines annexed to it (the so-called OECD Code of Conduct on MNE) and including a non-binding commitment to accord national treatment to foreign-controlled enterprises. This commitment was carried out, but only as to procedure, with the binding Decision on National Treatment of 1984, last revised in 1991. The decision requires the member States to notify exceptions

95. The text of the BIT between United States and Russia is followed almost *verbatim* in the "Understanding" with respect to Article 1 (6) of the Energy Charter Treaty, which adds that in cases of doubt "an investor claiming such control has the burden of proof that such control exists". According to the Protocol to the BIT between Netherlands and Poland of 1992 control (i.e. "the ability to exercise substantial influence over the management and operation of an investment") cannot derive solely "as a result of a contractual relationship for the provisions of goods or services or the extension of commercial credits in connection with such contracts". See also Article 1 (2) *(b)* of the BIT between Sweden and Poland of 1989 rendering purely contractual relations irrelevant. Germany's BITs (such as those with Peru of 1987 and Estonia of 1994) grant national treatment to investments owned or "under influence" of the other party's nationals or companies.

96. See United Nations, *Bilateral Investment Treaties, op. cit.*, 24. The object of the protection under the Treaty is not the nationals or companies of a party, but their investments; the latter may take the form of a company established under the law of the host State.

and transparency measures and provides for periodic examinations of their practices directed at encouraging the withdrawing of such exceptions. These instruments were aimed at equalizing the treatment of foreign-controlled enterprises with that of domestic enterprises, since the OECD Code of Liberation of Capital Movement only dealt with the regulation of entry and conditions of establishment[97].

Most BITs include special terms that make their standards of treatment applicable also to the life and activities of foreign-owned companies, though not up to the point to protect them in all aspects of their current conduct of business, thus in line with the reasoning of the *ELSI* judgment. The question is limited to direct foreign investments, where the investor through a substantial (even if not majority) share of ownership in the local company participates in its management and control, so as to have a say in its operations and not just a stake in the economic results, as is the case for portfolio investments[98].

The guarantee of fair and equitable, mfn, national and/or non-discriminatory treatment also for activities connected or associated with an investment (such as in the BITs between France and the USSR of 1989 and between Italy and Argentina of 1990) is of special importance in this respect. Some treaties specify that these "business activities in connection with the investment" include "the control and management of companies which they [the investors of the other party] have established or acquired"[99]. The BIT between the United States and Russia of 1992 defines in detail the concept of "associated activities", which include "the organisation, control, operation, maintenance and disposition of companies"[100]. Moreover BITs often accord specific rights to local companies owned or controlled

97. See OECD, *National Treatment for Foreign-Controlled Enterprises*, 1993, featuring also the list of existing national exceptions and transparency measures. The partnership agreement between the EC and its member States on the one hand and Russia on the other (OJ L 327 of 28.11.1997) relies on control as to subsidiaries as well as on capital ownership of more than 50 per cent in the case of banks (Art. 29 (4) and 30 *(b)*).

98. The BIT between Italy and Cuba of 1993 prohibits discriminatory measures also affecting "companies and enterprises in which investments have been made". According to Article 5 (3) of the BIT between Italy and Ukraine of 1995 its provisions on expropriation are also applicable to expropriation of assets of local companies in which investors of the other party hold any percentage of shares. For a similar provision see United Kingdom-India (1994), Art. 5 (3).

99. See Japan-China (1988), Art. 3 (3) *(b)*.

100. See Art. I (1) *(e)*.

by investors of the other party, such as that of engaging top personnel of their choice, regardless of nationality [101].

Another technique would be that of attributing to the local though foreign-controlled company the nationality of the controlling foreign investors, thereby granting it full protection under the treaty. This is a permissible option as to the right to invoke agreed dispute settlement procedures. This solution is envisaged as optional in Article 25 (2) *(b)* of the ICSID Convention, and is often adopted in bilateral treaties [102]. The BIT between the United States and Russia follows this approach as to investments disputes: Article 7 of the Protocol provides in this respect that companies of either party which are an investment of nationals or companies of the other party shall be treated for this purpose as nationals of such other party [103].

These BIT clauses extend the status of an investor of the other contracting State to a company of the host State basically only for the purpose of giving them *locus standi* as a party in the dispute settlement procedure. As to substantive matters such a company represents an investment, whose protection is accorded to the investor of the home State party to a BIT.

6. Nationality Requirements as to the Investor

In view of the fact that investment treaties are bilateral the need to determine their beneficiaries *ratione civitatis* is unavoidable. This is also required in regional agreements or in those based on reciprocity.

101. Article 2 (2) of the BIT between Italy and Cuba of 1993 and of the BIT between Italy and Brazil of 1995 containing the common prohibition against "unjustified or discriminatory measures against the management, enjoyment, liquidation of investments" extend it also in respect of "companies and enterprises in which such investments have been made".

102. See Chapter VI, section 6, for further discussion. See also M. Sornarajah, *op. cit.*, 247. Article 26 (7) of the Energy Charter Treaty makes Article 25 (2) *(b)* of the ICSID Convention applicable under the Treaty to the settlement of disputes between a contracting party and an investor national of the other contracting party.

103. In *Vacuum Salt Products Ltd.* v. *Ghana* the ICSID arbitral Tribunal declined jurisdiction notwithstanding the agreement between the parties to submit any dispute to ICSID, holding that a 20 per cent ownership by a national of another contracting State, without any management role, did not objectively comply with the requirement of foreign control under the Convention; see the Award of 16.2.1994, *ICSID Rev.*, 1994, 72 *et seq.* On parent-subsidiary relations see also F. A. Mann, "The Doctrine of International Jurisdiction Revisited after Twenty Years", *Recueil des cours*, Vol. 186, 1984, 56 *et seq.*; I. Seidl-Hohenveldern, *Corporations in and under International Law*, 1987, 2.

In theory, relevance might have been given to the origin of the capitals invested in view of the object of these treaties, but this has never been followed [104].

In general international law the requirement is well settled that, in case of exercise of diplomatic protection in favour of private persons or entities, a genuine nationality link, which is prima facie presumed if formal nationality exists, must exist between the claimant State and the person whose rights or interests are being protected. In case of individuals the standard requirement is that nationality be based on an effective link, as generally recognized by States in granting their nationality. In case of dual nationality the dominant and effective nationality prevails [105].

The issue is rarely dealt with in detail in BITs. Most treaties state that "national" means natural persons who are national of a contracting party in accordance with its laws, thus making such unilateral attribution of nationality controlling. Permanent residents are sometimes included, as in the BIT between Australia and Viet Nam of 1991. They are encompassed under Article 1 (7) of the Energy Charter Treaty and the Mercosur Protocols of 1994 [106].

Incorporation is generally recognized as a sufficient connecting factor as to companies. Therefore the foreign nationality of the shareholders, the foreign origin of the capital and/or the carrying out of substantial or prevailing activities outside the State according diplomatic protection does not prevent it from pressing a claim for a company, if it elects to do so, whenever it has bestowed upon it its

104. Mercosur Protocols of Colonia and of Buenos Aires (1994) on other members and on third countries' investments respectively (for the texts see United Nations, *International Investment Instruments*, *op. cit.*, Vol. III, at 513 and 527) exclude from their coverage investments by nationals of the home State which are residents in the host State, in any case when the capitals or assets invested are not imported from abroad. MIGA provides at Article 13 *(c)* for coverage of investments made from abroad by nationals of the host State, if this State consents, in order to promote repatriation of capital to developing countries.

105. See the *Nottebohm* case (*ICJ Reports 1955*, 4); the Iran-United States Claims Tribunal's case *A/18* of 6.4.1984 (24 *ILM*, 1984, 497); I. Brownlie, *Principles of Public International Law*, 4th ed., 480 *et seq.*

106. German BITs mention in a Protocol that the possession of a national passport delivered by a competent authority shall prima facie indicate citizenship, a provision which might be connected with the existence then of the German Democratic Republic. The BIT between Italy and Argentina of 1990 provides in an additional Protocol that the treaty shall not apply to nationals of one party who have been domiciled in the other party for more than two years at the moment of the investment, a provision probably justified by the large number of Argentinians of Italian descent.

nationality in conformity with its law. Under the *Barcelona Traction* doctrine the national State of the shareholders is not entitled on the other hand to act *in lieu* of the corporation's national State when this State has decided not to protect the latter's interests abroad [107].

The general definition of "company of a Party" encompasses accordingly as a rule any legal person incorporated, or organized under its law, without any limitation in this respect. The BITs of civil law countries tend to use the terms "legal entity" or "juridical persons" in the definition, thus including companies. The BITs where the term "company" is used (as is the case for United Kingdom and United States treaties) tend on the other hand to specify that all kinds of juridical persons (including associations and partnerships) are thereby covered, thus including also non-profit entities and governmentally owned bodies.

Treaty law is often more restrictive.

A genuine economic link with the economy of the country where a company is incorporated has been required in order to admit such a company to the benefits provided for in regional integration agreements. Thus Article 58 of the EC Treaty of 1957 requires that companies incorporated in a member State have their seat, central administration or centre of principal business anywhere in the Community, in order to benefit from the freedoms of establishment and from providing services in the common market. Ownership by investors of a third country is on the other hand immaterial.

Article 1401 (2) of the NAFTA Agreement provides as an exception that a party may deny the benefits of the Investment Chapter provisions to a company of another party "that is owned or controlled by persons of a non-Party and that has no substantial business activities in the territory of any other Party". The same approach has been laid down in Article 17 of the Energy Charter Treaty on non-application of its Part III on investment promotion and protection in certain circumstances [108].

Control besides incorporation is required in different contexts

107. See generally I. Seidl-Hohenveldern, *Corporations in and under International Law, op. cit.*, 27 *et seq.*

108. BITs entered by the Soviet Union (still in force for its successor States if not replaced by new treaties) provided that the investor must moreover be "competent in accordance with the law of that Contracting Party, to make investments in the territory of the other Contracting Party". This clause reflected the Soviet legislation then in force on entities authorized to trade with and invest abroad.

such as that of the Claims Settlement Declaration of the Algiers Agreements of 1981 between the United States and Iran. According to Article VII (1) of the Declaration, the Claims Settlement Tribunal may decide claims of "a corporation or other legal entity which is organised under the laws of Iran or the United States . . ." only "if, collectively, natural persons who are citizens of such country hold, directly or indirectly, an interest in such corporation or entity equivalent to fifty per cent or more of its capital stock" [109].

Contracting States of BITs may wish to limit the rights granted to their companies therein to those having such a genuine link with their economy. This in order to avoid "free riding", i.e. the incorporation of foreign-owned companies in their jurisdiction for the sole purpose of operating in the other party's territory under the umbrella of the treaty.

Any such limitation as to the beneficiaries would restrict the protection that a company incorporated in one of the contracting States might be accorded under general international law. Such a limitation is not lightly inserted in BITs, also in view of the uncertain identification of control or of other relevant links in a given case, which might further reduce the effective coverage of the treaty. Indeed few BITs contain specific provisions in this respect, and if they do so the exceptional and eventual role of the limitation tends to be spelled out.

The practice of some countries is to provide for such an economic link with the party of which a company is an investor. Recent Swiss BITs require that companies constituted under its laws have moreover their seat in Switzerland as well as "effective economic activities" in its territory, in order to be covered by the agreement [110].

The recent United States practice in this respect is that of reserving the right to either party to deny the advantage of the treaty to companies of the other party

> "if *(a)* (i) nationals of any third country control such company

109. See generally B. Stern, "Les questions de nationalité des personnes physiques et de nationalité et de contrôle des personnes morales devant le Tribunal des différends irano-américain", *AFDI*, 1984, 425 *et seq.* As to the Tribunal practice see P. Acconci, "Il collegamento tra stato e societa quale presupposto per la competenta del Tribunale Iran-Stati Uniti", *Dir. commercio internazionale*, 1998, 135 *et seq.*

110. See 1991 BITs of Switzerland with Peru and Cape Verde, Art. 1 *(c)*. Some treaties explicitly mention the State itself (UAE-Poland, 1993), State-owned entities (Italy-Cuba, 1993) or other "economic organizations" (China's BITs) among the investors.

> and (ii) that company has no substantial business activities in the territory of the other Party, or *(b)* such company is controlled by nationals of a third country with which the denying Party does not maintain normal economic relations",

the latter being a kind of political or security exception.

7. *Indirect Investments*

The widely followed practice of many companies to operate in foreign countries by means of local subsidiaries, owned through a holding subsidiary incorporated in a tax or financial haven for practical business purposes, would deny to such operating subsidiaries the benefit of a BIT between the home country of the original parent and the host country, in the absence of specific appropriate provisions extending the relevant definitions to cover also this case.

Most BITs do not cover specifically this issue. In view of the large network of existing BITs the holding companies' investments could be covered by those made by the country where they are incorporated. On the other hand many BITs of a number of countries, such as the United States ones, specify generally that investments include also those owned or controlled indirectly by individuals or companies of either party. Thanks to such a clause the BIT would protect, depending upon the existence of a factual control, the parent of the holding company as an indirect investor in the operating subsidiary.

The question is therefore whether or how far companies established in third countries, which are owned or controlled by investors of one of the parties of a BIT, are covered as investors.

In this respect several BITs include more detailed provisions in order to cover explicitly investments made by nationals (including companies) of either party carried out through third countries' entities. Thus Swiss treaties include among the investors legal entities established in conformity with the law of any (third) country, which are directly or indirectly controlled through a significant share of ownership, by nationals of either party or by companies having their seat and effective business activities in either party's territory [111].

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111. For an identical provision see France-USSR (1989), Art. 1 (1); Argentina-Egypt (1992), Art. I (2). The BIT between Sweden and Poland of 1989 is applicable to third countries' legal entities in which an investor of the parties has

A similar provision is found, in accordance with the Dutch model, in the BIT between Netherlands and Poland of 1992 : legal persons controlled directly or indirectly by nationals or companies of either party, not constituted under the law of that party, "wherever located", are included among the investors. Similarly, the BIT between Australia and Viet Nam of 1991 includes among the nationals of a contracting party companies incorporated under the law of a third country, controlled by one of their citizens, permanent residents or companies.

"predominant interests" except "if it had earlier invoked remedies available to it pursuant to another investment protection agreement concluded with the third country in question". The BIT between China and Japan of 1988 includes a specific provision at Article 12 covering in some respects "companies of any third country in which nationals and companies of either contracting Party have a substantial interest". United State-registered but Japanese-controlled companies making an investment in China would thus be covered, notwithstanding the absence of a BIT between the United States and China.

CHAPTER III

MARKET ACCESS BY FOREIGN INVESTORS

Summary : 1. The admission of foreign investments : international law and States' policies : (a) *General international law ;* (b) *Policies and multilateral undertakings of industrialized countries ;* (c) *The evolution of the former centrally planned economies ;* (d) *The change in policies by developing countries. 2. Admission of foreign investments in BITs : recent evolution. 3. Regional and multilateral regulation of market access by foreign investors.*

1. The Admission of Foreign Investments : International Law and States' Policies

(a) *General international law*

Under general international law, in the absence of treaty obligations and contractual commitments, States are free to regulate the admission of foreigners in their territory including the conditions and the extent of their carrying out economic activities, as a prerogative deriving from national sovereignty. Once foreigners have been admitted to enter their territory at any title and to do business, States are bound to extend to them the protection of the law and are subject to obligations concerning the standard of treatment to be granted to them as provided by customary rules, whose exact scope is the object of well-known discussions [112].

No general obligations exists as to the movement (admission) of capitals and the freedom for foreigners to carry out business and to establish themselves. Indeed the policy of different groups of countries have been substantially at variance in this respect, depending upon the principles of their economic system [113].

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112. See the *Barcelona Traction* case, *ICJ Reports 1970*, para. 33.

113. The freedom of States to regulate the entry of foreign capital is spelled out in such different texts as the OECD project of a Convention on the treatment of foreign investment of 1967, Art. 1 *(b)* ; the United Nations Declaration 1803 (XVII) of 14.12.1962 on permanent sovereignty of States on their natural resources ; paragraph 48 of the United Nations project of a code of conduct for TNCs (1983), and is generally implied by the OECD Code of liberalization of

(b) *Policies and multilateral undertakings of industrialized countries*

Industrialized, market-economy, capital-exporting countries have tended to be liberal in the area of capital movements, especially as to foreign direct investment. Portfolio investments and especially short-term capital movements of a financial nature have been more tightly controlled until recently by several countries. The post-World War II concerted efforts of these countries in this direction have been pursued in accordance with the OECD Code of Liberalization of Capital Movements of 1961, in parallel with the other Code on liberalization of current payments. Liberalization means the elimination of restrictions on the carrying out of the various transactions and transfers listed in the Annexes, whose scope has been progressively expanded.

The obligations provided therein are binding since the instruments are a binding decision of the Organisation. Reservations can be made by individual countries to specific obligations, when these are being inserted in the Code, and are subject to periodic review within the OECD with a view to their progressive elimination [114]. The obligations under the Code apply only to transactions between residents of different OECD member countries, but these should endeavour under the Code to extend the same treatment to all IMF members.

The obligations concerning the admission of foreign investments are prominent in the Code and they cover the right of establishment generally. Restrictions as to this right and differential treatments of foreign investors in respect of nationals as to the right to operate in certain sectors of the economy are subject to periodic reviews. The freedom of investment under domestic law is sometimes even larger than the commitments under the Capital Movement Code would require. FDI transactions can usually be effected without special requirements under the general provisions governing exchange trans-

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capital movements. The IMF commits its members to liberalize current payments but not capital movements (Arts. VI, VIII), although a reform in order to regulate also capital movements is being envisaged. See generally D. Carreau, T. Flory and P. Juillard, *Droit international économique*, 1990, 596.

114. Reservations cannot be made at a later date, nor can they be reintroduced once they have been withdrawn. They should be distinguished from temporary "derogations", which are a kind of safeguard measure for balance of payments purposes. See OECD, *Introduction to the OECD Codes of Liberalization*, 1987; OECD, *Liberalization of Capital Movements and Financial Services in the OECD Area*, 1990.

actions and those regulating the specific business activity concerned [115].

The very scope of the Code underlines the difference between the notions of entry, admission, access, establishment of foreign capital, basically FDI, and the question of its treatment once it has been admitted. The OECD Code covers only the initial making of an investment, i.e. the access to the market, including its most complete form, that of an establishment. Questions concerning the treatment of an investment once made, as in the form of property, branches, domestic foreign-owned or controlled companies, are not subject to the Code, which governs transborder operations only. The looser OECD Declaration and Decision on National Treatment cover these other aspects; their application is periodically reviewed by the OECD jointly with the Codes. Restrictive measures can affect in some cases both the making of an investment and its subsequent treatment, for example when the access by foreigners to a certain sector is subject to special requirements, which apply also to subsequent operations, while nationals are not subject to them. The dividing line may therefore be difficult to draw in many instances.

These obligations and the articulated review mechanism notwithstanding, several important OECD countries maintain substantial restrictions both as to certain types of capital movements (especially as to short-term flows with a potentially destabilizing effect, physical movements of gold, coins, currency, and in real estate), and as to significant sectors of their economy which have remained closed to foreign investors. A number of members derogate to the national treatment standard in respect of admitted investments in certain areas. Indeed, the extent of these restrictions is usually underestimated even by experts and is being understated for political and

115. This does not exclude the right of the admitting country to prescribe specific modalities, such as the use of normal banking channels, e.g. in order to gather data for statistical purposes, and to control the real nature of a transaction, provided this has not the purpose or the effect of derogating from the obligations undertaken. Freedom of capital movements is fundamental within the EC internal market, see EC Capital Movement Directive 361/88, Art. 4; ECJ judgments in cases 358, 416-493, of 23.2.1995.

Monitoring of and restrictions of foreign investment for national security reasons is also possible and may entail the prohibition of an acquisition of a local company by foreign investors, see in the United States the Exon-Florio Act of 1988, as amended in 1992 (amended section 721 of the Defense Production Act 1950). The EC objected to these provisions, under which however only one operation in 800 monitored has been blocked, 31 *ILM* 1992, 467.

ideological reasons by capital exporting countries in the current debate on the liberalization of international investment flows.

Thus the United States maintains reservations under the Capital Movements Code as to non-resident investments in atomic energy, broadcasting, air transport, coastal and domestic shipping. The United States reservation also lists ocean thermal energy, hydro-electric power and geothermal steam or related resources on federal lands, and mining on federal lands on the outer continental shelf and on the deep seabed. As to fishing in the exclusive economic zone and deepwater ports, a non-resident must invest through an enterprise incorporated in the United States [116].

Also other industrialized countries maintain a number of restrictions, based on local traditions, perceived strategic value of certain sectors, monopolistic approaches or infant industry arguments. Even within the European Community certain restrictions as to investments in real estate had to be admitted in favour of Denmark and Austria [117]. This solution was evidenced by the proposed reservations to initial liberalization commitments put forth during the negotiations of the Multilateral Agreement on Investment, which outnumber those registered under the OECD Capital Movement Code.

The negotiations within the WTO on liberalization of financial services, which were successfully concluded at the end of 1997, also involved commercial presence which is a form of international supply of services according to the GATS, i.e. establishment in banking,

116. Restrictions to foreign investments also exist in the United States under states' legislation, but these are not listed since such local measures are excluded from the Code by an OECD Council decision.

Other restrictions exist in the United States as exceptions or "transparency requirements" (which are often equivalent) to national treatment for foreign investments, both at the federal and states' level, filling 19 pages in the relevant document compiled by the OECD for the latest (1994) examination of US foreign direct investment measures (doc. DAFFE/FDI (94) 2). See generally OECD, *Review of Foreign Direct Investment-USA*, 1995. Federal restrictions cover atomic energy, air and maritime transport, mining, oil and gas on public land, telecommunications, fishing and fish processing, primary dealers in certain securities, certain aids and subsidies. Restrictions at state level exist in banking and financial services, insurance and notably as to ownership of real estate.

Canada's restrictions on FDI inflows were based on the "Foreign Investment Review Act" of 1973, which was replaced in 1985 by the "Investment Canada Act" which liberalized the Canadian FDI policy significantly. Canada has amended this Act with effect from 1 January 1995 in order to extend to all WTO members the liberalization accepted under NAFTA.

117. See especially Protocol *(d)* added by the Maastricht Treaty to the EC Treaty, safeguarding restrictive legislation in force as to the buying of second homes in Denmark.

insurance, securities and financial information where restrictions to access were and are widespread. This is true for the industrialized world but is a feature of these sectors especially in the developing world. The developing countries participating in the negotiations were among the fast developing economies of Central Europe, of South Asia and of the Far East; they had to weigh in the negotiations the overall advantages of liberalization (competition, efficiency) against that of reserving key financial industry to local business.

(c) *The evolution of the former centrally planned economies*

Centralized planned economies of the Soviet type have historically barred altogether access of foreign capital to their economy in any form, the carrying out of private business activities by foreigners being incompatible with their economic structure. It was only in the 1970s that some of them started admitting joint ventures between local State enterprises and foreigners, initially allowing under strict admission (authorization) procedures only a minority shareholding by the latter. The first BITs of countries such as Romania and China, which were at the forefront of this movement, date from those years. With the increased liberalization of those economies and, finally, their transition to the market, foreign investment has become generally welcome and admitted, while joint ventures have ceased to be a required channel [118]. Though the strict procedures governing authorization and operations of foreign-participated or owned companies have been relaxed, BITs with these countries, especially those of the former Soviet Union, include provisions which take into account the special features of these economies and the still widespread role of the State (such as the need for an authorization, in relation with activities associated with an investment and in connection with authorizations, permits, access to governmental resources) [119].

(d) *The change in policies by developing countries*

The dramatic change of traditional attitudes of most developing countries towards foreign investment has been discussed in Chap-

118. As to the evolution of the régime in centrally planned economies, see United Nations Centre on TNCs, *Joint Ventures as a Form of International Economic Cooperation*, 1988; UN/ECE, *East-West Joint Ventures Contracts*, 1989.

119. See Switzerland-Poland (1989), Art. 3 (2); France-USSR (1989), Art. I (1); Italy-Cuba (1993), Protocol, Art. 1 *(b)*; Italy-Ukraine (1995), Protocol, Art. 2.

ter I. This is illustrated by the new investment régimes now in operation in most countries which have virtually abolished the bulk of the previous tight controls and restrictions on the entry and establishment of foreign investment, which were viewed as potentially harmful if not kept within definite bounds. Investment laws or codes which imposed limitations on the entry and establishment of foreign enterprises have been substantially amended. The requirements of preventive screening and authorization have often been replaced by provisions based upon the principle of freedom of entry, subject to sectorial exceptions. The existing requirements of registration and of using specific banking channels are rather met to ensure the supply of information, the management of the balance of payment and the application of the standards of treatment extended to foreign investments under those laws [120].

Some countries have adopted very liberal legal and economic policies in these areas in order to attract foreign capital and investments for industrial policy purposes and in view of the increased competition for this resource in today's open world economy. The benefit of special advantages (incentives) provided under investment laws and/or obtainable through negotiation and agreement with governmental authorities, such as in respect to taxation, financing, custom duties, are often conditioned by localization and performance requirements of various types (especially as to local content of production and share of exports). The latter have been criticized in recent times as counterproductive, discriminatory and inconsistent with international trade obligations, especially when they are a condition of establishment, expansion or maintenance of an investment [121].

120. See e.g. the new investment laws of Argentina of 2.9.1993 (decr. 1853/93); the Mexican law on foreign investments of 27.12.1993; the Tunisian investment code of 27.12.1993 (law 93/120); I. Shihata, "Recent Trends Relating to Entry of Foreign Direct Investment", *ICSID Rev.*, 1994, 47 *et seq.* Restrictions to entry and exceptions to national treatment are still widespread, although unilateral liberalization has been substantial, see D. Conklin and D. Lecraw, "Restrictions on Foreign Ownership during 1984-1994", *Transnational Corporation*, 1997, 1, 1 *et seq.*

121. See also World Bank, *Guidelines on Treatment of Foreign Investments*, 1992, II (3). The TRIM Agreement concluded within the Uruguay Round of GATT concerning trade related investment measures (incentives) outlaws explicitly some of these measures (listed in an illustrative annex) as incompatible with Articles III or XI of GATT, but developing countries have obtained various exemptions. The US model BIT and several recent BITs commit contracting States not to subject the making and maintenance of investments to performance

2. *Admission of Foreign Investments in BITs: Recent Evolution*

As mentioned in Chapter I, BITs have not been viewed generally as a policy instrument to implement liberalization of barriers to the entry of foreign investments in the market of the countries concerned.

There are various explanations for this approach which at a first glance might appear in contradiction with the basic purpose of promoting FDI, a purpose which appears prominently in the very title of all BITs. First of all, their main purpose was historically that of protecting investments from the industrialized party into the developing one, thereby (hopefully) attracting capital into the latter's economy. Since the industrialized countries were more open to foreign direct investment, BITs' indirect liberalizing effect would mainly concern the developing party.

The opening of the economy of the latter to FDI was and is however rather a prerequisite for entering into such a treaty. For a developing country the impetus to liberalize access by bilateral negotiations was scarce for a variety of reasons: first, dealing with and agreeing on such a politically sensitive subject bilaterally with specific industrialized countries could appear as an undue restriction on the nation's sovereignty. Second, the play of the standard mfn clause included in BITs would immediately multilateralize any commitment, which a developing party might have preferred to keep bilateral instead in order to secure through negotiations some specific reciprocal undertaking by the capital-exporting party in return. BITs however do not contain specific commitments by the developed party to foster investments by its nationals or to provide special incentives, so that the granting by the developing party of a preferential access to its market would not be justified [122].

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requirements "which require or enforce commitments to export goods produced or which specify that goods or services must be purchased locally or which impose any other similar requirement": United States-Argentina, Art. II (5); United States-Russia (1992), Art. II (5); Italy-Ukraine (1995), Protocol, Art. 2 *(b)*. On the issue see generally Chapter IV, section 5.

As to the imposition of performance see Italy-Argentina, Art. II (5); Italy-Ukraine (1995), Protocol, Art. 2 *(b)*. The imposition of performance requirement to investments of other members is prohibited by Article 1106 of NAFTA. As to competition between developing countries to attract investments see UNCTAD, *Incentives and Foreign Investment*, doc. TD/B/ITNC/Misc.1, 12.4.1995.

122. When exceptionally such commitments are being made, other types of treaties are being concluded. See e.g. the "special association treaty" of Argentina with Italy of 1987, and Argentina's "general cooperation and friendship

The widespread practice of most countries, industrialized and developing alike, to enter into such agreements, even when mutual economic relations are minimal, also runs against the use of BITs as a tool of economic promotion and liberalization of investments. The text of the preamble of many BITs appears therefore appropriate when they mention that their conclusion is considered in itself by the contracting parties as a (predominantly legal) tool for creating favourable conditions for greater reciprocal investments, i.e. for their promotion, specifically thanks to the agreeing of reciprocal protection standards.

Based on these premises it is not surprising that most BITs, including recent ones (with the notable exception of the United States BITs discussed hereunder), though stating an "open door" policy to foreign investment on a bilateral basis, do not grant to the investors of the other party an enforceable right to be admitted.

In fact recent BITs usually provide that each contracting State shall "encourage as far as possible" and shall admit investments from the other party "in conformity with the applicable laws and regulations" (China-Japan, 1988), "with its laws and regulations" (Switzerland-Peru, 1991), "with its legislation" (Germany-Estonia, 1994), or "subject to its rights to exercise powers conferred by its laws or regulations" (Dutch model) [123].

This terminology does not imply a "stand-still" obligation, nor does it grant a right to make an investment. It indicates however a progress in this direction in comparison with expressions previously

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treaty" with Spain of 1988. The investments promotion and protection provisions of the Lomé Convention, as an instrument to foster the development of the ACP countries, are special in this respect in that they envisage a co-ordination of the activities of the EC Commission and the European Investment Bank in order to promote investments (Art. 272). The Asian-African Legal Consultative Committee revised 1985 draft of a BIT provides that

> "each Contracting Party shall take steps to promote investments in the territory of the other . . . . and encourage its nationals, companies and State entities to make such investments through offer of appropriate incentives, wherever possible, which may include such modalities as tax concessions and investment guarantees", United Nations, *Bilateral Investment Treaties*, 1988, 134.

This approach is however not generally followed in BITs between developing countries. For, some (vague) undertaking of this type, see the BIT between the UAE and Poland of 1993, Art. 2 (1).

123. Some agreements with (then) centralized economies explicitly cover only investments "made in accordance with the legislation of the contracting Party in whose territory they are made", see France-URSS (1989), Art. 1 (2). For an elaborate regulation of the screening of foreign investments see Viet Nam decree 191/CP effective from 1 January 1995.

in use and found in BITs still in force, which stated that investments should fit into national development plans; underlined the need for a specific approval by the host country, sometimes indicating the procedure; referred to the applicability of its *ad hoc* legislation on foreign investments [124].

The current formula does have in my opinion definite legal implications both as to procedure (due process) and as to the substance, in that it subjects the making of an investment only to legal rules in force at that time. A denial of admission, or its subjecting to requirements not in conformity with the law would therefore be a violation of the treaty, if not towards the investor, surely in respect of its national State. Whenever foreign investment operations are admitted under general legislation, as is currently the case in most countries and in respect to most sectors, the expression "in accordance with its laws" is almost redundant. It requires that prescribed procedures be respected, which is obvious, and authorizes the denying of the treaty benefits to illegal operations [125].

Investors' rights would be better protected if the standards of treatment (especially the mfn standard) granted by all BITs to investments of the other party's investors once made would be also applicable to the provision concerning admission. Such a clause, which is occasionally found in BITs, would be especially relevant in view of the emerging tendency towards granting in principle a right of access to foreign investments, though not unlimited, as evidenced by the GATS and, bilaterally, by the approach of the United States agreements [126].

In the latest BITs concluded by the United States on the other hand, there is no separate clause on admission. They provide instead

124. See United Nations, *Bilateral Investment Treaties*, *op. cit.*, 18; L. Migliorino, *Gli accordi internazionali sugli investimenti*, 1989, 41. H. Golsong, "Note to the US-Argentina BIT of 1991", 31 *ILM*, 1992, 124 *et seq.* The 1988 BIT between Thailand and Bangladesh stresses at Article 2 that the benefits of the agreement shall apply only to investments specifically approved in writing by the competent authority of the host State, which "shall be free to lay down appropriate conditions". The BIT between Australia and Viet Nam of 1991 provides at Article 3 (1) that each party shall admit investments "in accordance with its laws and investment policies applicable from time to time".

125. Cf. Article 2 of the 1993 BIT between UAE and Poland whereby each party shall admit investments "in exercise of powers conferred by its laws".

126. Article 2 of the BIT between China and Japan of 1988 endorses mfn treatment as to the admission of investments. The BIT between Italy and Ukraine of 1995, grants a "right of access", defined as the right of an investor of one of the parties to be admitted to make an investment in the other's territory, in accordance with the mfn and national treatments standards.

that national and mfn treatment shall be accorded with respect "to the establishment, acquisition, expansion, management . . . of covered investments". In contrast with most BITs the United States model thus assures in principle investors covered by the treaty that they will not enjoy fewer rights than other investors, both local and from third countries, in respect to market access.

As mentioned before, however, not even the United States, a champion of private initiative, is currently opening without restrictions its home market to foreign business, both in respect to the right to enter certain sectors and as to the type of rights and modalities of subsequent operations. It is therefore apparent that the United States approach requires a list of exceptions to the national and mfn treatment standards contained in the treaty, which is as a rule contained in a protocol annexed to the treaty, one for each party [127].

The United States approach in those annexes is of course to include in its list the exceptions to national and to mfn treatment lodged with OECD, except that some restrictions to mfn treatment may be waived, depending upon the concession granted by the other party to United States investors. This highlights the function that the United States approach may have as a tool for the reciprocal partial opening of national markets to foreign investors. This approach can probably be pursued with success only by a country like the United States which is both a major source of investment abroad and a major market for investments from the outside world. In evaluating further the merits of this approach, account must be taken that these concessions may benefit third countries, depending upon the mfn treatment clause contained in their BITs with the United States or the other State, or under the GATS [128].

127. See the United States BITs with Argentina (1991), Russia (1992) and the more recent ones drafted according to the same model. See K. J. Vandevelde, *US Investment Treaties, Policy and Practice*, 1992, 71; I. Shihata, "Recent Trends Relating to the Entry of Foreign Direct Investment", *op. cit.*, 55. United States BITs expressly state moreover that they shall not preclude measures necessary for the fullfilment of obligations with respect to the maintenance and restoration of international peace under the United Nations Charter, and that they are without prejudice to each party's right to maintain its public order and protect essential security interests. An annex to the BIT between United States and Russia of 1992 states the mutual understanding of the parties that this evaluation is "self-judging".

128. In fact the issue has been raised within the Uruguay Round negotiations that BITs may be in conflict with the mfn requirements of GATS when BITs provisions are not subject to this treatment and vary in one treaty from the other, e.g. as to dispute settlement mechanisms, see doc. MTN, GNS/W/177 Rev. 1 of 4.11.1993.

Moreover the United States reserves further the right to maintain existing restrictions and derogations from national and in some cases mfn treatment in existing state and federal law. It also safeguards the right to adopt new ones. On balance, therefore, the final result as to the guarantee of market access contained in United States agreements may not be so different than under other BITs, taking into account also the fact that no standstill commitment is undertaken [129].

3. Regional and Multilateral Regulation of Market Access by Foreign Investors

The widespread change of attitude as to the role of foreign investments in today's world economy has promoted the inclusion of binding provisions in this respect, in otherwise predominantly trade agreements of a regional scope (economic integration agreements) and in sectorial agreements (GATS, Energy Charter Treaty). The obligation to open the domestic economy to foreign investment, liberalizing progressively existing barriers and discriminations is a major item of the multilateral negotiations launched at OECD for the conclusion of a Multilateral Agreement on Investment [130].

(a) The European Community is peculiar also in this respect, since its principles and regulations reflect it being an integrated market subject to the rule of law. The right of establishment is granted without restrictions and discriminations in all the common (internal) market to all enterprises and companies of its member States as one of the basic freedoms guaranteed by the Treaty of Rome [131]. As to

129. In some cases the US approach may even be more restrictive. It has thus been underlined that, according to an explicit provision of its Protocol, the BIT between United States and Argentina of 1991 supersedes the bilateral FCN Treaty of 1854. "This provision was added at the behest of the US in order to override Art. IX of the 1854 treaty, which gives Argentine citizens national treatment with respect to real estate ownership in the US", see M. N. Leich, "US-Argentina", *AJIL*, 1993, 435.

130. See OECD, *New Dimensions of Market Access in a Globalising World Economy*, 1995. On the other hand at a late stage of the negotiations (1997-1998) doubts have been expressed as to the appropriateness of accepting across-the-board commitments in this respect, as far as they may prevent future national preferences in order to develop new "strategic" industrial and service sectors.

131. See Article 52 of the EC Treaty. Companies constituted by third countries' nationals in a member State and having their effective central business place in the Community also enjoy this right in accordance with Article 58 of the EEC Treaty, while third-country enterprises do not generally enjoy it under Community law. In those sectors where their right of establishment in the EC is

regulated industries the full exercise of this right has been made possible thanks to the harmonization policy and the principle of mutual recognition of legislations and controls, which may justify a different régime for enterprises from third countries which are not part of this process [132].

The right of establishment does not coincide with the freedom of movements of capitals within the Community, which has a different scope, and include both direct investment and other operations. While the other basic freedoms guaranteed to individuals and enterprises in the Community concerning goods, workers, establishment, services are based upon directly applicable rules, whose application cannot be restricted by the member States, the Court of Justice has held that the capital movement freedom under the original Treaty of Rome provisions was not unconditional and was therefore not directly applicable to private persons. Restrictions by the Community and the member States, for balance of payment reasons, according to the Community provisions laid down in this area were possible. The prerequisites for such an action have been made more stringent by the Maastricht Treaty and, in their absence, capital movement freedom has obtained the same status as the other fundamental freedoms [133].

Establishment rights for third country nationals depend mostly on member States' domestic legislation and their bilateral agreements, including BITs though Community law applies to such crucial sectors as banking, insurance and financial services [134].

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governed by the common system, restrictions are possible as a means of retaliation against denial to Community enterprises of effective access to the market of the foreign country concerned, see the much discussed Article 9 (4) of the EC Second Directive on Banking 89/646 of 15.12.1989 and Article 32 *(b)* of the First EC Directive on Life Insurance as amended by the Second Directive 90/619.

132. See J. Karl, "Multilateral Investment Agreements and Regional Economic Discrimination", *Transnational Corporations*, 1996, 2, 19 *et seq.*

133. See ECJ judgment in cases 286/82 and 26/83 of 31.1.1984. With the full liberalization of capital movements in the EC (Directive 88/361 of 24.6.1988) also provisions in this case have been held to be directly applicable, see ECJ judgment in case 358-416/93 of 23.2.1995. Capital movements connected to goods or service transactions were liberalized under the provisions applicable to the latter, in accordance with the original text of Article 106 EC and Directive 63/340.

134. The mixed competence of the Community and of its members as to third countries services providers has been upheld by the ECJ in its opinion 2/94 on the competence to enter the Uruguay Round Agreements. The new Article 73C of the EC Treaty as amended by the Maastricht Treaty admits the introduction

(b) NAFTA is the most prominent, among the most recent efforts to integrate markets by a group of countries including major economies in the world scene. NAFTA does not purport to establish a common market or even less an economic union such as the European Community. It does not harmonize legislations, does not establish a common economic policy between the member countries, does not create *ad hoc* institutions with normative or administrative powers, nor does it envisage a common commercial policy towards the outside world. While NAFTA has the traditional more modest features of a free trade area, based on reciprocal trade liberalization, it covers other related sectors of crucial importance in today's economy such as freedom of services, establishment, capital movements and public procurements [135].

The investment chapter of the NAFTA Treaty grants national and mfn treatment to investors of another party with respect to the establishment, acquisition and the "expansion management, conduct, operation, sale or other disposition of investments". These obligations are subject to present and prospective reservations by the parties with respect to sectors and regulations set out in Annexes to the Agreement [136].

(c) Regional liberalization of FDI has been dealt with recently also within the Andean Pact and Mercosur, an old attempt and a new one at regional liberalization in Latin America.

Decision 291 of 21 March 1991 of the Cartagena Agreement Commission has reversed the previous policy of the countries of the Andean Pact which favoured strict control on foreign investment and multinational companies. This decision covers only a part of the

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of new restriction to the freedom of capital movements with third countries, including direct investments also in real estate, in order to put pressure on them to liberalize their investment régimes.

The partnership agreement with Russia of 1994, OJ L 327 of 28.11.1997 does not grant reciprocally an automatic right of establishment. Mfn treatment is basically provided, while national treatment subject to exceptions (Annex 3 and Arts. 28 and 33).

135. See generally F. M. Abbott, *Law and Policy of Regional Integration*, 1995.

136. See Article 1102 of NAFTA which prohibits the imposition of minimum levels of local equity ownership (joint-ventures are not required) and of performance requirements. The same rules and the possibility of exceptions apply to the financial service sector, but the parties are not obliged to permit banks' operations through branches. Parties have not committed themselves to grant access to investments in the basic voice telephone sector; another notable exception is that by Mexico excluding investment in its petroleum sector.

typical subject matter of BITs and of other regional regulations. It defines foreign investors as well as "sub-regional" investors (those of another member country) providing for equality of treatment as to rights and obligations with national investors. In any case the right of entry is not spelled out, so that access depends on the various domestic legislations of the member countries, to which the regulation refers explicitly in many respects [137].

Mercosur has dealt with reciprocal investments from member countries and with investment from third countries in separate instruments. The Protocol of Colonia of 17 January 1994 for the reciprocal promotion and protection of investments in Mercosur follows generally the standard pattern of BITs. Article 2 on promotion and admission provides, however, that each contracting State

> "shall promote investments of investors of other Contracting States and shall admit them in its territory not less favourably than the investments of its own investors or of the investments made by investors of third States, without prejudice for the right of each Party to maintain transitorily limited exceptions corresponding to sectors listed in the Annex".

This approach reflects the freedom of reciprocal direct investment typical of a regional area, so that, understandably, it has not been followed as to this point in the Protocol of Buenos Aires of 1 August 1994 on the promotion and protection of investments of non-members investment. This instrument is generally inspired by the same favourable approach to FDI and affords by and large the same treatment and protection to third countries investments, once effected, as that granted to those originating from within the area.

According to Article B (1) of the Protocol "Each member State shall promote investments from third States' investors in its territory and shall admit these investments in conformity with its laws and regulations". The Colonia Protocol adopts thus the approach of the United States BITs, while the Protocol of Buenos Aires, a peculiar example of multilateral (regional) treaty in favour of third States, follows the pattern of the other BITs mentioned before, in referring the matter of the entry of foreign investments to the law of the host State, as existing from time to time.

137. See Decision 291 of 21.3.1991 (30 *ILM*, 1991, 1283 *et seq.*) replacing Decision 220.

(d) The Fourth Lomé Convention of 1979 contains an elaborate section on investments (Arts. 258-274 and Annex LIII) which was not found in the earlier texts and which is meant to complete the Community's members' BITs with ACP countries. These provisions state basic principles of treatment and a policy of encouragement of FDI from the Community to those countries. Article 258 includes a fairly standard recognition of the importance of FDI for development and of the need for member countries to take appropriate measures to support them. There is no firm commitment by the receiving countries to admit investments. On the contrary Article 258 *(a)* allows ACP countries to refuse those which do not conform with the EC-ACP development co-operation objectives and priorities, or with their applicable law and regulations.

The general formulation has been interpreted in the sense that there is a general presumption that FDI contributes to development so that, except if special circumstances would justify a refusal, admission criteria should be granted under liberal terms and subject to a mfn treatment [138].

(e) GATS lists "commercial presence" by other WTO members' service providers in any member's market as one of the modes for the international supply of services which is subject to the agreement (the other modes being cross-border supply, consumption abroad and temporary presence of natural persons). Indeed, substantial initial commitments have been undertaken by WTO members, especially by developing countries, as to the liberalization of commercial presences, evidencing that promoting this modality of supply has been the preferred choice, in comparison with cross-border supply. GATS can be considered therefore also in practice the first multilateral (potentially global) agreement on FDI, albeit limited to the service sector [139].

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138. The above-mentioned interpretation is found in doc. ACP-EEC 2172/92, *op. cit.* at footnote 72, para. 2.

139. Art. XXVIII *(d)* of GATS defines "commercial presence" as

> "any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or a representative office within the territory of a Member for the purpose of supplying a service".

According to a GATT study, *The Results of the Uruguay Round of Multilateral Trade Negotiations*, of November 1994, at 43,

> "eighty seven governments have entered horizontal commitments in their schedules with respect to commercial presence. Of these, thirty one entered

GATS includes a general obligation to grant mfn treatment to foreign service providers of WTO member States (Art. II) irrespective of their liberalization commitments.

Member States have to provide market access and national treatment (Arts. XVI and XVIII) with respect to the services and modes (such as "commercial presence") as to which they have undertaken specific obligations in their schedules of commitments (and under the terms, limitations, conditions and qualifications provided therein).

In order that market access commitments be effective, limitations on the number of suppliers, of operation, of employees, or on the total value of transactions are prohibited. Especially relevant to the FDI aspects is the prohibition in Article XVI (2) of

> "*(e)* measures which restrict or require specific types of legal entity or joint ventures through which a service supplier may supply a service; and *(f)* limitation on the participation of foreign capital in terms of maximum percentage limit on foreign share-holding or the total value of individual or aggregate foreign investment" [140].

GATS follows the approach of GATT in the area of trade, by committing its member to periodic rounds of multilateral negotiations in order to progressively increase the initial level of liberalization undertaken, as to sectors affected, modes of delivery bound, types of

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no horizontal limitations on market access through commercial presence. Fifty five have entered such limitations, of which ten authorise foreign investment on the basis of an 'economic needs test', twenty five impose ceilings on equity participation by foreign investors, and the remaining twenty require establishment to take the form of a specified legal entity, for example by requiring the establishment of a subsidiary. One country has offered no binding regarding market access through commercial presence. Regarding national treatment of foreign service suppliers established in their territories, sixty-eight of the eighty-seven governments making horizontal commitments have placed limitations on national treatment. Most of these concern the purchase of real estate and eligibility for subsidies (mainly for research and development)."

140. If a State allows commercial presence it is committed to allow related transfer of capitals into its territory (footnote to Art. XVI (1)). Of course not all commercial presence of service, especially as to some highly intellectual type of professional service, entails a movement of capital and relates necessarily to FDI. As to financial services on the other hand any market access commitment must include the right to establish but terms, conditions and procedures for authorization may be imposed, see the Understanding on Commitments in Financial Services, Arts. 5 and 6.

restrictions maintained. This dynamic aspect of GATS is shared with other multilateral texts, such as the OECD instruments (where future liberalization is however not compulsory), the Energy Charter Treaty (where this process is only vaguely indicated) and the Multilateral Agreement on Investment currently being negotiated in OECD. This feature distinguishes these multilateral endeavours from the more static approach of BITs where future liberalization commitments and an enforceable right of entry are absent, notwithstanding their explicit policy statements in the preamble in favour of an increased role for FDI in the domestic economy.

(f) The Energy Charter Treaty of 1994 aims at progressively liberalizing trade and investment in energy and related activities, materials and products, establishing a legal framework in order to promote long-term co-operation in the field. The pivotal sections of the treaty are accordingly those devoted to commerce (Part II) and to investment promotion and protection (Part III).

The right to make investments in this sector is central to the purpose of the Charter and is accordingly defined and regulated by the Treaty [141].

The relevant provisions lay down, however, only the general principles applicable in this respect, mostly in a non-binding form, while binding legal standards as to the treatment of foreign investors in respect to the making of investments will be laid down in a supplementary treaty which was negotiated between 1995 and the end of 1997. According to Article 10

> "each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for investors of other Contracting Parties to Make Investments in its Area".

These conditions shall include fair and equitable treatment, meaning national and mfn treatment (Art. 10 (3)). Initially the parties are, however, only bound to endeavour to accord such treatment, while definite obligations shall be provided in the supplementary treaty.

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141. See Article 1 (8). "Make Investments" or "Making of Investments" means "establishing new investments, acquiring all or part of existing investments or moving into different fields of investment activity".

For a detailed examination of the various aspects of the treaty dealing with investments see the contributions by T. W. Wälde, J. Salacuse, E. Paasivirta, P. Norton, M. Sornarajah, K. Vandevelde, J. Paulsson and M. Footer contained in T. W. Wälde (ed.), *The Energy Charter Treaty*, 1996, 251 *et seq.*

The immediate obligations as to the treatment of investments once made and their related activities is in comparison tougher. National and mfn treatment is compulsory from the outset, though with some exceptions and subject to certain States' declarations.

CHAPTER IV

THE STANDARDS OF TREATMENT OF FOREIGN INVESTMENTS: BITS AND MULTILATERAL INSTRUMENTS

Summary: 1. Standards of treatment of foreign investments in general. 2. Standards of treatment in recent multilateral instruments. 3. General standards in BITs: fair and equitable, full protection, international, national, most-favoured-nation treatment. 4. Exceptions and limitations: (a) *Regional integration;* (b) *Taxation;* (c) *Conclusions as to general treatment. 5. Specific rights granted to foreign investors in recent BITs:* (a) *Entry and employment of personnel;* (b) *Monetary transfers. 6. Preferential treatment, incentives and performance requirements. 7. Host and home countries' competence in the regulation of foreign investment:* (a) *Legal régime applicable in the host State;* (b) *Conflicts between home and host States.*

1. Standards of Treatment of Foreign Investments in General

The ongoing debate on the scope and content of the rules of international law dealing with the treatment of aliens (including corporate entities) in respect of their property has mostly focused on the deprival of such property. This may be effected through confiscation, expropriation, nationalization or other forms of hindrance or taking amounting to deprivation of property, including progressive erosion of the investor's rights by regulatory measures ("creeping expropriation"). Reported instances of diplomatic protection by home States in favour of their nationals deal predominantly with cases when the latter are faced with economic losses due to damaging illegal actions of host States' authorities. Such action may be due to a change in their political régime or in economic policy, to nationalism towards foreigners in general, or may be presented as reprisals in the context of bilateral tense relations. State practice is modest in relation to the treatment of foreign nationals and companies carrying out normal business operations in another country, since in this context the need for diplomatic protection is exceptional.

BITs focus in the first instance on the correct treatment of the foreign investments, which they intend to encourage, during their normal life. The purpose is that they may operate in accordance with the economic and business context, opportunities and specific merits, free from host countries' unjustified interference that could negatively affect them.

To this purpose BITs spell out general standards of treatment developed by international practice, applicable in all circumstances, whose content is not directly specified but is to be determined by reference to certain benchmarks. National, mfn, fair and equitable, international treatment are the best known examples of such contingent standards. On the other hand BITs list specific rights which they attribute to foreign investors in relation to matters which are central to the carrying out of investments. These specific (non-contingent) standards of treatment to be respected by the host country refer first of all to those aspects of an investment's life which are peculiar to foreign as distinguished from investments by nationals (such as remittance abroad of profits and dividends). Explicit standards are also found as to activities related to an investment which are incidental to the carrying out of business (such as freedom of operations, the right to make contracts and to have access to public services and resources).

The treatment of investments in case of expropriation or other comparable occurrences is of course an important content of BITs, in view of the uncertainty of general international law. It is not a surprise that almost invariably BITs provide for the highest standards of treatment in this respect, even to the point of neglecting economic realities that might render the strict adherence to the relevant obligation difficult or impossible to follow by the host country in some circumstances (such as in the case of financial stringencies).

The current evolution of economic thinking and of national policies recognizes the essential role of private business also in developing economies and aims at reducing the direct carrying out of economic activities by the State. As a consequence recent BITs deal more and more with ensuring adequate treatment and protection of investment as they are carried out, besides focusing on the contentious instance of its forcible termination. The latter situation is currently viewed as exceptional, while State interference with an investment operation during its normal life is seen as an actual danger especially in economies in transition where authorities are still unfamiliar with market operations.

It is well settled that once a State admits foreign investors it must grant them the protection of the law and ensure them a certain standard of treatment [142].

The exact content of these duties, i.e. the standard of treatment of the property of aliens in international law, is however subject to debate. Lawfully acquired property is protected by a minimum international standard, which is often defined as *fair and equitable*. Though probably no State would contend that international law admits an unfair and unequitable treatment of foreigners and of their property, it is difficult to spell out the scope of the ensuing obligations in detail. The instances in which the recognized exercise of State regulation of property and of the economy could interfere with, and prejudice the enjoyment of, property and the conduct of business are indefinite. This standard implies rather for any State an obligation to attain a certain result by whatever appropriate means: it requires that the State acts in such a way in all circumstances and instances so that the foreigner be always treated in a fair and equitable manner. This formulation does not eliminate the need to evaluate *"in concreto"*, based on criteria which are in part subjective or contingent, whether a given treatment was indeed fair and equitable.

Fair and equitable treatment is spelled out in several multilateral instruments without any reference to an international standard, possibly as a way of avoiding the divergence surrounding the latter and in order to give to it a direct content [143].

The right to private property is on the other hand a universally recognized human right which can be exercised individually or in common with others. Progress towards its effective recognition as a fun-

142. ICJ, *Barcelona Traction*, *op. cit.*, para. 33. As to the current tendencies of national legislations and international instruments, see A. R. Parra, "The Scope of New Investment Laws and International Instruments", in R. Pritchard (ed.), *Development, Investment and the Law*, 1996.

143. See Article 1 *(a)* of the OECD Draft Convention on the treatment of foreign property of 1967; Article 258 *(b)* of the Fourth Lomé Convention; paragraph 49 of the United Nations Draft Code of Conduct on TNCs. F. A. Mann, "British Treaties for Promotion and Protection of Investments", *BYIL*, 1981, 241 *et seq.* at 244, has argued that the minimum standard is less demanding than the "fair and equitable" one; but see UNCTC, *Bilateral Investment Treaties*, 1988, 30: "Fair and equitable treatment is a classical international standard." See also ACP-EEC doc. 2172/92, *op. cit.*, para. 3, for the view that fair and equitable includes respect for international law. Article 2 (2) *(c)* of the 1974 United Nations Charter of Economic Rights and Duties of States articulated only the national standard for the treatment of foreign investment, reflecting the critical view by the developing world of the minimum international standard as being vague and possibly biased.

damental right has been made with the adoption, among others, of United Nations resolution 43/123 of 1988 which reflected the change of attitudes and economic policies of the communist countries. It is however problematic to derive from these general statements positive precise rights, especially in respect of foreign corporations [144].

The *minimum international standard* which was advocated in the past especially by capital exporting countries was independent of the treatment applied by the host State to its own nationals (national standard), which might not respect the requirements of the international standard as to the protection of property [145].

Things appear to have changed in practice with the speedy transition to private ownership of means of production and the opening of the economy to local business in most countries. In respect of day-to-day operations the national standard can be considered as a guarantee of fair and non-discriminatory treatment since it ensures equal competitive opportunities [146] for foreign investors.

National treatment should be considered to satisfy "prima facie" the requirements of the international minimum standard. Invocation of the latter can be still considered relevant whenever national law does not provide, generally or in a specific instance, for adequate guarantees of fair treatment in accordance with generally shared values of substantial and procedural fairness and justice in respect of the enjoyment of property and the normal conduct of business operations [147].

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144. Commentators vary as to the customary law content of Article 17 of the United Nations Universal Declaration of 1948, even in an historical perspective, see R. Higgins, "The Taking of Property by States", *Recueil des cours*, Vol. 176 (1982), at 375; Final Report on the Status of the Universal Declaration of Human Rights, ILA, *Report of the 66th Conference*, Buenos Aires, 1994, 29 *et seq.*; L. V. Rodriguez, *The Right of Everyone to Own Property*, Report, United Nations doc. E/CN.4/1993/15, 37. The European Commission and Court of Human Rights have laid down a substantial case-law as to the "respect" due to private property by member States under Article 1 of the Additional Protocol to the EHR Convention in a variety of instances; see generally Council of Europe, *The European Convention on Human Rights and Property Rights*, 1991. As to the case-law of the European Court of Justice see generally M. Frigo, "Le limitazioni al diritto di proprietà e all'esercitio di attività economiche nella giurisprudenza della Corte di Giustizia", *Riv. dir. intern. privato e proc.*, 1998, 1 *et seq.*

145. See generally D. Carreau, T. Flory, P. Julliard, *op. cit.*, 627 *et seq.*

146. See M. Sornarajah, *op. cit.*, 250.

147. Procedural and judicial guarantees of due process and avoidance of denial of justice in respect of the conduct of business operations seem especially relevant; abstention from arbitrary measures, protection of property, and effective compensation in case of expropriation have been also listed as part of the international standard, see S. Marchisio, *op. cit.*, 578.

The other common contingent standard, is the *most-favoured-nation treatment*, according to which nationals of one foreign country shall not be treated worse (less favourably) than those of another country. This is a conventional standard and not one which would be prescribed by general international law, since States are under no obligation to treat all foreign nationals equally. However, differential treatment without justification (i.e. discrimination) by a host country of the nationals of one country in comparison with those of another country in a like situation could be considered a violation of the minimum international standard whenever this would cause them prejudice.

2. *Standards of Treatment in Recent Multilateral Instruments*

Recent multilateral instruments rely on the combination of fair and equitable, international, national and mfn standards in the matter of treatment of foreign investment.

The World Bank Guidelines advocate generally fair and equitable treatment "according to the standards recommended in these Guidelines" [148]. The Guidelines overcome the vagueness of this standard by indicating its content in respect to specific situations or matters, either by reference to other contingent standards, or by specifying directly the appropriate conduct of host countries' authorities towards foreign investors.

Treatment as favourable as that accorded to national investors in similar circumstances is recommended in respect of the protection and security of the foreign investors, their property rights and interests, and of the granting of permits, import and export licences, the authorization to employ and the issuance of visas to their foreign personnel.

As concerns such other matters as are not relevant to national investors, "treatment under the State's legislation and regulation will not discriminate among foreign investors on grounds of nationality".

The Guidelines do not rule out that the requirement of fair and equitable treatment may not be fully satisfied by the granting of national treatment and require that "full protection and security" be accorded in all cases to the investor's rights regarding ownership, control and substantial benefits over his property including intellec-

148. Guidelines, *op. cit.*, III. 2, 3, 5.

tual property. Moreover respect of all standards mentioned is without prejudice to "firmly established rules of customary international law".

The Mercosur protocols on regional and on third country investors provide for fair and equitable treatment of those investors and their investments, and enjoin the member States from impairing their operation, maintenance, use, enjoyment or disposal by unjustified or discriminatory measures [149].

Article 258 *(b)* of the Fourth Lomé Convention prescribes "fair and equitable treatment" of EEC investments, while Article 258 *(c)* commits the host countries to establish a predictable and secure investment climate [150].

GATS provides for national treatment for trade in services, including for service providers (and their services) which have established themselves in another WTO member through a commercial presence [151].

The Energy Charter Treaty commits at Article 10 each party "to accord at all times to investors of other Contracting Parties fair and equitable treatment". Investments "shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal". Moreover "in no case shall such investment be accorded treatment less favourable than that required by international law, including treaty obligations". Finally each contracting party shall endeavour to accord investors of the others parties treatment not less favourable to that accorded to its own investors or to those of any other party or third State, whichever is the most favourable.

The "Non-Binding Investment Principles" adopted as Guidelines

149. Cartagena Agreement Commission December 291 of 1991 provides instead only for national treatment to foreign investors.

150. According to ACP-EEC doc. 2172/92, *op. cit.,* fair and equitable treatment under the Lomé Convention requires that

> "all rules and practices affecting an investor's interest be transparent, predictable and non discriminatory. This standard refers implicitly to basic principles followed by countries abiding to the rule of law, namely transparency of investment conditions, non discrimination, legality, proportionality, non retroactivity of the law and respect of international law."

151. National treatment, i.e. treatment not less favourable than that accorded by a member to its own nationals, can be met according to Article XVIII of GATS by formally identical or formally different treatment, but either "shall be considered to be less favourable if it modifies the conditions of competition in favour of service or services suppliers of the Member compared to like services or service suppliers of any other Member". An economic test is thus prescribed.

by the APEC members in November 1994 endorse non-discrimination between investors from any economy in relation to the establishment, expansion and operation of their investments, i.e. treatment which is no less favourable than that accorded to investors from any other economy in like situations, without prejudice to relevant international obligations and principles. The Principles further advocate according national treatment to foreign investors, i.e. treatment no less favourable than that accorded in like situations to domestic investors, "with exceptions as provided for in domestic laws, regulations and policies" [152].

3. General Standards of Treatment in BITs : Fair and Equitable, Full Protection, International, National, Most-Favoured-Nation Treatment

In view of the uncertainty of the obligations stemming from general international law, the spelling out of both general and specific standards of treatment in BITs, in conformity with their purpose, is clearly understandable and is one of their major objects. BITs rely on a combination of standards. The emphasis on the various standards is not identical ; it depends on the legal tradition and on the type of economic model of the countries concerned.

The requirement of fair and equitable treatment appears often at the outset of the relevant provision of BITs, right after the definitions, under the headings either of "protection" or "treatment". This standard is invariably combined with national and mfn treatment. As a rule specifications are added as to its content while the matters to which it is applicable, such as activities related to an investment, are also specified [153].

Thus the Dutch model of 1994, which is typical in its formulation, reads as follows :

152. For the text see UNCTAD, *International Investment Instruments*, *op. cit.*, II, 535 ; M. Sornarajah "Protection of Foreign Investment in the Asia-Pacific Co-operation Region", *JWT*, 1995, 2, 128 *et seq.* The Guidelines also touch upon the issue of the investor's conduct as follows : "*Investors Behaviour* — Acceptance of foreign investment is facilitated when foreign investors abide by the host economy's laws, regulations, administrative guidelines, just as domestic investors should."

153. Fair and equitable corresponds to "juste et equitable", "justa y equitativamente", "giusto ed equo", "gerecht und billig" in other languages. No reference to this standard is found in China-Japan (1988), but it is included in China-Slovenia (1993).

> "Each Contracting Party shall ensure fair and equitable treatment of the investments of nationals of the other Contracting Party and shall not impair, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those nationals. Each Contracting Party shall accord to such investments full physical security and protection.
>
> More particularly, each Contracting Party shall accord to such investments treatment which in any case shall not be less favourable than that accorded either to the investments of its own nationals or to investments of any third State, whichever is more favourable to the national concerned." [154]

The investor is thus guaranteed the best of the treatments made by the host State to its own or other countries' investors and in any case he is entitled to being treated fairly and equitably. This implies the right to carry out his business activity free from unreasonable and discriminatory measures, a requirement which will have to be judged on a case-by-case basis.

Other requirements, which can also be considered a specification of the fair treatment standard, are usually included. Thus the Swiss BITs commit the parties to issue needed authorizations in relation to admitted investments with reference to licensing, technical, commercial or administrative contracts and foreign consultants activity. The France-Mongolia BIT of 1991 bars factual and legal impairment of the rights of the investor; it specifies that restrictions to the buying, transportation or selling of raw materials, energy and products, or other measures having similar effects, shall be considered such an impairment to the fair and equitable standard [155]. The BIT of 1996 between Italy and Russia couples the requirement of fair and equitable treatment with the undertaking to maintain favourable economic and legal conditions for investments and to abstain from adopting unjustified or discriminatory measures which might damage the

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154. The obligation to refrain from arbitrary and discriminatory measures is found also in US BITs. Discriminatory measures include those which are discriminatory in effect as well as those that are intentionally discriminatory, K. J. Vandevelde, *op. cit.*, 77.

155. France-USSR (1989), 29 *ILM*, 1990, 331, provides in an exchange of letters that the concept of fair and equitable treatment shall apply to the purchase and transportation of raw materials, of energy and fuel, and to the sale and transportation of products.

managing, keeping, using, disposing, transforming and the liquidation of an investment. Respect for investment contracts and other similar agreements and undertakings under civil or administrative law, which is spelled out in several recent BITs, can be considered covered by this standard.

The reference to "full protection" ("full legal protection" or "full protection and security") is also found in the United States and United Kingdom BITs, among others, but does not appear generally in BITs of France, Germany, Italy or Switzerland [156]. In our opinion this standard clause does not add to the protection to which foreigners are entitled as to their persons and assets abroad under international law. They are basically entitled to national treatment in this respect, except that the territorial States must adopt all reasonably necessary measures in order to protect their persons or assets from dangers affecting them specifically as foreigners or as citizens of a given country (such as in the case of xenophobic or nationalistic riots) [157].

Reference to international law is not always found in BITs. This could come as a surprise in view of the reliance on general international law insisted upon by industrialized countries, for example during the negotiations on the United Nations Code of Conduct on transnational corporations (TNCs).

French and United States BITs include in their treatment clause such a reference, albeit in a different formulation. According to the United States treaties, investment shall be accorded fair and equitable treatment and "shall in no case be accorded treatment less than that required by" or "inconsistent with the norms and principles of"

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156. Full protection and security is however provided in Italy-Russia (1996).

157. See A. Verdross, *Völkerrecht*, 5th ed., 1964, 370 ; I. Brownlie, *Principles of Public International Law*, 3rd ed., 1979, 453 ; I. Seidl-Höhenveldern, *Völkerrecht*, 8th ed., 1994, 368. In the *ELSI* case, *cit.*, at. para. 71, the ICJ held that the requirement for constant protection and security as found in the FCN Treaty between the United States and Italy of 1948 was not a warranty to a US investor that no disturbance would occur in any circumstances so that the requisition by an Italian Government entity of an insolvent Italian company owned by a US investor did not violate that provision. The Court also ruled that the requirement was to be measured by the "minimum international standard" and that a 16-month duration in a municipal judicial proceeding did not violate that standard. In the ICSID award of 21.2.1997, *AMT-Zaire*, *ICSID Rev.,* 1997, 1531 *et seq.* the tribunal held that the United States-Zaire (1984) clause guaranteeing "protection and security" to investments at all times had been breached by Zaire in not having prevented looting of the investor's property (breach of an "obligation of vigilance").

international law [158]. French BITs provide for "fair and equitable treatment, in conformity with the principles of international law" [159].

The reference to national treatment should be viewed in the light of the right to limit admission of the other party's investors safeguarded by most BITs. In these cases therefore this standard does not exclude that certain activities be reserved to nationals including the case of monopolies even if this is not spelled out in the treaty [160]. In view of the different approach of United States BITs, these treaties provide for national treatment also as to the making, besides as to the carrying out, of investments, but provide for exceptions as mentioned above.

National treatment has to be interpreted as a treatment not less favourable than that granted to domestic investors and extends as a rule also to associated or connected activities as defined in the treaties, which are necessary in order to conduct business effectively [161]. This standard of treatment does not only refer therefore to property but also and specifically to the business activity involved in the operation of an investment. These "activities connected with an investment" are spelled out in detail in recent BITs, notably in those with economies in transition of the former Soviet Union [162].

Formally different treatments can be substantially equivalent and

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158. See United States-Argentina (1991) and United States-Russia (1992), Art. II (2) *(a)*; for an identical provision see Canada-Poland (1990), Art. III (1).

159. See France-Argentina (1991), Art. 3. H. Goldsong, "Note" to the France-URSS BIT, 29 *ILM* 1990, 317, is of the opinion that such a qualification reduces the scope of the undertaking, a view to which we would agree only if it could be demonstrated that international law admits treatments which are unfair and unequitable. Poland-UAE (1993) provides for "full protection and security, in a manner consistent with international law".

Italy-Ukraine (1995), Article 11, provides that should a matter regulated by the BIT be regulated under more favourable terms in other agreements between the parties or by "general principles of international law" these terms shall be applicable. See also United Kingdom-India (1994), Art. 12, Germany-Bolivia (1987), Art. 8 (1), containing a similar provision with reference to existing or future domestic law provision or to "obligations under international law" of a general or specific nature.

160. Some BITs include specific exceptions in this respect. Cf. the Protocol to Italy-Brazil, 1995, whereby Brazil reserves its right under the Constitution to grant preferential treatment to Brazilian enterprises with Brazilian capital as to public procurements. For exceptions as to public procurements and other matters see also Canada-Trinidad (1995), Art. 6.

161. The obligation of each contracting party to accord national treatment "subject to its national legislation" (Norway-Peru (1995), Art. 4, Colombia-Spain (1995), Art. IV) deprives the reference of much of his value.

162. These activities are listed in some BITs in the definition of investment while in others they are defined separately. Included are the operation of companies, the making of contracts, the borrowing of funds, licences and authorizations, the granting of rights, access to financial institutions, importation of

therefore be compatible with national treatment as indicated in Article XVII of GATS although such a differentiation appears prima facie suspect [163]. On the other hand formally identical treatment may in some respects be more cumbersome for foreigners, and therefore less favourable. This happens when foreigners are in a situation which is *de facto* or legally different from that of nationals, especially because of their nationality or residence and this difference is such as to prejudice their enjoyment of a given right [164].

Some BITs with centralized economy countries provided in the past for national treatment "as far as possible". In view of the structure of those economies and the tight conditions of admission of foreign investments the focus of those BITs was that of guaranteeing access to resources, freedom of contracting, right to licences, rather that of seeking equalization with (State-owned) local companies. The emphasis in those treaties was accordingly more on mfn treatment, as is still the case for most BITs of China [165].

The most-favoured-nation standard is of crucial importance in

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necessary equipment, the marketing of goods and services, see United States-Russia, Art. I *(e)*. Article 1 (5) Italy-Russia (1996) also includes the buying, selling and issuing of stocks, the buying and selling in the domestic market and internationally of goods, raw materials, energy, the dissemination of commercial information.

163. The US treaties add the reference to "like situations" in respect of national treatment. This may potentially restrict the benefit of the national standard. This was indeed the purpose of the United States and Canada declaration to the Energy Charter Treaty, 34 *ILM* 1995, 378, stating that equality of treatment between foreign and domestic investors requires a case-by-case comparison in similar circumstances and emphazising that "legitimate policy objectives may justify differential treatments".

164. Residency requirements generally affect unfairly foreigners and should be justified by some public purpose or objective need in respect of the activity which is being so limited. In this respect one can mention the requirement of the Swiss company law of 1991 that the sole director or the majority of the board members of stock companies be Swiss citizens domiciled in Switzerland. This requirement has been filed by Switzerland under the OCDE National Treatment instrument not as an exception but as a "measure reported for transparency" while it has been filed under GATS as an exception to national treatment. Is this restriction compatible with the standard provision of Swiss BITs on treatment, which prohibits unjustified or discriminatory obstructions to the management of an investment?

The ECJ has held that a residency requirement (as found in Austria) for a manager of a company is a disguised discrimination, contrary to the freedom of movement of workers (Art. 48, EC Treaty) lacking a special justification, dec. C-350/96 of 7.5.1998.

165. See Italy-USSR (1989), Art. 3; Canada-Poland (1990), Art. III, 4. In most BITs of China national treatment, if granted at all, is subject to qualifications, see China-Slovenia (1993). No national treatment obligation is included in China-Uruguay (1993).

investment matters, as it is in trade matters where it was first developed. The undercutting of conditions obtained by a country for its investors in the market of a foreign country by this country granting presently or in the future better conditions to third countries' competitors could make the advantages obtained by the first country worthless. Therefore this standard is invariably present, to the point of being sometimes considered more meaningful than national treatment [166].

Mfn treatment is also especially relevant because of the rapid changes affecting many economies (Eastern Europe, Latin America, etc.) and the progressive liberalization, privatization and opening to foreign investors which they are undergoing. This clause guarantees the partners of these countries that new business openings, not considered at the time of the making of a BIT, will be available to their investors if they have subsequently been made available to those of other countries [167].

Mfn treatment implies that the standards of treatment included in a treaty, as directly provided therein or by reference to national treatment, is automatically replaced by the better treatment granted by the other party to third countries' investors, be it by treaty (bilateral or multilateral) or otherwise, with the standard exception of regional economic integration agreements [168].

4. *Exceptions and Limitations*

(a) *Regional integration*

This exception is explicitly spelled out in almost all recent BITs and is of special importance in view of the increasing regionalization

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166. Sweden-Poland (1988) requires mfn but not national treatment, in accordance with a traditional Swedish position, cf. OECD, *Intergovernmental Agreements Relating to Investment in Developing Countries*, Paris, 1985, para. 39.

167. Goldsong, "Note" to the United States-Argentina BIT, 31 *ILM* 1992, 124, has stressed that the United States has obtained better terms in its agreement with Argentina, as to compensation in case of expropriation and opening of certain sectors to US investors, in comparison with European countries' BITs. Under the mfn clause however the investors of these countries may avail themselves of any better term obtained by the United States.

168. Sometimes specific existing regional arrangements are listed as an exception, besides the reservation for current and future participation to "free trade areas, custom or economic unions". See Italy-Russia as to "agreements between the Russian Federation and the former USSR Republics in the field of economic co-operation"; Italy-Argentina as to investments enjoying special financing conditions under the co-operation treaties of Argentina with Italy of 1987, and with Spain of 1988.

of world economy, which also often covers liberalization of investments [169]. On the other hand the equal treatment of foreign investors irrespective of their country of origin is an economic necessity in today's market economies so that differentiation of third country investors is generally modest [170]. A typical clause excludes mfn and national treatment as to "privileges" (whatever this means) that either party grants or may grant to third countries' nationals or companies as a consequence of its participation in a free trade agreement, a custom or economic union or any other form of regional economic organization [171].

The scope of the regional exception has been debated at length in the MAI negotiations. A logical approach should distinguish between restrictions to access, whereby liberalization and national treatment accorded to regional investors might not automatically be extended to third countries' business, and regulation of the exercise of a given activity, open also to the latter. Discriminations as to the conduct of such an activity would unreasonably affect equality of opportunities and competitive conditions which is a standard feature of the open market and an element of fair treatment.

This does not mean however that legal and other relevant requirements should be identical. The example of the European Community shows that an integrated economic area, where extensive national competences on market regulation and requirements as to conduct

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169. The clause may exclude flatly the extension of the benefits provided in regional arrangements, as in United States-Argentina (1992), Art. II (9), or may just provide that there is no obligation to extend them, Switzerland-Peru (1991), Art. 3 (7). As to regionalism generally see WTO, *Regionalism and the World Trading System*, 1995, P. Demaret (ed.), *Regionalism and Multilateralism after the Uruguay Round*, 1997.

170. This principle inspires the 1994 amendments to the foreign investment legislation of Canada and Mexico extending the liberalization granted to investments of NAFTA nationals to third countries investors, see E. Murphy "Access and Protection for Foreign Investment in Mexico", 10 *ICSID Rev.*, 1995, 5 *et seq.* On the other hand non-EC investors cannot avail themselves directly of certain advantages deriving from the freedom of establishment under Articles 52 *et seq.* of the EEC Treaty. This is notably the case for operations of banks and insurance companies throughout the common market under the control of the home country supervising authorities. Non-EC investors may however avail themselves of this possibility by establishing a local company in any EC member State in accordance with Article 58 of the EC Treaty. French law 96-109 and decree 96-117 of 14.2.1997 providing for declaration of foreign investments and authorization for those involving the defence sector is equally applicable to EC and non-EC investments, while this was not the case for the previous legislation in the matter.

171. See Italy-Algeria (1991), Art. 3; France-Argentina (1991), Art. 4.

subsist (especially as to regulated sectors), relies on harmonization, mutual recognition of standards and controls and exchange of information between national authorities in order to minimize the impact of resulting differences.

This feature allows reducing controls by the host State in reliance on the standards and controls of the country of origin. In the absence of this mutual co-operation, as is the rule in respect of third countries, investors originating therefrom can be properly subject to tighter controls as to financial conditions or other prerequisites (e.g. residency). These should not however be more restrictive than that required in the public interest and in order to give guarantees comparable with those which national and regional investors must comply with [172].

Local companies which are the result of a foreign investment should basically be entitled to national treatment as to the conduct of business operations open to them. This is by and large the case as mentioned in the European Community, in the NAFTA and under the GATS [173].

Privatization of State-owned companies, including monopolies, is a field where the regional exception may be relevant. In some instances countries have made a preferential treatment to local investors as to the acquisition of shares offered in the market or had recourse to other non-transparent restrictions ("golden share", ownership ceilings, voting rights limitations) that may play against foreigners [174]. These restrictions are usually compatible with BITs in that they involve limiting the right of access to investments in a given field, which is not protected by most BITs. They may however run counter to investment and capital movement freedoms and to the prohibition against discrimination based on nationality laid

172. See generally G. Sacerdoti, "Standards of Treatment, Harmonisation and Mutual Recognition: A Comparison between Regional Areas and the Global Trading System", P. Demaret, J.-F. Bellis and G. Garcia Jimenez (eds.), *Regionalism and Multilateralism after the Uruguay Round*, 1997, 613 *et seq.*; P. Sauvé, "Regional vs. Multilateral Approaches to Services and Investment Liberalisation", *ibid.*, 429 *et seq.*

173. See Article V (6) of GATS on "Economic Integration":

> "A service supplier of any other member that is a juridical person constituted under the laws of a party to an agreement referred to in paragraph 1 shall be entitled to treatment granted under such agreement, provided that it engages in substantive business operations in the territory of the parties to such agreement."

174. See generally D. Campbell (ed.), *International Privatisation*, 1996.

down in regional integration agreements, as is the case of the European Community [175].

The regional integration exception to the mfn treatment justifies opening the privatization market without restrictions only to national and regional investors while limiting the access for non-regional investors. In practice, however, large privatizations, where shares of the companies to be privatized are being listed in stock exchanges and offered to the public, do rely on foreign underwriting and are offered on international markets.

Regional integration (and local border arrangements) are not the only exception spelled out in recent BITs, which tend to become more detailed both as to the content of the standards and as to the exceptions thereto. The list of Article II (mfn) exemptions filed by WTO member States under GATS shows that apart from regional integration derogations, States maintain a vast array of general or sectorial exceptions, i.e. of preferential treatments, in favour of certain countries' nationals only, also in the field of investments. The basis therefor appears to be linguistic, cultural and historical ties, geographic proximity, reciprocity.

While these issues are not always dealt with specifically in BITs, it is understandable that they have become one of the focuses of the negotiations on the conclusion of the MAI at the OECD. The regional exception has been especially contentious and has emerged as one of the major difficulties hindering a successful outcome of this undertaking.

(b) *Taxation*

Tax matters under bilateral treaties are often explicitly excluded from the application of the mfn clause of BITs. In fact BITs seem to skip the whole issue of taxation of foreign investment (i.e. avoidance of double taxation and related questions such as the review of transfer prices for tax purposes in international transactions between related persons) probably in view of the almost universal practice of

175. Thus the EC Commission objected to the 15 per cent ceiling of foreign ownership foreseen in the French privatization of 1986-1988 and in the British privatizations of Rolls-Royce and of British Airways, relying on Article 7.52 and 221 of the EC Treaty. See M. M. Brown and G. Ridley, *Privatisation — Current Issues*, 1994. The EC Commission has again objected at the end of 1997 to certain modalities of privatizations in Portugal, Italy and the United Kingdom on similar grounds.

regulating these taxation matters through specific bilateral treaties[176].

Double taxation treaties are sometimes entered into in parallel with BITs with a view to promoting bilateral trade and investment ties. These treaties include provisions on matters directly concerning foreign investment, such as the definition of permanent establishment and its tax treatment, withholding tax on dividends remittances (from which they may be exempted or be subject to a reduced withholding tax in case of controlled companies as is the case in the European Union)[177]. These treaties tend to be patterned after standard models such as those elaborated and recommended by the OECD. This practice should tend to reduce discriminations depending upon the source and destination of funds and therefore limit the interest of treaty shopping based upon the interposition of shell companies in certain countries.

The detailed regulation which is typical of these treaties is in a sense self-contained and explains why as a rule they are not subject to be invoked by third country nationals (investors) under an mfn clause. However, reduction of or exemption from withholding taxes by the host country for the benefit of certain foreign investors only, based on bilateral double taxation treaties, would affect competitive conditions among competitors of different foreign countries. On the other hand the overall tax burden would depend on the tax rate in the home country and on the deductibility there of the withholding taxes paid abroad, which are all matters outside the scope of BITs.

(c) *Conclusions as to general treatment*

Summing up the results of our examination on the general treatment clauses we conclude that the text of BITs show a common purpose and aim at ensuring the same result, though by relying in part on a different mix of standards. The objective is the granting by con-

176. For some references to tax matters in BITs see United Kingdom-URSS (1989), Art. 7; Netherlands-Poland (1992), Art. 3 (4); Italy-Brazil (1994), Art. III; Canada-Trinidad (1995), Art. 12. France-Argentina (1991) excludes from mfn and national treatment the "privileges" granted by either party to third countries' investors by a double taxation or any other convention in fiscal matters.

177. See generally Baker and Mackenzie (ed.), *International Transfer Pricing Laws*, 1994; OECD, *Model Tax Convention on Income and on Capital*, 1998; United Nations, *Model Convention on Double Taxation between Developed and Developing Countries*, 1980. As to intra-EC relations see Dir. 90/435 of 23.7.1990 on parent-subsidiary relations.

tracting States of the same treatment to investors competing in a given market, irrespective of their nationality of origin and of the source of capital. Both parameters are immaterial, once a foreign investor is admitted into a given sector and to practise a certain activity in free markets. In this respect national and mfn treatment, completed with a minimum international standard as a kind of safeguard net, and with the granting of those specific rights which are necessary for a foreign investor to operate, as found in current BITs, reflect a need of the economy and are a requirement in order to attract foreign investment.

Notwithstanding the practically universal acceptance of this "package", non-discrimination and equality of treatment cannot be considered binding on States that would not have subscribed to them, nor applicable irrespective of the exceptions and limitations mentioned, just as a result of the extensive network of BITs.

5. Specific Rights Granted to Foreign Investors in Recent BITs

From the standards of treatment discussed above, be they non-contingent (such as fair and equitable, international, full protection) or contingent (national, mfn), specific rights of foreign investors can be inferred on a case-by-case basis in view of the purpose and the object of the BITs, namely to make the effective conduct of the business possible, without discriminations. We have noted however that recent BITs have added new specifications, so that certain rights, though in a general formulation, are increasingly spelled out in the relevant clauses, such as the rights to obtain needed permits, to have access to raw materials and energy, the respect for investment contracts [178], publication of laws and regulations affecting investments [179].

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178. As to the latter matter see United States-Russia (1992), Art. II (2) *(c)*, "Each Party shall observe any obligation it may have entered into with regard to investments of nationals or companies of the other Party." This clause refers to any legal or contractual obligation, not just to an "investment agreement" defined in Article 1 (1) *(f)* as "an agreement between a Party (or its agencies or instrumentalities) and a national or company of the other Party concerning an investment". Identical or similar clauses are found in many recent BITs: Germany-Bolivia (1987), Art. 8 (2); Netherlands-Poland (1992), Art. 3 (5); Colombia-Spain (1995), Art. III (3).

179. See United States-Russia (1992), Art. II (7) providing for publication "in the customary form". Canada-Trinidad (1995), Article XVI, contains a similar provision under the heading of "transparency", a fashionable item in recent bilateral and multilateral treaties concerning trade and investments.

BITs have traditionally spelled out specific rights which are considered essential for the carrying out of investments and which relate to situations and needs typical of foreign investors. Reference to domestic provisions concerning local investors would be useless here since the latter do not enjoy such rights. The most relevant areas in this respect are those pertaining to:

(a) the entry and employment of personnel necessary in order to manage the investment, and
(b) the freedom to transfer profits and proceeds of the liquidation of an investment and to make related payments.

(a) *Entry and employment of personnel*

Two different provisions are usually found in BITs concerning this matter, one relating to the entry and stay in the territory of a contracting State of the other State's nationals in connection with an investment made by investors of the latter State, the other concerning the right of investors to employ top management of any nationality.

Both types of provision aim at ensuring effectively the rights of the investors rather than at conferring rights upon the natural persons who are their ultimate beneficiaries. The relevant clauses specify as a rule that these rights are to be exercised in conformity with the relevant domestic legislation concerning the entry, stay and work by aliens. This cannot be interpreted as meaning that the right exists only in so far as it is recognized by the general legislation of the party. On the contrary the undertaking implies that contracting parties may have to amend their legislation in the area in order to provide for the granting of necessary permits in accordance with a BIT provision [180]. On the other hand the rights so granted are not unconditional and have to be exercised within the framework of, and in accordance with the procedural requirements laid down by, the relevant regulations of the country concerned.

(i) As to the entry, stay and work of persons in connection with or for the need of an investment generally, the relevant provisions are

180. As to the implication of such clauses for the United States, a country that regulates in an elaborate way the entry and stay of non-resident foreigners, see K. Vandevelde, *op. cit.*, 95 (issuance of a "green card").

limited to nationals of the other contracting State only. In many BITs the provision is not couched in terms of rights. These BITs provide only for "favourable consideration" by the contracting parties of entry and residence applications by the other party's nationals in connection with an investment in order to work as employees or perform activities related to a covered investment [181].

Other treaties include a firm obligation in this respect, instead. As an example the Italy-Russia BIT of 1996 provides at Article 2 (7) that the signatories

> "in conformity with their legislation on the entry and stay of foreigners, shall permit to the citizens of the other Party who perform working activities in connection with an investment governed by this agreement, as well to their dependants, to enter, stay and leave its territory".

United States BITs are more specific as to the purposes of the entry and stay, which are indicated as those of "establishing, developing, administering, or advising on the operation of an investment". On the other hand the beneficiaries are limited to the investors themselves or to persons already employed by a company of the other party who "has committed or is in the process of committing a substantial amount of capital or other resources" [182].

(ii) The provision relating to the free choice of top personnel in order to manage foreign investments irrespective of nationality reflects the existence of a world market for professional competencies and the need of multinational companies (as well as of domestic companies competing in the global marketplace) to make use of these resources in their various units irrespective of their location. These provisions remind us of the importance of the human capital for economic development and of the manifold restrictions to which its movement across borders is currently subject, while trade and movements of funds is being liberalized at an increasing pace [183]. Similar provisions were already included in FCN treaties of the United States, are found in European Community and OECD texts and have been included in the partnership agreement of the EC with

181. See R. Dolzer and M. Stevens, *op. cit.*, 76, Germany-China (1983), Italy-Brazil (1995) Protocol, France-Mongolia (1991), Art. 3.
182. See United States-Russia (1992), Art. II (3).
183. See P. Stalker, *The Work of Strangers*, ILO, 1997.

Russia[184]. This personnel is hired as a rule by the local company which represents the foreign investment. A detailed clause, such as that found in recent United States BITs, specifies accordingly that

> "Companies which are legally constituted under the applicable laws or regulations of one Party, and which are owned or controlled by nationals or companies of the other Party, shall be permitted to engage top managerial personnel of their choice, regardless of nationality."[185]

This text does not mention the application of local laws concerning visas and employment to which equivalent provisions in other BITs make reference. The relationship between local legislation on the one hand and the treaty right enshrined in such a provision on the other does not involve only immigration law. The question of the content of this right has come up in relation to non-discrimination requirements in the hiring of personnel by enterprises provided by local labour laws. In the *Sumitomo* case United States Courts have held that such a clause, as included in the United States-Japan FCN Treaty of 1953, did not relieve a United States subsidiary of a Japanese company from the duty to respect such local requirements in its hiring practice[186].

(b) *Monetary transfers*

The provisions on monetary transfers are of the utmost importance for the foreign investor. The possibility of remitting from the

184. See FCN Treaty between the United States and Italy (1948), Art. 3; EC Treaty, Art. 54 (3) *(f)*; see also the paragraph on "Entry and Sojourn of Personnel" in the APEC Guidelines, *cit.*: "Member economies will permit the temporary entry and sojourn of key foreign technical and managerial personnel for the purpose of engaging in activities connected with foreign investment, subject to relevant laws and regulations." Domestic companies have a similar interest in having recourse to this personnel; many legislations on immigration provide accordingly for issuance of visas and working permits to managers and technicians on liberal terms, see e.g. Article 25 of the Italian law on immigration of 1998.

The EC partnership agreement with Russia of 1994, *cit.*, includes detailed (but cautious) provisions both on top personnel and on the temporary entry and stay of "intracorporate transfers". Liberalization of such entry and stay is included in the commitments of many WTO member States under the GATS.

185. See United States-Russia (1992), Art. II (4).

186. *Sumimoto* v. *Avagliano*, 457 US 176 (1982), summarized 76 *AJIL*, 1982, 853, holding that the subsidiary was a US company and not a Japanese company under the treaty definition.

investment country both the income produced and the value of the very investment made, plus any capital gain, in case of sale or liquidation is obviously of fundamental importance for any prospective or actual investor abroad [187].

Regulation of currency transfers pertains on the other hand to the monetary sovereignty of each State. Even when the above freedoms are provided in the law, specifically or in the framework of a liberal regulation of financial movements, the terms under which the relevant transactions are allowed are subject to modification in time. New restrictions have often been introduced as a consequence of the deterioration of the external financial position or of changes in the policy of a number of countries.

The provisions of the IMF, which is the only multilateral agreement covering the subject on a global scale, distinguishes between current international payments (which include remittance abroad *inter alia* of dividends, interests on loans, royalties, fees and salaries of expatriated personnel) and capital movements. IMF members have to allow as a general rule payments of the first type, except if they have been authorized transitorily to maintain restrictions in accordance with Article XIV of the IMF Agreement. The Agreement does not restrict, on the other hand, the freedom of members to impose controls on capital movements (which include funds transferred for the making or the sale or liquidation of an investment abroad) on the premise that these movements may in some cases be destabilizing and speculative. This approach is due to be changed and *de jure* progressive liberalization of capital movements should become one of the purposes of the Fund in accordance with decisions taken at the Annual Meeting held in Hong Kong in 1997 [188].

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187. Divestments by sale to other local or foreign investors are common, not as in the past because of a less favourable investment climate and profits outlook in the host country, but as a consequence of the mobility of capital and variable investment strategies by companies, see T. Hiby, *Desinvestitionen in Internationalem Recht*, 1995.

188. See IMF Interim Committee, Statement of 21 September 1997, *IMF Survey*, n. 18, 16 Oct. 1997, 302; S. Fischer, *Capital Account Liberalisation and the Role of the IMF*, IMF, 1997. The Fund has also admitted that controls and limitations on short-term capital movements (especially in respect of excessive speculative inflows) may be justified, thus revising the application in given situations of its doctrine as to financial liberalization, see "Keeping the Hot Money Out", *The Economist*, 24.1.1998, at 75-76.

In the light of the East Asia financial crisis of 1997-1998, it has been argued that international mobility for all types of capitals may bring more costs than benefits, see J. Bhagwati, "The Capital Myth", *Foreign Affairs*, 1998, 3, 7 *et*

The currency restriction risk is presently remote in respect of countries whose currencies are freely convertible in accordance with the IMF rules. OECD countries have committed themselves, under the terms of the formally non-binding Code on Capital Movements, to abolish most restrictions concerning capital transactions, especially those pertaining to direct investments. Full freedom of capital movement was established within the European Community in 1988 and has been included among the directly applicable basic freedoms guaranteed by the EC Treaty with the Maastricht Treaty. This principle is applicable also in the relations between the EC members and the rest of the world [189].

Under the APEC Guidelines of 1994 its members have undertaken to further liberalize towards the goal of the free and prompt transfer of funds related to foreign investment, such as profit, dividends, royalties, loan payments and liquidation in freely convertible currency.

These developments notwithstanding, currency restrictions, especially concerning capital movements, cannot be ruled out under domestic and international law. They are a reality in many countries of the developing world, which face chronic difficulties in their foreign exchange position.

It is therefore understandable that one of the typical protective clauses for investments in BITs guarantees the remittance abroad both of current payments concerning any investment covered by the treaty and of the proceeds of its sale or liquidation. The inclusion of such a clause enhances the promotional value of the BIT, in that it ensures the prospective investor from any future legal restriction

seq.; D. Rodrik, "Who Needs Capital-Account Convertibility? Should the IMF Pursue Capital Account Convertibility?", *Princeton Essays in Int. Finance*, No. 207, 1998. For a summary, see "Capital Controversies. Is the Case for Free Financial Flows as Strong as That for Free Trade?", *The Economist*, 23.5.1998, at 76.

189. See EC Directive on capital movement 361 of 1988 under Article 67 of the EC Treaty as interpreted by the ECJ in cases 358, 416/93; the new Article 73 B of the EC Treaty as amended by the Maastricht Treaty. Agreements of the EC with third countries are cautious as to any liberalization obligation by the latters. Thus the EC-Israel Free Trade Agreement (1996) proclaims on the one hand at Article 31 that there will be no restrictions nor discrimination as to movements of capital between the parties but this provision

> "shall be without prejudice to the application of any restriction which exist between them on the date of entry into force of this Agreement, in respect of the movement of capital between them involving direct investment, including in real estate, establishment, the provision of financial services or the admission of securities to capital market" (Art. 33).

by the host country and insulates an investment made, at least in theory, from the effects of any exchange crisis that might affect its economy.

Such clauses do not aim only at ensuring these transfers as a matter of right but also at facilitating them in practice. They take into account that even in respect of transfers which are allowed, exchange controls laws, where they exist, tend to subject the carrying out of these transfers to procedural requirements which may be applied in a needlessly cumbersome way and result in delays that are damaging for the investor.

On the other hand the free transferability clause does not protect the investor from the general exchange risk concerning the currency of the host country and the value of the investment as expressed in that currency. Devaluation risks are not assumed by the host country through a BIT. They may be covered at a price as non-commercial risks inherent in an investment abroad either in the private insurance market or within publicly run schemes of the home country covering such risks with a view to favouring investments in developing countries.

The specific clause or clauses found in almost all BITs concerning the transfers of funds related to an investment and their modalities list the types of transfers covered by the agreement and the content of the obligation undertaken by the parties [190].

Payments covered (the lists found in these provisions are declared as being merely illustrative and not exclusive) are those concerning the transfer of profits, returns and dividends from an investment, as well as the amounts derived from its total or partial sale or liquidation. Other payments covered are those connected with an investment which may accrue not to the investor itself but to third parties, such as royalties and fees, repayment of loans, earnings of natural persons (obviously not nationals of the host country) who are working there in connection with the investment. Other items are specifically listed in some treaties, such as "the funds necessary for the acquisition of raw or auxiliary materials, semi-fabricated or finished products, . . . additional funds necessary for the development of an investment" [191].

Payments due as compensation for expropriation or for other

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190. For example see R. Dolzer and M. Stevens, *op. cit.*, 90 *et seq.*
191. Netherlands-Poland (1992), Art. 4.

losses are listed either in the same article or in that concerning those issues, but are generally subject to the same régime.

The obligation undertaken is that of guaranteeing that those payments be transferable in the original currency or in a freely convertible currency "without undue restriction or delay". Often but not always a specification is found as to the exchange rate to be applied [192].

Some BITs (such as those of the United Kingdom) do not admit limitations to the above right of free transfer, while others include procedural or substantive conditions and allow limitations in specific instances. Recent United States treaties authorize each party to impose reporting requirements as to currency transfers, to impose income taxes also by way of withholding taxes on dividends, as well as to protect the rights of creditors and to ensure the satisfaction of judgments in adjudicatory proceedings "through the equitable, non-discriminatory and good faith application of its laws" [193]. Other restrictions may limit the share of income that persons working in connection with the investment may transfer [194].

As to the transfer itself some BITs specify the maximum period in which the transfer must be completed in order to comply with the "without delay" obligation [195].

Substantial capital divestments and outflows can cause strain on the foreign exchange reserves of a country encountering balance of payments difficulties. One would expect to find therefore a specific clause covering this extraordinary but not hypothetical event, taking into account the recognized distinction as to the legal régime governing capital and current payments respectively. On the contrary, most

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192. The transfer shall be made "at the market rate of exchange on the date of transfer with respect to spot transactions in the currency to be transferred", United States-Russia (1992), Art. IV. German BITs refer in this respect to the IMF rate of the currency in terms of SDRs at the date of payment.

193. See United States-Russia (1992), United States-Argentina (1991), Art. V. Italy's BITs with Russia, Cuba and Brazil provide that transfers are subject to the previous compliance by the investor of all its fiscal obligations, a reasonable requirement in abstract but which could easily become a hindrance for the investor depending on the practice of the host State.

194. France-Mongolia (1991) refers to an "appropriate share". Italy's BITs with Cuba, Brazil and Russia specify "in the amount and with the modalities provided for in the legislation and regulations of the Party concerned".

195. Two months seems a common term: Austria-Romania (1995), Germany-Swaziland (1990), Germany-Estonia (1994), Netherlands-Poland (1992), Poland-UAE (1993); six months: Italy-Brazil (1995), Italy-Ukraine (1995). Italy-Cuba (1993) and Poland-UAE (1993) provide in addition for mfn treatment as to transfers if more favourable.

recent BITs are mute on the subject [196]. Only few recent BITs contain a clause admitting the right of a contracting party to restrict the transfer of any payment connected with a covered investment in exceptional financial or economic circumstances affecting its balance of payments [197].

GATS Article XII on the other hand admits temporary, non-discriminatory restrictions on trade in services and related payment and transfers "in the event of serious balance-of-payments and external financial difficulties or threat thereof, with a special attention to the situation in which developing Members may find themselves in this respect". The relationship between multilateral treaties of a regulatory character, especially the IMF, allowing restrictions in case of serious balance-of-payments difficulties, and a BIT which does not cover specifically the issue is not prima facie clear. We would tend to conclude that such a BIT does not exclude the applicability of a restriction adopted in conformity with the multilateral treaty provision, save if the BIT contains a specific clause to be considered as *lex specialis* [198].

6. *Preferential Treatment, Incentives, Performance Requirements*

Foreign investment is often used as a tool of economic policy by the receiving country. Its inflow may be promoted by special legislation, such as the investment codes enacted especially by many African countries after their independence, guaranteeing legal stability, a favourable tax régime and financial advantages. Financial contribu-

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196. Cf. the World Bank Guidelines, III, 6 (1) *(d)*. US BITs of the 1980s, such as those with Egypt, Zaire, Bangladesh and Turkey allow an exception to free transferability during unusual periods of low foreign exchange. For a clause allowing restrictions to current and capital payments in cases of foreign exchange shortage see the FCN Treaty between the United States and Italy (Supplementary Agreement of 1951), Art. 4.

197. Germany-Swaziland (1990): in case of "extreme balance of payments difficulties", see also Japan-China (1988) safeguarding more generally the imposition of exchange restrictions, cf. R. Dolzer and M. Stevens, *op. cit.,* 89. According to Australia-Viet Nam (1991) a contracting party shall permit transfers "subject to its right in exceptional financial or economic circumstances to exercise equitably and in good faith powers conferred by its laws". Spain-Colombia (1995), Art. VII (6) allows bona fide non-discriminatory restrictions in case of exceptional balance of payments difficulties.

198. Authorized exchange restrictions and in general recourse to safeguard provisions in multilateral treaties are as a rule subject to non-discriminatory application. This would represent an additional limit to should a BIT derogation would be invoked.

tion and other monetary or non-monetary advantages aimed at inducing foreign investments may be targeted at the development of certain parts of the country or be limited to certain types of investments. These benefits may be limited to investments which will promote foreign exchange inflows through the export of most of the production; they may include custom duties reductions or exemptions and other tax exemptions within certain areas ("export platforms"). The host country legislation may further provide that the exact content of the benefits that can be granted shall be negotiated with the foreign investor and determined in contractual arrangements, depending upon the importance of the foreign investment at issue, the commitments undertaken by the investor as to employment, output, innovation, etc., and the advantages thus brought to, or at least expected for, the local economy [199].

These policies are not limited to developing countries eager to attract foreign investment which might otherwise direct itself to other countries offering a more favourable investment climate and economic setting, without the inducement of those incentives. Certain members of the European Union, such as Ireland, and some states of the United States have promoted with success the establishment of a number of large foreign industrial operations through such schemes, combining tax and financial advantages with other benefits or subsidies, such as the offering at favourable terms of land already equipped by State authorities for the establishment of industrial projects [200].

As concerns developing countries the economic soundness of these policies has been debated, depending *inter alia* on their specific content and their authorities' capability to administer them efficiently. Thus the relevant section of the World Bank Guidelines cautions against the granting by host States of such exemptions and incentives which are increasingly motivated by competition among host States. These practices are considered to represent often unjus-

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199. Peru has followed a partly different model under the Decree 162-92 EF on the "private regimes of guarantee to private investment", which is applicable to both domestic and foreign investors. The Decree offers and guarantees to them a status of "legal stability" which can be obtained through the entering of a specific agreement to this end.

200. The European Union has adopted a non-binding code of conduct to be followed by member States in tax matters in order to avoid reciprocally harmful competition to attract investments, see the EU Council and Member States Resolution of 1.12.1997, OJ C 2/1 of 6.1.1998.

tified sacrifices on the part of host States and to serve as poor substitutes for appropriate overall policies affecting investments. Fiscal incentives to investors by their home States are recognized as a possibly more effective means of encouraging such flows [201]. Indirect incentives consisting in the relaxation of health, safety and environmental regulations in order to attract foreign investments are also viewed critically in a larger perspective.

Available incentives are usually offered to any foreign investor meeting the conditions set by the country concerned, without distinction between source economies, i.e. home States. The granting of incentives just to a specific foreign investment venture would be subject to mfn extension, or be in conflict with other BITs, besides falling also under the GATT mfn clause if the benefits were to include customs procedures and duties [202]. BITs do not contain as a rule specific provisions in this respect, in line with their general approach of aiming at promoting investment through the legal security inherent in their mere existence. They accordingly do not include financial, fiscal or economic undertakings in favour of the foreign investors of either party, which may be rather found in specific bilateral co-operation and assistance agreements. BITs would not be the appropriate instrument to this end : their structure is reciprocal, whereas the policies of the various countries differ in respect of the offering of these incentives. Moreover the widespread practice of BITs being entered into by all sorts of States results in they binding also countries with little reciprocal economic intercourse ; the likelihood that bilateral investment flows will in fact take place in such a context is limited.

The absence of treaty undertakings concerning the granting of benefits or incentives in BITs is consistent with the obvious principle that no State can be compelled to grant preferential treatment to foreign investors (though it may of course freely elect to do so), a

201. World Bank, *Legal Framework*, *cit.*, II, 23-24. For an overview see OECD, *Investment Incentives and Disincentives and the International Investment Process*, 1983. As a typical example see the decree of 6 February 1988 issued by Russia granting a package of custom, tax and administrative advantages to joint ventures (mixed companies) with foreign participation for big projects involving a foreign investment in excess of US$250 million, provided that the local added value of the production be at least 50 per cent.

202. The EC has strongly objected on those reasons in 1997-1998 to incentives granted by Ukraine to a major investment by the Korean car manufacturer Daewoo only, as being inconsistent with the EC-Ukraine Interim Trade Agreement, see EC Press Communiqué ip/98/173 of 20.2.1998.

principle which developing countries were keen to have spelled out in the (never completed) code of conduct for transnational corporations at the United Nations in the late 1970s and early 1980s [203].

BITs' mfn and national treatment clauses represent in any case a guarantee that special benefits granted by one party to local or other foreign investors, even if subject to specific conditions, will be available for investors of the other treaty party under the same terms. Any exception or restriction, for instance in the delicate area of eligibility to subsidies, should therefore be spelled out [204].

Many recent BITs tend to include a specific mfn obligation in respect of incentives. Other BITs follow a more restrictive approach and include clauses aimed at avoiding practices by either party which subject the carrying out of foreign investments to certain restrictive and possibly distorsive conditions, or as a condition in order to be eligible for specific incentives.

As to the first type of clauses the following provision in Article 11 (2) of the Italy-Ukraine BIT of 1995 is worth quoting as a significative example:

> "The more favourable treatment shall apply whenever the treatment granted by either contracting Party to the investor of the other Party in conformity with its laws, regulations or other provisions, any specific contract, investment authorisation or investment agreement is more favourable than the one provided by this Agreement." [205]

The insertion in BITs of an obligation to refrain from performance requirements as a condition for the admission or maintenance of an investment appears to be specific to the United States practice, dating back to the mid 1980s. This approach has been only scantily followed in recent agreements of other countries.

203. For this principle see the United Nations Charter on Economic Rights and Duties of States (1974), Art. 2 (2) *(a)*. As to the proposed treatment of the subject in the MAI, see M. Daly, "Investment Incentives and the MAI", *JWT*, 1992, 2, 5 *et seq.*

204. Parties may of course make exceptions to the extension of any of these benefits. Thus Canada-Trinidad (1995), Article XV, contains a detailed reservation as to Government-granted or supported subsidies, grants, loans, insurance, development or export credits which may be restricted to domestic enterprises. Similar precautionary clauses appear to be standard in Canada's BITs.

205. The provision goes on guaranteeing the application of any previous more favourable legislative treatment applicable to an investment should the legislation be modified.

The United States BIT with Argentina of 1991 is typical of the current United States practice in this respect, where it provides that

> "Neither Party shall impose performance requirements as a condition of establishment, expansion or maintenance of investments, which require or enforce commitments to export goods produced, or which specify that goods or services must be purchased locally, or which impose any similar requirements." [206]

The rationale of inserting such a prohibition in a BIT can be debated. As a condition pertaining to the admission of foreign investment this kind of provision would not be appropriate in BITs which do not regulate entry, and which therefore do not limit the competence of each party to freely regulate this matter, provided that relevant regulations are not discriminatory. If the acceptance of export or local purchase or content requirements is induced by fiscal or other incentives, as often happens, these conditions might not limit foreign investment but in fact promote it. On the other hand such requirements are not in line with the promotion of investment generally and with their subjection to national treatment that BITs pursue.

The real objection to these policies pertains rather to their distorsive trade effects. By artificially promoting exports or restricting the demand for imports through local content requirements, such provisions may be considered equivalent to export subsidies or import restrictions, deemed incompatible with the spirit if not always with the letter of GATT.

Widespread concern has been raised as to the economic soundness and trade effects of such governmental policies, since they may result in "beg your neighbour" practices. They would reciprocally offset themselves and generate a cumulative loss of revenues to the countries concerned, while encouraging red tape and unproductive administrative interference with trade flows.

This has led to the elaboration of a specific agreement on investment measures related to the trade in goods (TRIMs), within the Uruguay Round of multilateral trade negotiations concluded in 1994.

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206. A Protocol provision recognizes however that Argentina was maintaining such performance requirements in the automotive industry and includes a best efforts roll-back undertaking.

This Agreement bans TRIMs, such as local content purchase requirements and trade balancing requirements (performance requirements), which are deemed to be inconsistent with the obligation of national treatment of Article III of GATT. Restrictions affecting imports or exports are also banned as being contrary to the obligation of general elimination of quantitative restrictions of Article XI[207]. Incentives that do not affect trade directly, such as fiscal advantages and other kind of subsidies, are however not within the TRIM Agreement.

The Agreement underlines the relation between trade and investment regulations in today's global competition environment. Its provisions may render dealing with this subject matter in BITs superfluous, at least among WTO members, while other incentives, which do not have direct trade effects, are legitimate both under GATT and under BITs[208].

7. Host and Home Countries' Competence in the Regulation of Foreign Investments

In practical terms, but also from a theoretical point of view, it is appropriate to make a conclusive summing-up of the legal régime to which foreign investments benefiting from a BIT's protection are subject.

BITs rarely indicate as such the law applicable to these investments[209]. The United Kingdom-India BIT of 1994 is an exception where it provides at Article 11 (1) on "Applicable Laws" that "Subject to the provisions of this Agreement, all investments shall be

207. See generally R. Scheibach "Foreign Direct Investment", in J. Bougeois (ed.), *The Uruguay Round Results,* 1995, 445 *et seq.*; P. Juillard, "L'accord sur les mesures concernant l'investissement et liées au commerce", SFDI, *La réorganisation mondiale des échanges* (Colloque de Nice), 1996, 113; W. Fennel and J. Tyler, *Trade Related Investment Measures* (The Uruguay Round Negotiating History), 1996. The list of TRIMs annexed to the Agreement is "illustrative". Prohibited TRIMs are both those which are mandatory and those "compliance with which is necessary to obtain an advantage".

208. Among the few non-United States BITs dealing with this subject matter see Italy-Ukraine (1996), Protocol, and Poland-UAE (1993). The latter provides that the parties "shall seek as far as practicable" to avoid those performance requirements thus reflecting a flexible approach also found in several US BITs dealing with the matter, see K. Vandervelde, *op. cit.*, 110 *et seq.*

209. Some BITs provide indirectly as to the law applicable, by indicating the rules to be applied in the arbitral settlement of disputes between the host State and the investor, mostly by restating the content of Article 42 of the ICSID Convention. See *infra* Chap VI, section 6.

governed by the laws in force in the territory of the Contracting Party in which such investments are made." [210]

Two separate questions are involved here, one concerning the type and the hierarchy of the legal provisions governing such foreign investment in and by the host State, the other relating to the jurisdiction of the home State to regulate matters concerning investments made in a foreign country by one of its investors, notwithstanding the fact that they would basically fall under the latter's territorial jurisdiction.

(a) *Legal régime applicable in the host State*

It is an accepted principle under international law that the economic activity of a foreigner carried on in a given State, especially if this is done through an entity established there in accordance with the local law, is in principle governed by the law of the host State [211]. BITs take this for granted when they address the issue of the treatment to be accorded by the host State to investment made in its territory by a national of the other party. This implies that foreign investors, be they multinational companies, other entities or individual businessmen, are subject to those laws and must abide by them, without the need to spell this out in the treaty [212].

Foreign investments are subject in the first place to the general legislation and to any specific applicable law and regulation of the host States. The national treatment standard appears to be paramount

210. Article 11 (2) states further that:

> "Notwithstanding para. (1) of this Article nothing in this Agreement precludes the host country Contracting Party from taking action for the protection of its essential security interests or in circumstances of extreme emergency in accordance with its laws normally and reasonably applied on a non-discriminatory basis."

This clause appears to allow the application of domestic laws in conflict with the BIT in exceptional situations.

211. See Article 8 of the United Nations Draft Code on Conduct on Transnational Corporations, "TNCs should/shall respect the right of each State to regulate and monitor accordingly the activities of their entities operating within its territory" which was accepted by both developed and developing countries as reflecting current international law. UN doc. E/C.10/1984, reprinted in 23 *ILM* 1984, 626.

212. It has been suggested in the MAI negotiations to append the OECD nonbinding guidelines for Multinational Enterprises of 1976, as revised, to the MAI text on the law applicable to foreign investment, see generally P. Juillard, "L'évolution des sources du droit de l'investissement", *Recueil des cours*, Vol. 250 (1994), 9 *et seq.*

in this respect. Save for any treaty exception (e.g. as to admission, monopolies, special advantages reserved to locally owned enterprises), it prescribes the application to foreign investments and to their operation of those laws which are applicable to similar entities and govern those operations when carried out by local investors. Specific national law provisions governing foreign investment in the host State, including guarantees, preferences and incentives, as well as regulating those aspects which are typical of international operations, are of course also applicable. These provisions are especially relevant in the case of non-market economies whose BITs therefore do not rely principally on the national treatment standard [213].

The application of the national standard, that is of the local legislation in general, is completed under any BIT by the non-contingent standards they typically provide for, both general and specific. As to general standards, it is enough to mention here the requirements of fair and equitable treatment, full security and protection, as well as the international standard with which the legal system and practice of law-abiding States are expected to conform. The application of any domestic law or host State action incompatible with those requirements must be avoided, as being in violation of the treaty. It can be remedied, as any other violation, through recourse to the dispute settlement proceedings provided in the BITs should local courts not be empowered to supply directly the BITs provisions.

Specific treatment requirements, such as those found in the areas of employment, transfers and expropriation may require that the legislation of a BIT contracting party be amended in order to carry out those specific bilateral obligations.

Recourse to the mfn contingent treatment would seem to be less frequent. This standard justifies invoking the application of a specific more favourable provision contained in another treaty of the host State (not necessarily a BIT) in lieu of a domestic law provision (or the relevant BIT's provision) which would otherwise be applicable [214].

213. National treatment will also be applicable where a BIT does not include it, such as for many of China's BITs, when this standard is prescribed in at least one of its BITs with any third country, by application of the mfn standard.

214. There is a tendency to apply this clause restrictively, e.g. requiring that the treaty taken as reference deals with the same subject matter, or that procedural requirements laid down in the latter be complied with. See e.g. Cassazione 13.12.1979, *Rivista di diritto internazionale*, 1980, 880; Cassazione 14.10.1985 n. 4976, *Rivista di diritto internazionale privato e processuale*, 1987, 350 denying *de facto* the better treatment provided in treaties made by Italy with third countries.

In conclusion international law both customary and stemming from treaties can be a viewed as a limit to the application of inconsistent domestic provisions. One might object to the hierarchy just presented putting the BIT (and any other applicable international law provision) in the first place instead. While this may be theoretically more satisfactory, from an overall point of view things look different. Foreign investors and their operation in another country, especially if they establish themselves there using local companies, are subject to local law and are basically entitled to be treated on the same footing as their local competitors, subject to specific restrictions as to entry in general and as to specific sectors open to them. BITs operate *"ex ante"* as an instrument of modification of the local legal system, especially in specific areas of major concern to foreign investors, in order to ensure them the enjoyment of certain standards. *"Ex post"*, in case of violation, they operate as an instrument of a superior legal value in order to ensure compliance and, if warranted, indemnification through defined procedural remedies.

This construction of the relationship between domestic law and BITs obligations indicate that the freedom of the host State to enact or change its laws and regulations in the furtherance of general or specific policies (e.g. in respect of the environment, labour and consumer protection, technological research, industrial development) is basically unaffected by BITs.

Foreign investors are subject to such legislations. They are basically entitled to the fair, non-discriminatory treatment and to the respect of their acquired rights of an economic value as guaranteed by applicable BITs. As shown in our analysis, these treaties tend to apply in this respect principles and standards generally recognized in international law and included in multilateral instruments governing transnational economic intercourse.

(b) *Conflicts between home and host States*

The basic competence of the host country to regulate foreign investments within its borders as an expression of its political and economic sovereignty, subject to any applicable international obligation as indicated above, should not overshadow the fact that not only the establishment but also the subsequent operation of a direct foreign investment involve cross-border transactions and produce transnational effects. This implies a more or less active, but most of the

time constant, interest of the home State and the relevance of its own legislation in many respects.

First of all the home State has a legitimate interest in the exercise of its sovereignty to regulate the outflow of capital and may impose limitations as to its geographical or sectorial destination [215].

Home countries may further wish to impose certain modalities on the operations carried out abroad by their companies through subsidiaries fully owned or controlled by them, with a view to avoiding indirect elusion of their legislative standards, ensuring the repatriation of profits for balance of payment reasons, as well as in order to protect their own tax revenues on resources originally stemming from the domestic economy and invested abroad [216].

Home countries often impose upon their companies investing abroad the respect of certain administrative and accounting policies that are directly relevant for the parent company, for instance in relation to consolidated balance sheets, financial statements and maintenance of an overall sound position [217].

In regulating foreign investments by its nationals a home State may wish to promote certain political or economic aims. These may conform to the policies of foreign countries, such as in the case of incentives to invest abroad in respect of States wishing to attract foreign capital. In other instances they may conflict instead with foreign countries' policies. A home country may wish to use its investments abroad as a tool to put pressure on a host or a third country in a given instance, or may at least wish to ensure that its policies (for instance an export restriction in case of crisis) not be undermined by the fact that its investments abroad escape basically from its authority. In a different perspective the home country may insist on adherence in their operations to certain basic principles (e.g. in the area of

215. Liberalization of capital movements, as current in industrialized countries, implies also the freedom of outward movements, which, on the other hand, may be and has been restricted in case of balance of payments problems. In these instances selective authorization procedures may be introduced. In the past industrialized countries in balance of payment difficulties (such as the United Kingdom after after World War II) have even resorted to compulsory divestments of their companies' investments abroad.

216. Measures of this kind do not necessarily imply any action or effect abroad, e.g. when taxes paid abroad are disallowed as a deduction of domestic taxes on the same revenue.

217. This may not be imposed by the home State but be a requirement consequent to the listing of the parent company in a stock exchange in a third country.

human rights, environmental protection and labour standards) which it feels that its nationals should respect worldwide.

These policies cannot be directly enforced abroad in view of the territorial limitation on State sovereignty. They can be carried out only indirectly, by compelling the parent company to exercise its control on its foreign subsidiaries in conformity with the home State prescriptions. Should this be impossible because the parent is not in the position to obtain such compliance, for instance when a minority investment is involved or when this conflicts with compulsory norms of the host State, the home country may only resort to ordering the parent company to divest.

Legislative or administrative prescriptions of the type mentioned cannot be put all on the same level from the point of view of their function, the conflicts which they may create, their legality in respect of international standards and the competence of the host State.

Investments and capital flows liberalization and, more generally, the opening of economies to trade in goods and services worldwide have led to interdependence and have increased the concurrent interest of different States in regulating activities which by their very nature are not clearly localized in a given country and have transnational effects. The risk of conflicts is thus increased whenever the goals pursued by different countries are not shared and when there is no procedure in place for harmonizing standards and procedures prescribed by Governments or rules followed by enterprises operating in different countries as a single unit. The absence of co-ordination in the exercise of national economic sovereignty, directly or through international organizations, is then bound to increase conflicts and to hamper the very international investment climate.

Harmonization of goals and standards and co-ordination of preventive and repressive actions as to the conduct of business on a transnational scale is well under way in various areas especially when a large number of countries share common values. This tends to be the case when interests of a more general nature are involved. The examples of drug trafficking, money laundering, prudential controls on transnational banking and financial operations, fighting insider trading and corruption of foreign public officials in international transactions are all areas where in recent years a network of treaties, informal understandings, exchange of information and co-operation schemes between supervising authorities have been put in

place. These measures deal with selected aspects of transnational business and are not principally aimed at regulating multinational companies and foreign investments. They indicate the emergence of primary values in international economic law shared by the international community as a whole.

BITs recognize the existence of a shared interest of home and host States in the promotion and protection of foreign investments on a bilateral basis, but fail to apportion regulatory and enforcement competences among them. In fact BITs extend their protection, the application of their standards and recourse to their dispute settlement procedures to companies incorporated in the host States, whenever they are considered to be a foreign investment. While these local companies are established and operate in accordance with the host State legislation, they enjoy basically the protection of the BIT provisions, in view of their ownership and control by foreign investors. The economic interest of the home State as to their protection is thereby being recognized, and therefore also its competence in regulating them, albeit indirectly and in a subordinate way, based on an extended nationality principle. The *Barcelona Traction* rule, whereby the foreign investor could be protected by its national Government only as to the residual patrimonial interest in the value of its shares in case of liquidation or similar events, is discarded under the current BIT schemes. By undertaking treatment obligations as to these kinds of investments in order to promote them, host countries not only admit procedurally the legitimacy of the home State diplomatic protection but should also take into account that home countries' legislation may properly regulate operations and aspects of these companies which are not purely limited to the host country's territory [218].

The lack of clear competence apportionment may increase the possibility of conflicts, though BITs reflect the common interest of home and host States in the promotion and protection of investments and the need for reciprocal co-operation.

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218. The recognition of the link between the locally foreign-owned company and the home States would justify on the other hand the treatment of such entities as foreign, based on the control element, whenever this link justifies under international law subjecting foreign property to special restrictive measures as alien property, such as in case of war, collective sanctions, and alike. For recent developments see G. Burdeau, "Le gel d'avoirs étrangers", *JDI* 1997, 5 *et seq.*

On the other hand widespread differences in legislation and control, in technical, environmental and other standards, lack of co-ordination by enforcing authorities of different States and the granting of incentives by certain countries to attract foreign investments may create situations where able businessmen or efficient global companies may reap extra advantages, escape restrictive legislation and profit from loopholes.

In fact, it is often difficult to distinguish between the consequences of different legislations within the traditional territorial competence of each State, regulating conduct carried out therein, on the one hand, and the effects of the clashes of regulations which, in order to be effective in view of the very nature of today's transnational business operations, have an "extraterritorial" applicability or may have such an effect.

Different types of such at least potentially extraterritorial regulations should in our opinion be distinguished, limiting ourselves to the case of foreign investments and specifically of foreign-owned companies.

In the first case prescriptions by the home State directed at, or directly affecting, the subsidiary located and operating in a foreign country do not conflict with compulsory regulations by this country, or in any case compliance does not require violating such regulations.

This is the case for instance of the prescriptions concerning accounting, financial discipline, internal administrative set-up, respect for standards which are more restrictive than the one locally required. Respecting these kind of prescriptions entails a burden and additional costs for the company as a whole, which can be viewed as a necessary price for operating internationally in a legally and politically divided world.

Home State prescriptions as to the business set-up and conduct of foreign subsidiaries have further to be considered when they conflict with local regulations pertaining to the same fields. In this case the company as a whole, or rather legally speaking the parent company, finds itself in the situation of having to respect conflicting obligations. The home country may be tempted to enforce compliance on the parent company although the conduct or obligation relates to the foreign subsidiary which is a distinct legal subject, governed by foreign law and jurisdiction. While jurisdiction over the subsidiaries pertains basically to the host country, the home country may pre-

scribe rules applicable to them for limited purposes, concerning accounting, disclosure and consolidated tax returns [219].

When "normal" regulation of business is involved a friendly solution of the potential or actual conflict, possibly on a case-by-case basis, is usually found between the authorities concerned. While the different regulations and their different territorial scope hint at different underlying aims and views by the States concerned, these appear not to be so fundamental as to preclude agreement, in the best interests of the business operations. This problem has been dealt with by the OECD in the 1980s in connection with the Organisation's work on multinational enterprises and international investments, resulting in a "Procedural Decision on Conflicting Obligations" of June 1991 [220]. While not entering into the substance of the competence of home and host States in the matter, the Decision provides for a forum for consultations within the OECD, where any issue raised by a member may be resolve in a spirit of mutual co-operation.

The most complex problems are raised when the home State intends to subject to its legislation foreign subsidiaries of its corporations and to enforce it directly or more often indirectly by acting against the parent company, in areas where it considers that a paramount public interest is at stake. This may happen in relation to the regulation of business activity in general, such as antitrust, including control over international mergers and acquisitions, but emerges more often when political objectives are being pursued through the

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219. This solution is laid down in the *Restatement (Third) of the Foreign Relations Law of the United States*, 1987, Sec. 414, 1, 2 *(a)*. Other instances admitted therein (para. 2 *(b)*) "in exceptional cases", provided reasonableness is established, "when the regulation is essential to implementation of a program to further a national interest of the state exercising jurisdiction" are debatable. They should be evaluated as to their admissibility on a case-by-case basis, taking into account the host State position and interests.

See F. A. Mann, "The Doctrine of International Jurisdiction Revisited after Twenty Years", *Recueil des cours*, Vol. 186 (1984), 9 *et seq.* As to the private law aspects see IDI, Resolution on "The Liability of Multinational Enterprises for Obligations of Member Companies Imposed by National Law" and the Report by A. Lowenfeld, "Obligations of a Company Belonging to an International Group and Their Effects on Other Companies of that Group", *Annuaire IDI*, 65, 1993, I, 244 *et seq.* For a comparative overview (by now dated) see OECD, *Responsibility of Parent Companies for Their Subsidiaries*, 1980.

220. See OECD, *The OECD Declaration and Decisions on International Investment and Multinational Enterprises*, 1991, Review 1992, 127. See also the OECD Members Revised Declaration of 1976-1991 on multinational enterprises (para. III), *ibid.*, 109, where mutual co-operation is recommended in order to avoid or alleviate conflicting obligations.

use of economic instruments. In today's world, where recourse to military force is severely constrained by legal rules and political considerations, the use of a country's (especially a major power's) economic potential, including its international dimension, is frequently resorted to, both unilaterally and within the application of collective sanctions.

When the countries concerned do not share a given policy (as was the case with NATO export restrictions towards the Soviet bloc countries during the Cold War), conflicts are inevitable. International law does not give a clear and satisfactory answer to the question of how far, even in these circumstances, the competence of the home State can extend in applying its laws to companies organized and established abroad based on the control link. Basically the home State lacks jurisdiction to apply its laws and enforce them when the conduct it requires is unlawful in the foreign country. The parent company might be forced to comply with the prescription in its own home country, but may not use its control over the subsidiary to compel it to act illegally except at the risk of itself violating the foreign laws. Generally speaking customary international law does not in principle prohibit States from applying their law and exercising the jurisdiction of their courts to persons, property and acts outside their territory, as recognized by the PCIJ in the *Lotus* case [221]. The "effect" doctrine is widely accepted and followed, whereby a State can prescribe rules against activities occurring outside its borders that have harmful effects within the State's territory. The limits of its application are debated and a differential approach, depending upon the subject matter (e.g. criminal acts, antitrust, etc.), the nature and intensity of those effects, and the importance of the interest at stake seem to prevail. Relying on the distinction between legislative and enforcement jurisdiction is not satisfactory by itself, because the mere issuance of prescriptions as to the conduct taking place abroad may encroach upon a foreign State's sovereignty, even if enforced only domestically. It can interfere unreasonably with a person's conduct abroad, including legal entities, when they transact business also in the country issuing the prescription as is the case for most multinational companies in today's economy [222].

221. *SS Lotus (France* v. *Turkey), PCIJ, Ser. A., No. 10*, 1927, at 19.

222. On the issue of extraterritorial application of laws and the related exercise of jurisdiction as to private business activities see "Resolution on the Extraterritorial Application of Antitrust Legislation", ILA, *Report of the 55th Confer-*

Self-restraint, under the names of comity or balancing of interests, has been advocated and is practised in economic matters. The application of these principles is often biased when unilaterally applied, for instance by the courts of the home State, a criticism that has been directed from abroad to the practice of the United States. Other States whose interest were affected have often answered by "blocking statutes" under which complying with the conduct required from local companies (not necessarily just foreign-owned) is prohibited under criminal sanctions so to avoid any possibility of voluntary compliance [223].

Such instances are luckily rare but when they emerge they have the peculiar effect of straining relations between friendly countries (the Western industrialized countries where most of the parent and subsidiaries of multinational companies operate). The question has been raised in the negotiations for the OECD Multilateral Agreement on Investments and is a major issue, in a wider dimension, in United States-European Union relations.

In general, and as a conclusion, the issue reminds us that, notwithstanding the ubiquity of multinational enterprises and the "denationalization" of capital, the relaxation of these companies' ties with specific countries of origin, which is being viewed as a typical feature of the global economy, is in no way irreversible. It is not accepted, neither legally nor politically, in crucial situations of political concern by their home States.

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ence, New York, 1972, at 19; *The Restatement (Third) of the Foreign Relations Law*, 1987, Secs. 402, 403; A. Lowenfeld, "Public Law in the International Arena: Conflicts of Laws, International Law, and Some Suggestions for Their Interaction", *Recueil des cours*, Vol. 163 (1969), 315 *et seq.*; W. Meng, *Extraterritoriale Jurisdiktion im öffentlichen Wirtschaftsrecht,* 1994, 299 *et seq.*; H. Maier, "Jurisdictional Rules in Customary International Law", in K. M. Meessen (ed.), *Extraterritorial Jurisdiction in Theory and Practice*, 1996, 64 *et seq.*; B. von Behr, *Multinationale Unternehmen und Exportkontrollen*, 1996.

223. For recent developments see the following US Statutes: Cuban Liberty and Democracy Solidarity Act 1996 (Helms-Burton Act) and the Iran and Libya Sanctions Act 1996, whose extraterritorial provisions prompted the EU Joint Action of 22.11.1996 and the EC Council Regulation No. 2271 of 29.11.1996 (EC OJ L.309 of 29.11.1996) "protecting against the effects of the extra-territorial application of legislation adopted by a third country". For a debate on the Helms-Burton Act and international law, see 90 *AJIL*, 1996, 419 *et seq.* (comments by A. Lowenfeld and B. Clargett). See also M. Cosnard, "Les lois Helms-Burton et d'Amato", *AFDI*, 1996, 33 *et seq.* An initial solution of the conflict has been agreed in the G-7 meeting of May 1998 in Birmingham.

CHAPTER V

EXPROPRIATION AND COMPENSATION

Summary: 1. Expropriation and nationalization in international law. 2. Public purpose and non-discrimination. 3. The issue of compensation. 4. The standards of compensation and methods of evaluation of expropriated property in recent multilateral agreements and BITs. 5. "Prompt" and "effective" compensation. 6. Compensation for other damages in BITs. 7. Recognition of subrogation.

1. Expropriation and Nationalization in International Law

Given the well-known uncertainty of international law as regards the treatment of foreign investments in this respect in the light of the mass of expropriations and nationalizations without compensation which have taken place in this century, all BITs have specific provisions laying down under which conditions expropriations (including nationalizations) can be carried out by a contracting State and which compensation obligations arise therefrom, in order to protect the economic interests of the foreign investors.

By expropriation is meant the coercive appropriation by the State of private property, usually by means of individual administrative measures. Nationalizations do not differ in substance from expropriations except that they are directly statutorily based and have a wide coverage. They have been the instruments of widespread political and economic policy changes by States, with a view to subjecting specific sectors or the entire process of production and distribution to the ownership of and management by the State, excluding private economic initiative[224].

224. See I. Foighel, *Nationalisation and Compensation in International Law*, 1957; B. A. Wortley, *Expropriation in Public International Law*, 1959; G. White, *Nationalization of Foreign Property*, 1961; G. Tesauro, *Nazionalizzazioni e diritto internazionale*, 1976; R. Dolzer, *Eigentum, Enteignung und Entschädigung im geltender Völkerrecht*, 1985; V. D. Verwey and N. J. Schrijver, "The Taking of Foreign Property under International Law: A New Legal Perspective?", *Nether. Year. Int'l Law*, 1984, 1 *et seq.*; J.-P. Laviec, *Protection et promotion des investissements*, 1985, 159 *et seq.*; I. Seidl-Hohenveldern, "Semantics of Wealth Deprivation and Their Legal Significance", in D. C. Dicke (ed.), *Foreign Investment in the Present and a New International*

BITs intend to protect foreign investments in respect of this political or non-commercial risk whatever the language used by the contracting party carrying out these measures [225]. The terminology in BITs refers to "expropriation", "nationalization" and "measures having similar effects" [226], or "any measure having effect equivalent to nationalization or expropriation" [227], or "any other measure the effects of which would be tantamount to expropriation or nationalization" [228], or other equivalent ones [229].

According to general international law a State is free to adopt measures of expropriation or nationalization of a foreign investment in its territory.

In fact, following the changes that have affected the international community after the Second World War (namely, decolonization and the birth of many new States), such a freedom is no longer disputed because private property is no longer deemed to be basically inviolable. BITs do not deny this right but aim at subjecting expropriation to the full respect of substantive and procedural requirements prescribed by international law and to afford effective means of redress in case of violation [230]. The lawful recourse to these measures, in any

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Economic Order, 1987, 218 *et seq.*; T. Hefti, *La protection de la propriété étrangère en droit international public*, 1989, 78 *et seq.*; D. Carreau, T. Flory and P. Juillard, *Droit international économique*, 1990, 693 *et seq.*; P. T. Muchlinski, *Multinational Enterprises and the Law*, 1995, 501 *et seq.*

225. In *Amco Asia* v. *Indonesia* — award of 21.11.1984 (25 *ILM*, 1985, 1022 *et seq.*) — the ICSID Arbitral Tribunal established that ". . . it is generally accepted in international law, that a case of expropriation exists not only when a state takes over private property but also when the expropriating state transfers ownership to another legal or natural person" (at 1025). See also P. Cameaux and S. Kinsella, *Protecting Foreign Investment under International Law*: *Legal Aspects of Political Risk*, 1997.

226. See Japan-China (1988), Art. 5 (4); Germany-USSR (1989); Argentina-Egypt (1992), Art. IV (1); Norway-Peru (1995), Art. 6.

227. See the Swiss BITs; Australia-Romania (1993), Art. 5 (1); Bolivia-Peru (1993), Art. 5 (2); Czech Republic-Hungary (1993), Art. 5 (1); Argentina-Venezuela (1993), Art. 6 (1); Italy-Cuba (1993), Art. 5 (2); Estonia-Israel (1994), Art. 5 (1); United Kingdom-Turkmenistan (1995), Art. 5 (1); Spain-Colombia (1995), Art. V (1) *(a)* and *(b)*; Canada-Trinidad and Tobago (1995), Art. VIII (1); Italy-Brazil (1995), Art. IV (2).

228. See Germany-Barbados (1994), Art. 4 (2) and the US BITs of the 1990s.

229. See BITs quoted *infra* at footnote 247.

230. See also E. J. De Aréchaga, "Application of the Rules of State Responsibility to the Nationalization of Foreign-Owned Property", in K. Hossain (ed.), *Legal Aspects of the New International Economic Order*, 1980, 220 *et seq.*; M. Frigo, "La sovranità permanente degli Stati sulle risorse naturali", in P. Picone and G. Sacerdoti, *Diritto internazionale dell'economia*, 1982, 245 *et seq.*; M. Sornarajah, *The International Law on Foreign Investment*, 1994, 277 *et seq.*; I. Brownlie, *Principles of Public International Law*, 4th ed., 1990, 537. A peculiar

case when foreigners are affected, is subject under international law to certain requirements, basically those of a public purpose or interest, non-discrimination, the payment of compensation [231], and the procedural requirement of legality or due process [232].

As to the type and content of the rights covered, a wide concept tends to be used. All rights and interests having an economic content come into play, including immaterial and contractual rights [233].

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provision is that of Article 4 of Italy-Algeria (1991) which lays down a prohibition against expropriation, but then admits it as an exception, subject to the usual requirements, in case of "imperative needs of public good, security or national interest".

231. According to Brownlie (*op. cit.*, 537) "expropriation for certain public purposes, e.g. exercise of police power and defence measures in wartime, is lawful even if no compensation is payable". A few BITs, notably those of the United Kingdom, where they provide for compensation for losses other than expropriation, however, specify that the investors shall be accorded restitutions or adequate compensation for losses due to destruction of their property by forces or authorities of either contracting State if such losses are not caused in combat action or are not required by necessity of the situation. See for example United Kingdom-India (1995), Art. 6 (2).

232. As to due process many BITs do not include any specific requirement. Some BITs limit themselves to prescribing the conformity of the measure with the law of the expropriating country. See for example Italy-Brazil (1995), Art. IV (2) (i); Switzerland-Peru (1991), Art. 5 (1). Other BITs, notably those of the United States, contain specific obligations as to court review of any expropriation without prejudice of the specific dispute settlement procedure provided in the treaty. See for example United States-Russia (1992), Art. III (2), which reads as follows:

> "a national or company of either Party that asserts that all or part of its investment has been expropriated shall have a right to prompt review by the appropriate judicial or administrative authorities of the other Party to determine whether any such expropriation has occurred and, if so, whether such expropriation, and any compensation therefor, conforms to the principles of international law, and to decide all other matters relating thereto".

For similar specific clauses, albeit less detailed, see United Kingdom-India (1994), Art. 5 (2); Canada-Trinidad and Tobago (1995), Art. VIII (2).

233. As to the relevance of contractual rights see generally R. Higgins, "The Taking of Property by the State: Recent Developments in International Law", in *Recueil des cours*, Vol. 176 (1982), 263 *et seq.* See also *Libyan American Oil Co. (Liamco)* v. *Libya* (12.4.1977) (20 *ILM*, 1981, 103) and the case-law of the Iran-United States Claims Tribunal, in particular the *Starret Housing Corp.* v. *Iran* interlocutory award (19.12.1983); the two awards of 14.7.1987: *Amoco International Finance Corp.* v. *Iran* and *Mobil Oil Iran et al.* v. *Iran* (on which see M. Pellonpaa and M. Fitzmaurice, "Taking of Property in the Practice of the Iran-United States Claims Tribunal", *Nether. Year. Int'l Law*, 1988, 53 *et seq.*); the *Phillips Petroleum Co.* v. *Iran* award (29.6.1989). See also the jurisprudence of the European Court of Human Rights, in particular the judgment *Greek Refineries Stran and Stratis Andreadis* v. *Greece* of 9.12.1994, where the Court stated that "une créance certaine et liquide, reconnue par une sentence arbitrale définitive, obligatoire et valant titre exécutoire d'après le droit interne, est un bien" (ECHR, Series A, No. 301-B, para. 61).

BITs in fact include their own definitions of investments for the purpose of application of each agreement, and these definitions are also applicable to their provisions on expropriations[234].

Not only express measures of nationalization or expropriation, but also so-called *de facto* expropriations or nationalizations, i.e. measures that do not involve an overt taking but that effectively neutralize the benefit of the property for the foreign owner, are subject to those requirements[235]. The question relates to what constitutes a property right, whether possession only or also use and free alienation.

The European Court of Human Rights — in the *Mellacher and Others* judgment of 15 December 1989 — has held that "a formal expropriation" means a measure aimed at "transfer of the property", while "a *de facto* expropriation" occurs when a State deprives the owner of his "right to use, let or sell (his) property"[236].

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234. On this point see the definition of "property, rights and interests" in the BITs, as described in Chapter II above. United Kingdom BITs, however, specify that

> "where a Contracting Party expropriates the assets of a company which is incorporated or constituted under the law in force in any part of its own territory, and in which investors of the other Contracting Party own shares, it shall . . . guarantee prompt, adequate and effective compensation in respect of their investment to such investors of the other Contracting Party who are owners of those shares".

See United Kingdom-Honduras (1993), Art. 5 (2); United Kingdom-India (1994), Art. 5 (3); United Kingdom-Turkmenistan (1995), Art. 5 (2).

235. As to the relevance of *de facto* expropriation without need of a formal measure see the *German Interests in Polish Upper Silesia* case, 1926, *PCIJ, Series A, No. 7*; the *Oscar Chinn* case, 1934, *PCIJ, Series A/B, No. 63*; the *Norwegian Shipowners'* claims case, UN Arb. Rep. 1 (1922), 307. See generally G. C. Christie, "What Constitutes a Taking of Property under International Law?", *BYIL*, 1962, 307 *et seq.*; J.-P. Laviec, *op. cit.*, 164-172. Also a temporary administrative interference with property rights and the permanent deprivation of those rights, if serious enough, may be considered as an expropriation falling under the relevant principles of general international law and of specific international agreements. See the *Sedco* case of 24.10.1985 (9 *Iran-United States CTR*, 248 *et seq.*) where the Iran-United States Claims Tribunal decided that "when . . . on the date of the government appointment of 'temporary' managers there is no reasonable prospect of return of control, a taking should conclusively be found to have occurred as on that date".

236. In particular the Court has found that "the contested measures which, admittedly, deprived the applicants of part of their income from the property amounted in the circumstances merely to a control of the use of property. Accordingly, the second paragraph of Article 1 applies in this instance" (ECHR, Series A, No. 169, para. 44). Indeed, in the *Sporrong and Lönnroth* case of 23.9.1982 the Court denied that a *de facto* expropriation had occurred because the right of property, which had lost its substance, was still existent (ECHR, Series A, No. 88, para. 63).

As regards the jurisprudence of the Court on this point see also: *Papamichalopoulos and Others* v. *Greece* (first judgment of 24.6.1993); *Klaas* v. *Germany*

The concept of creeping expropriation/nationalization [237] may be distinguished from that of *de facto* expropriation. Creeping expropriations are the so-called indirect expropriations, namely measures which, even if they are not aimed at transferring property rights, imply an interference with the exercise of such rights equivalent to that of a measure of expropriation.

International practice is not, however, consistent as to the criteria on the basis of which to determine whether or not a State's action, not aimed at taking foreign property, results in an internationally relevant expropriation (i.e. a creeping expropriation).

The Commentary to Article 3 of the OECD Draft Convention on the Protection of Foreign Property of 1967 [238] dealing with taking of property defined creeping nationalization as measures otherwise lawful

> "applied in such a way as to deprive ultimately the alien of the enjoyment or value of his property, without any specific act being identifiable as outright deprivation. As instances, may be quoted excessive or arbitrary taxation; prohibition of dividend distribution coupled with compulsory loans ; imposition of administrators; prohibition of dismissal of staff; refusal of access to raw materials or of essential export or import licenses."

A "creeping nationalization" would exist besides when "there is no immediate prospect that the owner will be able to resume the enjoyment of his property" [239].

According to the Iran-United States Claims Tribunal "an interfer-

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(22.9.1993); *McMichael* v. *UK* (24.2.1995); *Agrotexim and Others* v. *Greece* (24.10.1995); *Loizidou* v. *Turkey* (18.12.1996). See generally L. Condorelli, "Premier Protocole additionnel. Article 1", L.-E. Pettiti, E. Decaux and P.-H. Imbert, *La Convention européenne des droits de l'homme. Commentaire article par article*, 1995, 983 *et seq.*

237. According to I. Seidl-Hohenveldern (*op. cit.*, 219) it is "fairer to the host State to designate such measures by the more neutral term 'constructive nationalization' " because such a State may have acted "for bona fide reasons of social reform".

238. See UNCTAD, *International Investment Instruments. A Compendium*, *cit.,* II, 113 *et seq.* For a history of this Draft see G. Schwarzenberger, *Foreign Investments and International Law*, 1969.

239. See also Article 11 *(a)* (ii) of the 1985 MIGA Convention according to which the Agency's guarantee can be provided for losses due to

> "any legislative action or administrative action or omission attributable to the host government which has the effect of depriving the holder of a guarantee of his ownership or control of, or a substantial benefit from, his investment, with the exception of non discriminatory measures of general application which governments normally take for the purpose of regulating economic activity in their territories".

ence by a State in the use of property or with the enjoyment of its benefits" is a deprivation or taking of that property "even where legal title to the property is not affected"[240]. In particular the Tribunal has held that compensation under international law

> "is warranted whenever events demonstrate that the owner was deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral. The intent of the government is less important than the effects of the measures on the owner, and the form of the measures of control or interference is less important than the reality of their impact."[241]

The term "taking" is also frequently used to cover all types of expropriations and nationalizations, meaning

> "a conduct attributable to a State that is intended to, and does, effectively deprive an alien of substantially all the benefit of his interest in property even though the State does not deprive him of his entire legal interest in the property"[242].

Deprivation of property should be distinguished from regulation, especially in relation to the use of property. Regulating measures are

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240. Under Article II (1) of the Claims Settlement Declaration of 1981 the (Iran-US Claims) Tribunal has jurisdiction to hear claims arising, *inter alia*, out of "expropriations or other measures affecting property rights". The Tribunal must, however, also apply Article IV of the Treaty of Amity of 1955 between Iran and the United States which reads as follows:

> "Each Contracting Party . . . shall refrain from applying unreasonable or discriminatory measures that would impair [the] legally acquired rights and interests [of nationals and companies of the other High Contracting Party]; and shall assure that their lawful contractual rights are afforded effective means of enforcement, in conformity with the applicable law. Property of nationals and companies of either High Contracting Party, including interests in property, shall receive the most constant protection and security within the territories of the other High Contracting Party, in no case less than that required by international law. Such property shall not be taken except for a public purpose, nor shall it be taken without the prompt payment of just compensation . . . Nationals and companies . . . shall enjoy the right to continued control and management of such enterprises."

241. See *Tippetts, Abbett, McCarthy, Stratton* v. *TAMS-AFFA Consulting Engineers of Iran et al.* of 22.6.1984 (6 *Iran-United States CTR*, 219 *et seq.*). See also *Starret Housing Corp.* v. *Iran* of 19.12.1983 (interlocutory award) (4 *Iran-United States CTR*, 122 *et seq.*)

242. See *Restatement (Second) Foreign Relations Law of the United States*, Sec. 192 (1965). See also B. H. Weston, "The Charter of Economic Rights and Duties of States and the Deprivation of Foreign-Owned Wealth", 75 *AJIL*, 1981, 438, note 5, according to whom the term "wealth deprivation" is preferable to the term "taking".

common in all types of legal and economic systems, in order to avoid that the use of private property be contrary to the general welfare. Drawing the line may not be easy in specific instances. Regulation implying restrictions on the use of certain property, such as rent control, zoning and town planning may reduce the commercial value of property. They entail, also under domestic law, the obligation of public authorities to indemnify the economic losses which are imposed only on certain owners in the common interest, when these are substantial enough[243].

BITs tend to cover all forms of State action depriving the foreign investor of his investment whose effects are equivalent to a formal deprivation of property rights. The expressions most used in BITs are "measures having similar effects"[244], "any measure having effect equivalent to nationalization or expropriation"[245], "any other meas-

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243. See *Restatement (Third) Foreign Relations Law of the United States* (1987), Sec. 712 *(g)*, on which in general see P. D. Trooboff, "Responsibility toward Foreign-Owned Investment", in D. C. Dicke (ed.), *op. cit.*, 201 *et seq.* A substantial case-law in this respect has been developed by the European Commission and the European Court of Human Rights applying Article 1 (third paragraph) of the First Protocol to the Convention according to which

> "the preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties".

Cf. generally Council of Europe, *The European Convention on Human Rights and Property Rights*, 1991, 24 *et seq.*

According to Article 1110 (8) of NAFTA

> "a non-discriminatory measure of general application shall not be considered a measure tantamount to an expropriation of a debt security or loan covered by this chapter solely on the ground that the measure imposes costs on the debtor that cause it to default on the debt".

In accordance with Article 215 of the EC Treaty, institutions of the EC can be held liable for damages to private parties caused by lawful measures even of general application interfering with their rights, if the damages are found to be abnormal and excessive, see EC Tribunal of First Instance, case T-184/95 of 28.4.1998.

244. See Japan-China (1988), Art. 5 (4); Germany-USSR (1989); Argentina-Egypt (1992), Art. IV (1); Norway-Peru (1995), Art. 6.

245. See Germany-Poland (1989), Art. 4 (2); France-USSR (1990), Art. 4 (3); Australia-Viet Nam (1991), Art. 7 (1); Australia-Romania (1993), Art. 5 (1); Bolivia-Peru (1993), Art. 5 (2); Czech Republic-Hungary (1993), Art. 5 (1); Argentina-Venezuela (1993), Art. 6 (1); United Kingdom-Honduras (1993), Art. 5 (1); Italy-Cuba (1993), Art. 5 (2); Israel-Estonia (1994), Art. 5 (1); United Kingdom-Turkmenistan (1995), Art. 5 (1); Spain-Colombia (1995), Art. V (1) *(a)* and *(b)*; Canada-Trinidad and Tobago (1995), Art. VIII (1); Italy-Brazil (1995), Art. IV (2). The BITs of Switzerland refer to "toute autre mesure ayant le même caractère ou le même effet": see Article 6 (1) of the 1990 BIT with the USSR; Article 6 (1) of the 1990 BIT with Poland; Article 5 (1) of the 1991 BIT with Peru.

ure the effects of which would be tantamount to expropriation, or nationalization" [246], or other equivalent ones [247].

2. *Public Purpose and Non-Discrimination*

Reference to the two requirements of public interest and non-discrimination are present in recent multilateral agreements [248] and are generally included in BITs [249].

246. See Germany-Barbados (1994), Art. 4 (2) and the BITs of the United States with Poland of 1990 and with Argentina of 1991, Art. IV (1); with Russia of 1992, Art. III (1).

247. Art. 6 (1) (ii) of the 1993 BIT between Poland and the United Arab Emirates provides that

> "any measures of expropriation or nationalization or freezing or any other measures having effect of this position or to subject the investment to any measures direct or indirect tantamount to expropriation including the levying of taxes, the compulsory sale of all or part of an investment or the impairment or deprivation or its management or control".

Under Article 4 (1) of the 1993 BIT between China and Uruguay "neither Contracting Party shall expropriate, nationalize or take similar measures". Under Article III (1) of the 1995 BIT between Nicaragua and the United States "neither Party shall expropriate or nationalize a covered investment either directly or indirectly through measures tantamount to expropriation or nationalization". See also Article III (1) of the 1982 BIT between the United States and Egypt which considers equal to expropriation or nationalization

> "any other measure, direct or indirect (including, for example, the levying of taxation, the compulsory sale of all or part of such an investment, or impairment or deprivation of management, control or economic value of such an investment by the national or company concerned), if the effect of such other measure, or a series of such other measures, would be tantamount to expropriation or nationalization".

248. See Article 1110 (1) *(a)* and *(b)* of NAFTA of 1993; Article 13 (1) *(b)* of the Energy Charter Treaty of 1994; Article 4 (1) of the Mercosur Protocol on reciprocal promotion and protection of investments of 1994; Article 2 (D) (1) of the Mercosur Protocol on promotion and protection of investments from States not Member of Mercosur of 1994.

249. As to the requirements of public interest or public purpose and non discrimination see United States-Turkey (1985), Art. III (1); United States-Egypt (1986), Art. III (1) *(a)* and *(c)*; Sweden-Poland (1989), Art. 4 (1) *(a)* and *(b)*; Switzerland-Poland (1990), Art. 6 (1); Australia-Viet Nam (1991), Art. 7 (1) *(a)* and *(b)*; United States-Argentina (1991), Art. IV (1); Switzerland-Peru (1991), Art. 5 (1); United States-Russia (1992), Art. III; Poland-United Arab Emirates (1993), Art. 6 (ii) *(a)* and *(c)*; Italy-Cuba (1993), Art. 5 (2); Argentina-Venezuela (1993), Art. 6 (1); China-Uruguay (1993), Art. 4 (1) *(a)* and *(c)* (see also China-Slovenia (1993), Art. 4 (1) *(a)* and *(c)*); Australia-Romania (1993), Art. 5 (1) *(a)* and *(b)*; Czech Republic-Hungary (1993), Art. 5; United Kingdom-India (1994), Art. 5 (1) (see also United Kingdom-Turkmenistan (1995), Art. 5); Israel-Estonia (1994), Art. 5 (1); Netherlands-Lithuania (1994), Art. 6 *(a)* and *(b)*; Canada-Trinidad and Tobago (1995), Art. VIII (1); Spain-Colombia (1995), Art. V (1) *(b)*; United States-Nicaragua (1995), Art. III (1); Italy-Brazil (1995), Art. IV (2); Norway-Peru (1995), Art. 6; Italy-Russia (1996), Art. 5 (1).

Public interest is generally held to be a necessary requirement of a lawful deprivation of property[250]. It has been pointed out on the other hand that it is difficult to question the existence in specific instances of this requirement, except in the most evident cases of abuse, since this would require appreciating a sovereign State policy and the motivation of its action[251].

In fact, only in few instances have international tribunals been called on to evaluate the existence of a public purpose[252]. In the well-known Libyan oil cases, where it was alleged that the expropriation was motivated by way of reprisals, the arbitrators upheld the challenge only in the *BP* award, while it was rejected in the *Texaco* and *Liamco* cases[253].

As to the meaning of the expression "in the public interest" (included in the first paragraph of Article 1 of the First Protocol to the European Convention on Human Rights), the European Court has stated that

> "because of their direct knowledge of their society and its needs, the national authorities are in principle better placed than the international judge to appreciate what is 'in the public interest'. Under the system of protection established by the

250. The Charter of Economic Rights and Duties of States of 1974, which reflects the then dominant view among developing countries, did not mention at Article 2 (2) *(c)* public purpose and non-discrimination requirements. According to the General Assembly Declaration 1803 of 1962 instead "Nationalization, expropriation or requisition 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" (para. 4).

251. See M. Sornarajah, *op. cit.*, 317; S. Marchisio, "Investimenti esteri nel diritto internazionale", *Digesto delle Discipline Pubblicistiche*, 1993, 582-583; *Restatement (Third)*, *cit.*

252. See, e.g., the *LETCO* v. *Liberia* case (31.3.1986) where the ICSID Arbitral Tribunal held that the revocation of a concession by the Government was illegal under applicable law, because it "was not for a bona fide public purpose, was discriminatory and was not accompanied by an offer of appropriate compensation" (27 *ILM*, 1987, 648).

The Iran-United States Claims Tribunal considered the lack of public utility as a *per se* cause of illegitimacy in many awards. See in particular *American International Group* v. *Iran* (19.12.1983); *INA Corp.* v. *Iran* (12.8.1985); *Amoco International Finance Corp.* v. *Iran* (14.7.1987). However, in the latter case the Iran-United States Tribunal pointed out that the term public utility ". . . as a result of the modern acceptance of the right to nationalize . . . is broadly interpreted and . . . States, in practice, are granted extensive discretion" (at 233).

253. See the award of the arbitrator Dupuy on the case *Texaco (Clunet*, 1977, 366 *et seq.*), where he decided that Libya had behaved lawfully because its expropriation had been made according to its "sovereign appreciation of the national interest".

> Convention, it is thus for the national authorities to make the initial assessment both of the existence of a problem of public concern warranting measures of deprivation of property and of the remedial action to be taken." [254]

The Court is, however, entitled to evaluate the conduct of the State as to this requirement in the light of certain relevant criteria, such as bona fide, reasonableness and proportionality[255].

As regards the "non-discrimination" requirement, a specific question is whether this term refers to the relationship between nationals and foreigners or to that between foreigners only or to both relationships.

Both kinds of differential treatment tend to be considered forbidden under international law [256].

Discrimination may derive from the expropriation of citizens of a specific State only, or may concern the procedure and the amount of compensation.

Non-discrimination is usually mentioned in recent multilateral agreements as one of the requirements of a lawful expropriation [257].

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254. The *James and Others* judgment of 21.2.1986 (ECHR, Series A, No. 98, para. 31).

255. On this point the European Court — in the *James and Others* judgment — stated that

> "the Court, finding it natural that the margin of appreciation available to the legislature in implementing social and economic policies should be a wide one, will respect the legislature's judgment as to what is 'in the public interest' unless that judgment be manifestly without reasonable foundation" (*cit.*, para. 32).

See also *Pressos Compania Naviera S.A.* v. *Belgium* (20.11.1995); *Matos e Silva, Lda., and Others* v. *Portugal* (16.9.1996).

256. See generally W. D. Verwey and N. J. Schrijver, *op. cit.*, 9-13, with reference to the case-law of the International Court of Justice and a number of international and domestic decisions. See also *Restatement (Third)*, *cit.*

257. See the reference made in footnote 248. See also Article 261 (2) of the Fourth Lomé Convention, according to which

> "the State party to such agreements shall practise no discrimination between Contracting States party to this Convention or against each other in relation to third countries when opening negotiations for, concluding, applying and interpreting bilateral or multilateral investment promotion and protection agreements".

Article 1 of the First Protocol to the European Convention on Human Rights does not make expressly reference to this requirement. However, it must be kept in mind that it refers to the general principles of international law. As to "the thesis that the requirement of non-discrimination could be derived from general principles of international law not specifically related to the treatment of foreign property" see W. D. Verwey and N. J. Schrijver, *op. cit.*, 11.

The prohibition of discrimination is usually found in BITs without further specifications. Some BITs, however, notably those of Germany, instead of prohibiting discrimination refer to most-favoured-nation treatment in matters of expropriation [258].

3. The Issue of Compensation

The determination of the compensation which the expropriating State is obliged to pay under international law is a crucial question since the effective protection of the economic interests of foreign nationals (in particular foreign investors) depends on it.

We deal here with the economic consequences of a lawful expropriation. If a taking is unlawful because of a violation of the requirements of international law, the principles pertaining to State responsibility for a wrongful conduct become applicable [259]. The ensuing obligation is that of reparation of the damages caused to the foreign national, *via* diplomatic protection by his home State, and not just that of providing compensation corresponding to the value of the property taken.

Full restitution is in principle due. In view of the inexpediency in most cases of compelling or obtaining the annulment of those takings, reparation in the form of monetary compensation as an alternative should cover all connected losses including *lucrum cessans* and indirect damages [260].

The traditional view is that compensation for property lawfully

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258. See, e.g., Germany-Estonia (1992), Art. 4 (4) and Germany-Barbados (1994), Art. 4 (4).

259. On the law of State responsibility in connection with damages caused to the economic interest of aliens see generally C. F. Amerasinghe, *State Responsibility for Injuries to Aliens*, 1967; R. Higgins, *op. cit.*, 298 *et seq.*; J.-P. Laviec, *op. cit.*, 190-196.

260. In *Papamichalopoulos* v. *Greece* (Second judgment of 31.10.1995) the European Court held that the taking by the State of land belonging to private individuals which had lasted 28 years in defiance of courts' orders

> "was not an expropriation that would have been legitimate but for the failure to pay compensation . . . The unlawfulness of such a dispossession inevitably affects the criteria to be used for determining the reparation owed by the State, since the pecuniary consequences of a lawful expropriation cannot be assimilated to those of an unlawful dispossession" (at para. 36).

Failing restitution, the Court held that Greece had to pay applicants the current value of their land increased by the appreciation brought about by the existence of the buildings that the State authorities had erected and their construction costs, with interest until payment.

taken from foreign investors by the host State must be paid in accordance with international law[261].

The content of this obligation has traditionally been expressed by the well-known "Hull formula" of full compensation, that is prompt, adequate and effective compensation[262].

Under these criteria compensation should correspond to the value of the property taken, be paid speedily and in a currency which the owner can transfer from the expropriating State.

This requirement was challenged first by communist countries, engaging in widespread nationalizations of private property both of nationals and of foreigners, and subsequently by developing countries, especially those born from the decolonization process, which aimed at affirming national economic sovereignty and at freeing themselves from the control by former colonial powers and other foreign interests on their natural resources.

Article 2 (2) *(c)* of the Charter of Economic Rights and Duties of 1974 reflected this view by underlying the right of each State

> "to nationalise, 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 controversy it shall be settled under the domestic law of the nationalising 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."[263]

The consequent uncertainty as to the level of protection of foreign

261. See GA res. 1803 of 1962 on permanent sovereignty. It provided that in case of nationalization or expropriation the owner should be paid appropriate compensation "in accordance with rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law".

262. Notes from Secretary of State Hull to the Mexican Ambassador, [1938] 5 *Foreign Relations of the United States*, 674 *et seq.*

263. See generally R. Dolzer, "New Foundations of the Law of Expropriation of Alien Property", 75 *AJIL*, 1981, 571 ; B. H. Weston, "The New International Economic Order and the Deprivation of Foreign Proprietary Wealth : Some Reflections upon the Contemporary International Law Debate", in R. Lillich, *International Law of State Responsibility for Injuries to Aliens*, 1983, 89 *et seq.* ; J.-P. Laviec, *op. cit.*, 178.

property under international law influenced negatively the flow of foreign private investments to developing countries.

Many nationalizations gave rise to disputes between the expropriating State and the home country of the foreign investor. They were often settled through lump-sum agreements, covering globally the investors of a given affected country, which were motivated by political and economic expediency and under which foreign investors were generally only partially indemnified [264].

The more vague requirement of "appropriate" compensation, which obtained some popularity as evidenced by resolution 1803 of 1962 of the General Assembly, also remained subject to conflicting interpretations [265]. While according to some views this formulation still implies the "Hull formula", according to others it allows a more flexible approach on a case-by-case basis, taking also into account the public interest involved [266].

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264. According to the International Court of Justice *dictum* in the *Barcelona Traction* case the practice of lump-sum settlement agreements has an "exceptional character", and consequently has no particular value for the determination of customary law (*ICJ Reports 1970*, para. 61). *Contra*, see R. Lillich and B. Weston, *International Claims: Their Settlement by Lump Sum Agreements*, 1975, 9-43. In these agreements the standards of compensation have generally been determined by making no reference to the so-called Hull rule. See also R. Dolzer, "New Foundations of the Law of Expropriation of Alien Property", *op. cit.*, 559-560.

265. See also the Seoul Declaration of the ILA on the Progressive Development of Principles of Public International Law Relating to a New International Economic Order of 1986, Article 5 (5) of which reads as follows:

> "a State may nationalise, expropriate, exercise eminent domain over or otherwise transfer property or rights in property within its territory and jurisdiction subject to the principle of international law requiring a public purpose and non-discrimination, to appropriate compensation as required by international law, and to any applicable treaty, and without prejudice to legal effects flowing from any contractual undertaking", ILA, *Report of the Sixty-Second Conference*, Seoul, 1986, 7.

266. In the *Liamco* case, *cit.*, the Tribunal pointed out that the Hull formula "was not always accepted neither in the inter-war period nor after World War II" and (that) it "retains only the value of a technical rule for the assessment of compensation, and a useful guide in reaching settlement agreement, as was well and justly asserted. It stands only as a maximum rarely attained in practice" (20 *ILM*, 1981, at 73). The Tribunal — having decided that the formula of "equitable compensation" was to be applied in the event of nationalization or expropriation — stated (that)

> "this formulation ('equitable compensation') is certainly in complete harmony with the general trend of international theory and practice on the concepts of sovereignty, destination of national wealth and natural resources, nationalistic motivations in the attitude and behaviour of 'Third World' nations, the lawfulness and frequency of nationalization, and the recent dec-

Notice should also be taken of the jurisprudence of the European Court of Human Rights. In the *James* case the Court observed that

> "the taking of property without payment of an amount reasonably related to its value would normally constitute a disproportionate interference which could not be considered justifiable under Article 1. Article 1 does not, however, guarantee a right to full compensation in all circumstances. Legitimate objectives of 'public interest', such as pursued in measures of economic reform or measures designed to achieve greater social justice, may call for less than reimbursement of the full market value." [267]

On the other hand according to ICSID tribunals and the Iran-United States Claims Tribunal case-law, the standard to be applied in determining the amount of compensation payable under general principles of international law for expropriation is "full compensation" [268].

Recourse to the private law principle of unjust enrichment has also been advocated as an alternative basis to determine the amount of compensation which should be paid [269].

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larations affirmed in successive United Nations Resolutions by the majority of members of the General Assembly".

As to the question of what constitutes "appropriate compensation" see also the *Aminoil* award, according to which: "the determination of the amount of an award of "appropriate" compensation is better carried out by means of an enquiry into all the circumstances relevant to the particular concrete case, than through abstract theoretical discussions" (21 *ILM*, 1982, 143-144).

267. Judgment of 21 February 1986 (ECHR, Series A, No. 98, para. 54). See also *Sporrong and Lönnroth* (ECHR, Series A, No. 52, paras. 56-75); *Lithgow* (ECHR, Series A, No. 102, paras. 111-174). The Court has noted however that nationals may properly receive less compensation for expropriated property than foreigners, i.e. less than the full market value due under international law since "there may well be legitimate reasons for requiring nationals to bear a greater burden in the public interest than non-nationals" (*James* case, *cit.*, para. 63; *Lithgow* case, *cit.*, para. 116).

268. As to ICSID awards see *AGIP* v. *Congo*; *Benvenuti & Bonfant* v. *Congo*; *Amco Asia* v. *Indonesia* and *LETCO* v. *Liberia*. As to the case-law of the Iran-United States Claims Tribunal, see especially *INA Corp.* v. *Iran* (8 *Iran-US CTR* 380).

269. See E. J. De Aréchaga, *op. cit.*, 222-223; C. Schreuer, "Unjustified Enrichment in International Law", *Am. J. Comp. L.*, 1974, 281; R. Dolzer, "New Foundations of the Law of Expropriation of Alien Property", *op. cit.*, 581; W. Lieblich, "Determination by International Tribunals of the Economic Value of Expropriated Enterprise", *J. Int'l Arb.*, 1990, 24-25. See also P. D. Friedland and E. Wong, "Measuring Damages for the Deprivation of Income-Producing Assets: ICSID Case Studies", *ICSID Rev.*, 1991, 403, according to whom

Finally, a separate question relates to what is the effect of a stabilization clause in a treaty or contract under the umbrella of which the foreign investor may claim not only full compensation but also immunity from nationalization [270]. A nationalization in contravention of such a clause would make the measure illegal, in accordance with the applicable domestic and international law. On the other hand, since no sovereign State may irrevocably subject the needs of the common good as to the future to contractual undertakings towards private parties, public need may still justify expropriation, but its existence must be evaluated under a strict good-faith standard when a State acts in disregard of such an obligation. Full compensation for the damages so caused is warranted in these instances, although not necessarily *restitutio in integrum* [271].

In this respect two types of clauses often found in recent BITs may be considered relevant. The obligation of the host State to respect generally undertakings towards, and contracts with, foreign investors does not seem to restrict the right to expropriate their interest, provided that the relevant treaty obligations are respected [272].

"adjudicators may find that, in certain cases, the appropriate approach to an award of damages is that of unjust enrichment. Damages calculated under a unjust enrichment theory need not be based on the value of the asset taken, and . . . methods which are appropriate for valuing assets are not necessarily appropriate for calculating damages in cases of unjust enrichment."

270. See generally F. A. Mann, "State Contracts and State Responsibility", 54 *AJIL*, 1960, 572 *et seq.*; A. Fatouros, *Government Guarantees to Foreign Investors*, 1962; P. Weil, "Les clauses de stabilisation ou d'intangibilité inserées dans les accords de développement économique", *Mélanges Rousseau*, 1974, 301 *et seq.*; A. Giardina, "State Contracts: National versus International Law", 5 *Italian Yb. Int'l Law*, 1980-1981, 147 *et seq.*; P. Lalive, "Sur la bonne foi dans l'exécution des contrats d'Etat", *Mélanges Van der Elst*, 1986, 425 *et seq.*; G. Sacerdoti, "State Contracts and International Law. A Reappraisal", 7 *Italian Yb. Int'l Law*, 1986-1987, 45-46; M Sornarajah, *The Pursuit of Nationalized Property*, 1986, 81 *et seq.*; S. R. Chowdhury, "Permanent Sovereignty over Natural Resources: Substratum of the Seoul Declaration", in P. De Waart, P. Peters and E. Denters, *International Law and Development*, 1988, 73; P. M. Norton, "A Law of the Future or a Law of the Past? Modern Tribunals and the International Law of Expropriation", 85 *AJIL*, 1991, 480; G. Delaume, "L'affaire du Plateau des Pyramides et le CIRDI. Considérations sur le droit applicable", *Rev. de l'arbitrage*, 1994, 64.

271. See the *BP* v. *Libya* case (53 *ILR*, 1979, at 353); the *Liamco* v. *Libya* case (*cit.*, at 125). *Contra* see the *Texas Overseas Petroleum Co. & California Asiatic Oil Co.* v. *Libya* case (17 *ILM*, 1977, at 32-34) where arbitrator Dupuy decided that the Chorzów holding that, in principle, *restitutio in integrum* is the preferred remedy in international law for a wrongful expropriation, such as one in violation of a stabilization clause, was still valid under international law.

272. See, e.g., United States-Russia (1992), Art. 2 (2) *(c)*, which reads as follows "each party shall observe any obligation it may have entered into with regard to investments of nationals or companies of the other party".

Other clauses commit the host State not to expropriate when it has entered a specific obligation to this effect [273]. An expropriation in disregard of such a specific commitment would violate the BIT and would entail full reparation of the damages caused by such wrongful conduct.

It is worthwhile mentioning in this respect that under the MIGA Convention insurance for non-commercial risks provided by the Agency includes breach of contract, defined as

> "any repudiation or breach by the host government of a contract with the holder of a guarantee, when *(a)* the holder of a guarantee does not have recourse to a judicial or arbitral forum to determine the claim of repudiation or breach, or *(b)* a decision by such forum is not rendered within such reasonable period of time as shall be prescribed in the contracts of guarantee pursuant to the Agency's regulations, or *(c)* such a decision cannot be enforced" [274].

4. The Standards of Compensation and Methods of Evaluation of Expropriated Property in Recent Multilateral Agreements and BITs

In recent years the change of policies of most host countries and the interest shown by the developing world for the inflow of direct foreign investments has led to a change in their attitude, evidenced also in their domestic laws, such as investment codes aimed at guaranteeing the security of foreign investments.

All recent multilateral agreements dealing with this matter include a high standard of compensation in case of expropriation and nationalization [275].

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273. See, e.g., France-Mongolia (1991), Art. 5 (2), which reads as follows

> "les Parties contractantes ne prennent pas de mesures d'expropriation ou de nationalisation ou toutes autres mesures dont l'effet est de déposséder, directement ou indirectement, les nationaux et sociétés de l'autre Partie des investissements leur appartenant, sur leur territoire et dans leur zone maritime, si ce n'est pour cause d'utilité publique et à condition que ces mesures ne soient ni discriminatoires ni contraires à un engagement particulier".

See also Poland-United Arab Emirates (1993), Art. 6 (1) (ii) *(d)*.

274. Art. 11 *(a)* (iii).

275. As to non-binding instruments the first paragraph of the Guideline IV of the 1992 World Bank Guidelines on the treatment of foreign direct investment states that an "appropriate compensation" must be paid in case of expropriation. Paragraph 2 specifies that "compensation . . . will be deemed appropriate if it is adequate, effective and prompt". The 1994 APEC Non-Binding Investment Principles provides for "the prompt payment of adequate and effective compensation".

According to Article 13 (1) *(d)* of the Energy Charter Treaty of 1994 compensation must be "prompt, adequate and effective".

Article 1110 (2) of NAFTA focuses on the determination of the value as follows:

> "compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ('date of expropriation'), and shall not reflect any change in value occurring because the intended expropriation had become known earlier".

As to the two Mercosur Protocols on promotion and protection of investments — one relating to reciprocal investments[276], the other relating to investments coming from States not parties to Mercosur[277] — they provide for slightly different standards of compensation. The first requires "prevía, adecuada y efectiva" compensation[278], while the second provides for "justa, adecuada y pronta u oportuna" compensation[279].

BITs generally include a high standard of compensation by referring to a variety of expressions basically incorporating the traditional "Hull formula"[280].

Since BITs are concluded in order to promote and protect investments abroad it is only natural that they prescribe the highest standard of compensation although they rarely address specific issues, such as those concerning the methods of valuation, that have been discussed in the relevant literature. In our opinion the fact that BITs

276. Decision 11/93 of the Mercosur Council, UNCTAD, *International Investments*, *op. cit.*, 513.

277. Decision 11/94 of the Mercosur Council, UNCTAD, *ibid.*, 527.

278. See Art. 4 (1). This Article specifies that such a compensation shall correspond to the real value of the expropriated investment immediately before the date when the decision to nationalize or expropriate was officially announced or became public. Such compensation can either produce interests or correspond to the actual value at the date of payment.

279. See Art. 2 (D) (1). As to the meaning of such a compensation, this Article simply states that it shall correspond to the value of the expropriated investment.

280. See Sweden-Poland (1989), Art. 4 (1) *(c)*; Italy-Argentina (1990), Art. 5 (1) *(b)*; Australia-Viet Nam (1991), Art. 7 (1) *(c)*; United States-Russia (1992), Art. III (1); Argentina-Venezuela (1993), Art. 6 (2); Australia-Romania (1993), Art. 5 (1) *(c)*; Czech Republic-Hungary (1993), Art. 5 (1); United Kingdom-Honduras (1993), Art. 5 (1); Poland-United Arab Emirates (1993), Art. 6 (1) (ii) *(h)*; Israel-Estonia (1994), Art. 5 (1); Norway-Peru (1995), Art. 6; Spain-Colombia (1995), Art. V (1) *(b)*; Canada-Trinidad and Tobago (1995), Art. VIII (1); United States-Nicaragua (1995), Art. III (1); United Kingdom-Turkmenistan (1995), Art. 5 (1).

are widespread and that they refer to the "Hull formula" is not *per se* conclusive evidence of State practice to the effect that "prompt, effective and adequate compensation" is a requirement of customary international law[281]. Such requirement might not be invocable against a country that is not a party to such a treaty, may be subject to exceptions in view of special circumstances, such as balance of payments problems, and might not be fully applicable to property which is not an investment.

It would also be natural that treaties like BITs, entered into in order to afford specific protection to investments with a view to promoting them, impose a higher standard of compensation than that due under general international law. In fact, the standard of compensation required by BITs, implying full equivalence between the market value of the property taken and the compensation due, tends to approach the standard of compensation (indemnification) required by international law in cases of unlawful takings, where States must redress the damages caused in accordance with the principles of responsibility for wrongful conduct.

The laws of most countries on the other hand give weight to the public interests and needs involved in case of lawful expropriations in the exercise of sovereignty for the public good. They admit some balancing criteria in order to avoid making these measures too burdensome. This may lead to provisions on compensation which, while being considered just, may in specific instances provide for less than full compensation for the private interests so sacrificed[282]. As evidenced by the case-law of the European Court of Human Rights, these domestic standards may be considered the foundation of general international law in this respect, while BITs clauses impose stricter conditions and requirements.

There is indeed case-law to the effect that the standard of com-

281. See R. Dolzer, "New Foundations of the Law of Expropriation of Alien Property", *op. cit.*, 565; S. R. Chowdhury, *op. cit.*, 78; R. Dolzer and M. Stevens, *Bilateral Investment Treaties*, 1995, 117.

282. According to the European Court of Human Rights (*Lithgrow* case, *cit.*, para. 121; *James* case, *cit.*, para. 54) under the First Protocol the payment of an amount reasonably proportional to the value of the expropriated property is adequate. According to the Court Article 1 of the First Protocol does not guarantee in all cases the right to a full compensation since legitimate objectives of public good, such as in cases of economic or social reforms, may justify a compensation which is less than the full commercial value.

See also *Restatement (Third), cit.*, Sec. 712 *(d)*, referring to "exceptional circumstances" such as extensive land reforms.

pensation under a bilateral treaty may well be higher than the one prescribed generally in a constitution that fully respects individual property rights [283].

In any case the consistency of the standard prescribed in BITs warrants the conclusion that at present, in principle, the members of the international community share the view that foreigners cannot be deprived of their property for domestic policy reasons without being effectively compensated for the current value of their investment.

Reference to "adequate" compensation does not by itself determine the actual amount to be paid. In order to evaluate if in a given instance compensation granted corresponds to the full value of the assets taken, the value of these assets must be determined. Thus, it is appropriate to discuss what method of valuation should be used in meeting the applicable standard. This implies the application of accounting criteria rather than reference to legal rules, depending moreover on the type of assets concerned.

The World Bank Guidelines of 1992 have entered into the matter in order to provide "important practical details suggested by judicial and arbitral experience" [284] as to the determination of the fair market value upon which compensation must be based in order to be adequate. Guideline IV establishes that

> "without implying the exclusive validity of a single standard for the fairness by which compensation is to be determined and as an illustration of the reasonable determination by a State of the market value of the investment . . ., such determination will be deemed reasonable if conducted as follows:

283. The Italian Supreme Court has held that German citizens expropriated in Italy are entitled to a higher valuation of their property (that is to the equivalent of its commercial value) than Italian citizens, in application of Article 6 (4) of the bilateral FCN Treaty of 1957. This provides for an "adequate" compensation, corresponding to the value of the expropriated property. See Cassazione (grand chamber) judgment of 28.7.1986, n. 4811, *Rivista di diritto internazionale privato e processuale*, 1987, 788 *et seq.* According to the Italian Constitutional Court (judgment of 19.7.1983, n. 223) on the other hand the Italian Constitution does not require that compensation for expropriated property be equivalent to its sale price in an arms' length negotiation; it must represent in any case a substantial indemnification also in respect of the equality principle.

284. See "The Report to the Development Committee on the Legal Framework for the Treatment of Foreign Investment, September 21, 1992", World Bank, *Legal Framework for the Treatment of Foreign Investment*, 1992, II, 25.

(i) for a going concern with a proven record of profitability, on the basis of the discounted cash flow value [285];

(ii) for an enterprise which, not being a proven going concern, demonstrates lack of profitability, on the basis of the liquidation value [286];

(iii) for other assets, on the basis of *(a)* the replacement value [287] or *(b)* the book value [288] in case such value has been recently assessed or has been determined as of the date of the taking and can therefore be deemed to represent a reasonable replacement value".

Surprisingly, most BITs tend to skip the issue, while a few indicate the elements to be taken into account for valuation purpose [289].

285. " 'Discounted cash flow value' means the cash receipts realistically expected from the enterprise in each future year of its economic life as reasonably projected minus that year's expected cash expenditure, after discounting this net cash flow for each year by a factor which reflects the time value of money, expected inflation, and the risk associated with such cash flow under realistic circumstances. Such discount rate may be measured by examining the rate of return available in the same market on alternative investments of comparable risk on the basis of their present value."

Thus, compensation determined by the DCF method allows to attribute great relevance to *lucrum cessans*. The calculation of *lucrum cessans* is based on the assumption that the profit margin for the foreign investor would not fall below its calculated level for the remaining period of the contract/licence.

286. " 'Liquidation value' means the amounts at which individual assets comprising the enterprise or the entire assets of the enterprise could be sold under conditions of liquidation to a willing buyer less any liabilities which the enterprise has to meet."

Actually, this method is a specific application of the philosophy underlining the DFC method.

287. " 'Replacement value' means the cash amount required to replace the individual assets of the enterprise in their actual state as of the date of the taking." The United States generally does not consider such a method as adequate because it does not take into account earning capacity. In any event, the least acceptable method to the United States is the book value one.

288. " 'Book value' means the difference between the enterprise's assets and liabilities as recorded on its financial statements or the amount at which the taken tangible assets appear on the balance sheet of the enterprise, representing their cost after deducting accumulated depreciation in accordance with generally accepted accounting principles."

289. See, as an exception, the side letter to United States-Panama (1982), Art. III (which reads as follows "with respect to [the expropriation clause], both Parties understand that the estimate of the full value of the expropriated investment can be made using several methods of calculation depending on the circumstances thereof"); United States-Haiti (1983), Art. III ("compensation will be equivalent to the fair market value of the investment, as determined according to different methods of calculation as appropriate in each specific case"); Israel-Romania (1991):

In dealing generally with the subject matter, some BITs make reference to the "fair market value" [290], while others refer to "the genuine value of the investments affected" [291] or to "full and genuine value" [292] or to "the real value" [293] or simply to "the market value" [294]. Last, some treaties, notably those of China, provide that the compensation

> "in the event that market value cannot be easily ascertained, the compensation shall be determined based on equitable principles taking into account, *inter alia*, the capital invested, its appreciation or depreciation, current returns, replacement value and other relevant factors";

Japan-China (1988), Art. 5 (4) (according to which the amount of compensation shall be determined by the competent court of justice and administrative tribunals and agencies of the expropriating contracting party "in accordance with (its) applicable laws and regulations". It must be noted that such a provision is mitigated by paragraph 5 according to which "the treatment accorded by either Contracting Party within its territory to nationals and companies of the other Contracting Party . . . shall not be less favourable than that accorded to nationals and companies of any third country". For a similar provision see also Bangladesh-Thailand (1988), Art. 5 (1) *(a)*); China-Slovenia (1993), Art. 4 (according to which "the compensation shall be determined in accordance with generally recognized principles of valuation and on equitable principles taking into account, *inter alia*, the capital invested, depreciation, capital already repatriated, replacement value and other relevant factors").

290. See United States-Turkey (1986), Art. III (2); Australia-Romania (1993), Art. 5 (2); Argentina-Venezuela (1993), Art. 6 (1); Czech Republic-Hungary (1993), Art. 5 (1); Israel-Estonia (1994), Art. 5 (1); United States-Nicaragua (1995), Art. III (1) which specifies that "the fair market value shall not reflect any change in value occurring because the expropriatory action had become known before the date of expropriation"; in this connection see also United States-Egypt (1982), Art. III (1); Canada-Trinidad and Tobago (1995), Art. VIII (1) (which specifies that "valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value"); Italy-Russia (1996), Art. 5 (2).

291. See Netherlands-Argentina (1992), Art. 7; United Kingdom-Honduras (1993), Art. 5 (1); Netherlands-Lithuania (1994), Art. 6 *(c)*; United Kingdom-India (1995), Art. 5 (1); United Kingdom-Turkmenistan (1995), Art. 5 (1); Italy-Cuba (1993), Art. 5 (3); and Italy-Brazil (1995), Art. IV (3) ("il risarcimento verrà determinato sulla base di una valutazione degli elementi costitutivi dell'impresa nonché delle componenti e dei risultati delle correlate attività di impresa").

292. See United Kingdom-Barbados (1993), Art. 5 (1).

293. See Belgium-Luxembourg-Hungary (1986), Art. 4 (1) *(c)*; France-Laos (1989), Art. 5 (2); United Kingdom-USSR (1989), Art. 5 (1); France-Mongolia (1994), Art. 5 (2) (which specifies that such a value shall be determined on the basis of a normal economic situation); Spain-Colombia (1995), Art. V (2).

294. See Switzerland-Ghana (1991), Art. 7 (1) G; Argentina-Egypt (1993), Art. IV (1); Argentina-Venezuela (1993), Art. 6 (2); Poland-United Arab Emirates (1993), Art. 6 (2), according to which

> "compensation shall be determined in accordance with recognized principles of valuation such as market value; where the market value cannot be readily ascertained, the compensation shall be determined on equitable prin-

> "shall be such as to place the nationals and companies in the same financial position as that in which nationals and companies would have been if expropriation, nationalisation or any other measure the effects of which would be similar to expropriation or nationalisation, . . ., had not been taken" [295].

Article 1110 (2) of NAFTA provides that "valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value".

As to the "method of valuation", also ICSID tribunals and the Iran-United States Claims Tribunal have used different methods in order to take into account the nature of the property being valued and the arguments and evidence presented by the parties.

No single method is deemed as generally applicable in all cases. Still a common view emerges with respect to the relevance of intangible factors such as "goodwill" or "lost future profits". ICSID tribunals and the Iran-United States Claims Tribunal have recognized that such factors are proper elements in the calculation of the compensation payable for the expropriation, but only if a going concern business enterprise is affected and these factors can be proven with a reasonable degree of certainty [296].

> ciples taking into account, *inter alia*, the capital invested, depreciation, capital already repatriated, replacement value, goodwill and other relevant factors";

Australia-Romania (1993), Art. 5 (2), which provides that

> "where the market value cannot be readily ascertained, the compensation shall be determined in accordance with generally recognized principles of valuation and equitable principles taking into account the capital invested, depreciation, capital already repatriated, replacement value, currency exchange rate movements and other relevant factors".

295. See, for example, Japan-China (1988), Art. 5 (3). China-Uruguay (1993), Article 4 (1) *(d)* refers to "fair compensation" and at paragraph 2 specifies that "the compensation . . . shall be equivalent to the value of the expropriated investments at the time when expropriation is proclaimed, be convertible and freely transferable" and "shall be paid without unreasonable delay".

296. As to the ICSID case-law see the *LETCO* award (*cit.*, at 669); the First *Amco* award (*cit.*, at 274-280); the Second *Amco* award (*cit.*, at 188-200); the *MINE* award (*cit.*, at 38-39) and the *MINE* Annulment Decision (at para. 5.13). As to the Iran-United States Claims Tribunal case-law see *Phelps Dodge Corp.* v. *Iran* (10 *Iran-US CTR*, 121); *Thomas Earl Payne* v. *Iran* (12 *Iran-US CTR*, 3); *INA Corp.* v. *Iran* (*cit.*, 380); *Starret Housing Corp.* v. *Iran* (*cit.*, 157); *Phillips Petroleum Co. Iran* v. *Iran* (21 *Iran-US CTR*, 122). See generally J. A. Westberg, "Applicable Law, Expropriatory Takings and Compensation in Cases of Expropriation; ICSID and Iran-United States Claims Tribunal Case Law

As to the question of the critical date which is to be assumed as reference for the determination of compensation (the "date of expropriation") BITs tend to be consistent. The date "immediately before the expropriation", or immediately prior to the moment when "the proposed expropriation became public knowledge" [297] tend to be indicated [298]. By referring to these dates the depreciation effect that the expropriation measure or its announcement normally has on the market value of the property concerned does not reduce the expropriating State's obligation to compensate [299].

5. "Prompt" and "Effective" Compensation

The terms "prompt" and "effective" imposes the additional requirements that compensation be paid without delay and in a freely

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Compared", *ICSID Rev*., 1993, 19, according to whom "goodwill" and "lost future profits" should not be included unless the business enterprise was really a "going concern" at the time it was expropriated. According to commentators these tribunals have determined amounts of compensation "which, on the facts reported in the cases, appear to have been reasonable, at least from the perspective of the expropriating countries".

297. BITs take into consideration that public knowledge of an imminent expropriation can cause a decrease of the investment's value and that the valuation therefore needs to precede any information in the public domain that may have a negative impact in this respect. See Germany-Bolivia (1988), Art. 4 (2); Bolivia-Peru (1993), Art. 5 (3); Australia-Romania (1993), Art. 5 (2); Argentina-Venezuela (1993), Art. 6 (2); Poland-United Arab Emirates (1993), Art. 6 (2); Canada-Trinidad and Tobago (1995), Art. VIII (1); Spain-Colombia (1995), Art. V (2); Norway-Peru (1995), Art. 6; United Kingdom-Turkmenistan (1995), Art. 5 (1).

China-Uruguay (1993), Article 4 (2), refers to "the time when expropriation is proclaimed". A similar formula is used in the 1988 BIT between China and Japan (Article 3 of the Agreed Minutes states "the compensation . . . shall represent the equivalent of the value of the investments and returns affected at the time when expropriation, nationalization, or any other measures the effects of which would be similar to expropriation or nationalization are publicly announced or when such measure are taken, whichever is the earlier").

298. See Germany-Poland (1989), Art. 4 (2); Germany-Swaziland (1990), Art. 4 (2); United Kingdom-Argentina (1990), Art. 5; Argentina-Egypt (1993), Art. IV (1); Argentina-Venezuela (1993), Art. 6 (2), which provides that the compensation shall be determined on the basis of the market value of the investment immediately before the expropriation or, if higher, before the moment of time when the the imminent expropriation became public; China-Slovenia (1993), Art. 4; Norway-Peru (1995), Art. 6; United States-Nicaragua (1995), Art. III (2). United Kingdom-India (1994), Art. 5 (1), and United Kingdom-Turkmenistan (1995), Art. 5 (1) refer to either dates ("whichever is the earlier").

299. In this respect see Article 1110 (2) of NAFTA which refers to the date "immediately before the expropriation took place ('date of expropriation')" in order to avoid the possibility that compensation "reflects any change in value occurring because the intended expropriation had become known earlier". See also Article 4 (1) of the Mercosur Protocol on reciprocal promotion and protection of investments.

convertible currency. Thus, beyond the issue of the amount of compensation, matters of time and convertibility are made relevant [300].

Recent BITs impose a requirement that payment be fully realizable, freely transferable and made in convertible currency [301]. Furthermore, most treaties also emphasize that compensation must be paid "without delay" [302]. Only a few treaties admit payment over a period of time in case of exceptional balance of payment problems,

300. See generally K. J. Vandevelde, *United States Investment Treaties. Policy and Practice*, 1992, 117-120.

301. See Bangladesh-Thailand (1988), Art. 5 (1) *(a)*; Japan-China (1988), Art. 5 (3), according to which "the compensation shall be effectively realizable and freely transferable at the exchange rate in effect on the date used for determination of amount of compensation"; Switzerland-USSR (1990), Art. 6 (1); Switzerland-Peru (1991), Article 5 (1), according to which the amount of compensation, including interest, shall be paid in the currency of the national State of the investor; Netherlands-Argentina (1992), Article 7, according to which the currency should be "the currency of the country of which the investor is national, or the currency in which the investment has been made, or any freely convertible currency, whichever is accepted by the investor"; Australia-Romania (1993), Article 5 (4), which provides that "the compensation shall be payable either in the currency in which the investment was originally made or, if requested by the investor, in any other freely convertible currency"; Netherlands-Lithuania (1994), Article 6 *(c)*, according to which "compensation shall . . ., in order to be effective, be paid and made transferable . . . in the currency of the country of which the investors are or in any freely convertible currency accepted by the investors"; United States-Nicaragua (1995), Article III (3), provides that

> "if the fair market value is denominated in a freely usable currency, the compensation paid shall be no less than the fair market value on the date of expropriation, plus interest, at a commercially reasonable rate for that currency, accrued from the date of expropriation until the date of payment",

while according to paragraph 4

> "if the fair market value is denominated in a currency that is not freely usable, the compensation paid — converted into the currency of payment at the market rate of exchange prevailing on the date of payment — shall be no less than: *(a)* the fair market value on the date of expropriation, converted into a freely usable currency at the market rate of exchange prevailing on that date, plus *(b)* interest, at a commercially reasonable rate for that freely usable currency, accrued from the date of expropriation until the date of payment".

302. In this regard see Protocols to recent German treaties which consistently provide

> "*(a)* transfer shall be deemed to have been made 'without delay' within the meaning of Article 7 [on transfers] if effected within such period as is normally required for the completion of transfer formalities. The said period shall commence on the day on which the relevant request has been submitted and may on no account exceed two months."

As to the German BITs see generally J. Karl, "The Promotion and Protection of German Foreign Investment Abroad", *ICSID Rev.*, 1996, 1 *et seq.* It must be

by application of the relevant provision of the BIT in matters of transfers generally [303].

Such a provision allows the taking into account of the fact that these difficulties might render the host State unable to accommodate the transfer of a large amount of foreign exchange out of the country at any one point in time [304].

The lapse of time that may occur between the time when the obligation of the host State to make payment has been definitively established and the date on which payment is made raises the issue of entitlement to interest.

Payment of interest(s) from the date of taking to the date of (actual) payment is usually required in international practice.

Surprisingly, BITs tend not to be consistent on this point. Even if

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stressed that German treaties have frequently included a provision which requires that "provision shall have been made in an appropriate manner at or prior to the time of expropriation for the determination and payment of such compensation" (Germany-Romania (1979), Art. 3 (1)). The Protocol to the 1982 BIT between the United States and Egypt provides instead that "the term 'prompt' does not necessarily mean instantaneous. The intent is that the Party diligently and expeditiously carry out necessary formalities." In this connection, see also Article 4 of the Agreed Minutes to the 1988 BIT between China and Japan, according to which "the term 'without delay' . . . shall not exclude a reasonable period of time necessary for deciding amount, way of payment and so on".

Article 6 (1) of the 1990 BIT between Switzerland and Poland reads as follows:

> "le montant de l'indemnité sera réglé dans la monnaie du pays d'origine de l'investissement et sera versé sans retard injustifié à l'ayant droit, sans égard à sa résidence ou à son domicile. Un transfert est réputé avoir lieu 'sans retard injustifié' s'il est effectué dans une période telle que normalement requise pour l'accomplissement des formalités de transfert. Ladite période commence le jour où la requête pertinente a été présentée et ne peut excéder trois mois."

China-Slovenia (1993), Article 4, provides that "the amount of compensation finally determined shall be paid to investors in freely convertible currencies and allowed to be repatriated without undue delay". The same formula is provided in Poland-Sweden (1989), Art. 4 (1) *(c)*.

Art. 1110 (3) of NAFTA provides that "compensation shall be paid without delay and be fully realizable".

303. See Chap. IV, section 5 *(b)*.

Art. 1110 (6) of NAFTA provides that "on payment, compensation shall be freely transferable as provided in Article 1109".

Some United Kingdom BITs of the 1980s provided that under certain balance of payments circumstances transfers could be made in instalments. See United Kingdom-Sierra Leone (1981), Article 6 (2), according to which "in cases where compensation has been paid . . . the Contracting Party concerned may in exceptional foreign exchange situations require the transfer thereof to be effected in reasonable instalments". See also Bangladesh-Thailand (1988), Art. 6 (2).

304. See generally R. Dolzer and M. Stevens, *op. cit.*, 89-90.

some treaties specifically provide that compensation shall include interest from the date of expropriation, most of them do not specify the date from which interest payments shall be calculated, but simply provide that the compensation shall earn interest until the date of payment [305].

BITs tend moreover not to refer to the rate of interest to be applied. The United States and United Kingdom BITs represent an exception [306]. They provide that "the compensation shall include payments for delay as may be considered appropriate under international law" [307] or that interest must be paid at a "normal commercial rate" [308] or at a "reasonable market rate" [309] or at a "fair and equitable

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305. See, however, China-Slovenia (1993), Article 4, according to which "the compensation shall include interest at the current rate of interest applicable to the currency in which the investment was originally undertaken from the date of expropriation until the date of payment". In the *Akkus* decision of 9.7.1997 the ECHR upheld a claim to interest and revaluation in a case of late payment of compensation by Turkey.

306. However, United States-Turkey (1986), Article III (2), simply provides that

> "in the event that payment of compensation is delayed, such compensation shall be paid in an amount which would put the investor in a position no less favourable than the position in which he would have been had the compensation been paid immediately after the date of expropriation".

307. See the United States-Egypt (1982), Art. III (1).

308. See United Kingdom-USSR (1989), Article 5 (1), which provides that "compensation shall be made within two months of the date of expropriation, after which interest at a normal commercial rate shall accrue until the date of payment"; United Kingdom-Argentina (1990), Art. 5; United Kingdom-Mongolia (1991), Art. 5 (1); United Kingdom-Turkmenistan (1995), Art. 5 (1). See also Argentina-Venezuela (1993), Art. 6 (2); Netherlands-Lithuania (1994), Art. 6 *(c)*; Canada-Trinidad and Tobago (1995), Art. VIII (1). Australia-Romania (1993), Article 5 (4), provides that "the compensation shall include interest at a commercially reasonable rate". A similar formula is provided in United States-Nicaragua (1995), Art. III (3).

309. See United States-Czechoslovakia (1991), Art. III (1). See also France-Mongolia (1994), Art. 5 (2); Norway-Peru (1995), Article 6, which provides that the compensation "shall, from the date of expropriation, include interest at a commercial rate established on a market basis".

Article 1110 (4) of NAFTA specifies that "if payment is made in a G7 currency, compensation shall include interest at a commercially reasonable rate for that currency from the date of expropriation until the date of actual payment". On the other hand, paragraph 5 states that

> "if a party elects to pay in a currency other than a G7 currency, the amount paid on the date of payment, if converted into a G7 currency at the market rate of exchange prevailing on that date, shall be no less than if the amount of compensation owed on the date of expropriation had been converted into that G7 currency at the market rate of exchange prevailing on that date, and interests had accrued at a commercially reasonable rate for that G7 currency from the date of expropriation until the date of payment".

rate"[310]. A few treaties require that interest be paid at a rate agreed by the parties[311]. Recent German treaties provide that compensation "shall carry the usual bank interest until the time of payment"[312]. From the lack of specification of the rate a dispute may arise between the parties about the determination of what is "reasonable" or "normal" interest rates and of what market should be considered. This risk is avoided under those few treaties providing that "compensation . . . shall be made without delay and shall include interest at LIBOR rate[313] for the appropriate currency until the date of payment"[314].

6. *Compensation for Other Damages in BITs*

Foreign investments may be affected by political and non-commercial risks other than expropriation, such as war or armed conflict and civil disturbance.

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310. See United Kingdom-India (1994), Art. 5 (1).

311. See Poland-United Arab Emirates (1993), Article 6 (1) (ii) *(h)*, according to which

> "in the event that payment of compensation is delayed, such compensation shall be paid in an amount which would put the investor in a position no less favourable than the position in which he would have been had the compensation been paid immediately after the date of expropriation or nationalization. To achieve this goal the compensation shall include an appropriate interest at a commercially reasonable rate as agreed upon by both Contracting States or at such rate as prescribed by law, for the currency in which the investment is denominated from the date of nationalization or expropriation until the date of payment".

See also Article 3 of the Agreed Minutes to the 1988 BIT between China and Japan which provides that the compensation "shall carry an appropriate interest taking into account the length of time until the time of payment". In this connection, see also France-USSR (1989), Article 4 (3), according to which "as of 30 days after the measures have been taken or have become public knowledge interest at an appropriate rate shall accrue until the date of payment".

312. See Germany-Bolivia (1988), Art. 4 (2); Germany and Poland (1989), Art. 4 (2); Germany-Swaziland (1990), Art. 4 (2); Germany-Uzbekistan (1993), Art. 4 (2). See also Bolivia-Peru (1993), Art. 5 (3).

313. LIBOR is the London Inter-Bank Offered Rate, namely the rate which banks have to pay for obtaining marginal funds in the inter-bank market.

314. See Denmark-Poland (1990), Art. 5 (1). See also Canada-Poland (1990), Art. VI (according to which "compensation shall be made within two months of the date of expropriation, after which interest at the rate agreed between the investor and the Contracting Party concerned and in no case less than the London Inter Bank Offered Rate (LIBOR) shall accrue until the date of payment"); Norway-Hungary (1991), Art. VI (according to which "compensation . . . shall carry an annual rate of interest equal to 12 months LIBOR quoted for the currency in which the investment was made until the time of payment"); Italy-Cuba (1993), Art. 5 (3) and Italy-Brazil (1995), Art. IV (3), which specify that the compensation shall include interests calculated on the basis of the LIBOR rate at 6 months applicable on the date of expropriation accrued until the date of payment.

Under general international law the host State has no obligation to compensate the losses suffered thereby, apart from the obligation not to discriminate against foreign investors in case of indemnification, provided that the requirements of minimum due protection have been complied with [315].

In order to avoid that this risk — which may be high in many countries — discourage foreign investments, BITs usually include specific provisions aimed at giving a certain protection to foreign interests in respect of losses incurred in these situations [316].

Typically, BITs provide that

> "each Party shall accord national and most favoured nation treatment to covered investments as regards any measure relating to losses that investments suffer in its territory owing to war or other armed conflict, revolution, state of national emergency, insurrection, civil disturbance, or similar events" [317].

However, a few BITs refer either to most favourable treatment [318] or to national treatment [319]. Another approach is that of the BITs of Switzerland, which provide that foreign investors shall be granted in this respect the same standard of treatment which the BIT refers to generally [320].

These clauses do not impose on the host State an obligation to provide specific compensation (although they usually specify that "resulting payments shall be freely transferable" [321]). They aim

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315. For references see Chapter IV, section 3, and footnote 157.

316. As to multilateral agreements see the two Mercosur Protocols: Article 4 (2) of the Protocol on reciprocal promotion and protection of investments and Article 2 (D) (2) of the Protocol on promotion and protection of investments from States not members of Mercosur which both provide for most favoured nation treatment.

317. See United States-Nicaragua (1995), Art. IV (1). See also France-Mongolia (1991), Art. 5 (3); Argentina-Egypt (1992), Art. IV (2); United States-Argentina (1992), Art. IV (3); Argentina-Venezuela (1993), Art. 7; Czech Republic-Hungary (1993), Art. 4 (1); Italy-Cuba (1993), Art. 4; Poland-United Arab Emirates (1993), Art. 5 (1); Israel-Estonia (1994), Art. 4 (1); Netherlands-Lithuania (1994), Art. 7; United Kingdom-India (1994), Art. 6 (1); Canada-Trinidad and Tobago (1995), Art. VII; Italy-Brazil (1995), Art. V; Italy-Ukraine (1995), Art. 4; Spain-Colombia (1995), Art. VI; United Kingdom-Turkmenistan (1995), Art. 4 (1); Italy-Russia (1996), Art. 4.

318. See Canada-Poland (1990), Art. V; Australia-Viet Nam (1991), Art. 8; Australia-Romania (1993), Art. 6; China-Uruguay (1993), Art. 5; Norway-Peru (1995), Art. 5.

319. See especially BITs of Germany. See also Bolivia-Peru (1993), Art. 6.

320. See, for example, Switzerland-Peru (1991), Art. 5 (2).

321. See generally BITs quoted *supra* at footnote 314.

rather at ensuring equality of treatment should the host State so provide to its nationals or to other foreign interests.

United Kingdom BITs are, however, an exception in this respect, since they distinguish the origin of the losses. They provide that

> "nationals and companies of one Contracting Party who . . . suffer losses in the territory of the other Contracting Party resulting from: *(a)* requisitioning of their property by its forces or authorities, or *(b)* destruction of their property by its forces or authorities, which was not caused in combat action or was not required by the necessity of the situation, shall be accorded restitution or adequate compensation" [322].

The same BITs limit themselves to prescribe non-discrimination in respect of damages and losses due to other causes in case of war or civil disturbance.

322. See United Kingdom-Honduras (1993), Art. 4 (2); United Kingdom-India (1994), Art. 6 (2); United Kingdom-Turkmenistan (1995), Art. 4 (2). The United States model treaty similarly specifies that "each Party shall accord restitution, or pay compensation" in accordance with treaty's provisions on compensation for expropriation

> "in the event that covered investments suffer losses in its territory . . . that result from: *(a)* requisitioning of all or part of such investments by the Party's forces or authorities, or *(b)* destruction of all or part of such investments by the Party's forces or authorities that was not required by the necessity of the situation".

See K. J. Vandervelde, *op. cit.*, 212 *et seq.* The actual treaties' texts rarely include fully this provision, apart from United States-Nicaragua (1995), Art. IV (2).

Such a clause was examined in the ICSID award in *AAPL* v. *Sri Lanka, ICSID Rev.*, 1991, 526 *et seq.* The case concerned losses to the property of a local company controlled by a foreign investor (AAPL) caused by the use of force against rebels. The Tribunal held that Sri Lanka was liable to AAPL under Article 4 (1) of the BIT which provided that United Kingdom investors should be accorded treatment no less favourable than that which Sri Lanka accorded to its nationals and citizens of any third State. According to the majority opinion, this meant that Sri Lanka's responsibility and the compensation due to AAPL would have to be determined according to general international law rules which dictated minimum standards of behaviour. The Tribunal found that customary international law, and thus Article 4 (1) of the BIT, imposed on Sri Lanka a duty of due diligence or a duty to provide reasonable protection to AAPL's investment which the Government had not respected. The Tribunal held that, under the BIT, damages were not due for the actual assets destroyed but only for the value of AAPL's shareholding.

In the award of 21.2.1997 in the case *AMT-Zaire* brought under the United States-Zaire BIT of 1994 an ICSID Tribunal found that Zaire was responsible for the damages suffered by the property of the subsidiary in Zaire of the US claimant both under the general BIT clause that guarantees "protection and security" to investment and under the specific provision covering riot or act of violence, *ICSID Rev.*, 1997, 1531 *et seq.*

United States BITs follow this approach. There are on the other hand a few examples of BITs that include a general, though generic, obligation of the host State to provide compensation for such losses [323].

7. Recognition of Subrogation

In order to protect investments of nationals abroad against non-commercial risks as a whole (such as currency inconvertibility, various forms of expropriation, war, revolution or insurrection and civil strives) most industrialized countries have established national insurance schemes aimed at guaranteeing against those losses private capital investments in developing countries in order to encourage them [324].

The eligible countries vary according to the policy of the home State concerned and the level of political risk involved. Basically, an investor may make an arrangement with its national State insurance agency in order to have certain damages due to non-commercial risk that its investment abroad may suffer guaranteed against a given premium. These policies are also offered by private insurers; often State support and private underwriting are combined.

As a result, in case of effective damage the agency would compensate the insured investor, although usually the coverage is not for the full amount of the loss. As a consequence the agency, by having paid the affected investor, is subrogated to all and any claim that the investor may have against the host State. Subrogation, i.e. transfer of

323. See Italy-Cuba (1993), Article 4, and Italy-Ukraine (1995), Article 4, that provide for the obligation to pay adequate compensation for these losses.

324. The United States national insurance scheme started in 1948 as part of the Marshall Plan is usually considered the precedent for such instruments. The task was then assumed by the AID (Department of State's Agency for International Development established under the 1961 Foreign Assistance Act) and was continued by the OPIC (Overseas Private Investment Corporation established by the Foreign Assistance Act of 1969 as a federally chartered corporate agency of the United States Government). According to the OPIC Investment Insurance Handbook of 1982 OPIC's purpose is "to mobilize and facilitate the participation of U.S. private capital and skills in the economic and social development of less-developed friendly countries and areas, thereby complementing the development assistance objectives of the U.S.".

See generally T. Meron, *Investment Insurance in International Law*, 1976; P. Peters, *Arbitration and Renegotiation of International Investment Agreements*, 1986, 225 *et seq.*; G. Loibl, "Foreign Investment Insurance Systems", in D. C. Dicke (ed.), *Foreign Investment, op. cit.*, 102 *et seq.*; J. S. Diaconis, "Political Risk Insurance: OPIC's Use of a 'Fiduciary Agent' to Facilitate Resolution of Subrogation Claims", *Int'l Lawyer*, 1989, 271 *et seq.*

the claim, is provided by many domestic legal systems as an automatic effect of the indemnification of the insured party by the insurer in third-party liability insurance. The relevant statutes and contracts do provide for it in investment and export insurance for commercial and non-commercial risks[325].

Besides protecting and supporting investments, in the view of Western capital-exporting countries, the existence of such an arrangement should deter host States from abuses against investments of their nationals abroad thanks to the direct involvement of the home State[326].

The arrangement between a national insurance State agency and a national investor does not have *per se* international relevance. It should be recognized abroad under the principles of private international law, but the host State might still refuse to recognize the subrogation, even more so in view of the source of the claim or credit which is a State act. The issue of compensation of the State agency is thus more likely to develop into an international dispute between the home State and the host State in case of subrogation. As a consequence, the conflict avoidance purpose of the home State's national investment insurance scheme would be frustrated, while the investment climate of the host State may be affected.

The MIGA Convention of 1985 concluded under the auspices of the World Bank aims specifically at avoiding such undesirable outcome from an otherwise positive device.

According to Article 2 of the Convention

> "the objective of the Multilateral Investment Guarantee Agency shall be to encourage the flow of investments for productive purposes among member countries, and in particular to developing member countries . . . To serve its objective the Agency shall: *(a)* issue guarantees, including coinsurance and reinsurance, against non-commercial risks in respect of investments in a member country which flow from other member countries."

Subrogation by MIGA in case of loss of an insured investment due to a political risk, such as expropriation or nationalization, is an integral part of MIGA's operation. Under the MIGA Convention subrogation by the Agency shall be recognized by all members, and

325. See Chap. I at footnote 62.
326. See W. Peters, *op. cit.*, 252.

specific provision apply as to indemnification and any dispute that may arise[327]. In this way the MIGA Convention represents an effective means of conflict avoidance at multilateral level which is limited, however, to those investments covered by it.

As to bilateral relations some home countries, notably the United States, Switzerland and France, have concluded in the past *ad hoc* international agreements ("investment guarantee agreements") with selected host States in order to avoid the possible lack of recognition of subrogation by these States in respect of the insurance given to their nationals' investments[328].

BITs address directly the issue of international recognition of subrogation through the inclusion of an explicit provision. A typical clause provides that

> "where one Contracting Party or its designated agency has guaranteed any indemnity against non-commercial risks in respect of an investment by any of its investors in the territory of the other Contracting Party and has made payment to such investors in respect of their claims under this Agreement, the

327. See Article 18 on subrogation which provides at paragraph *(c)* that

> "amounts in the currency of the host country acquired by the Agency as subrogee pursuant to Section *(a)* above shall be accorded, with respect to use and conversion, treatment by the host country as favorable as the treatment to which such funds would be entitled in the hands of the holder of the guarantee".

As to dispute settlement see Article 57 *(b)* concerning claims of the Agency acting as subrogee of an investor referring to *ad hoc* arbitration in accordance with Annex II or any other alternative method agreed.

328. See, for example, the agreement between United States and Ecuador (1984), Article 3, which reads as follows:

> "if the Issuer makes payment to any party under coverage, the Government of Ecuador shall recognize, . . ., the transfer to the Issuer of all currency, credits, assets or investment on account of which payment under such coverage was made, and shall recognize as well the appointment of the natural or juridical person to whom, as fiduciary agent or holder of the issuer in Ecuador, the Issuer has assigned any right, title, privilege, claim, or cause of action existing or which may arise in connection with said payment and which constitutes an effective right in favor of the Issuer over all currency, credits, assets, or investment on account of which payment under such coverage was made. *(b)* Neither the Issuer nor the fiduciary agent or holder acting in its name in Ecuador shall assert greater rights than those of the assigning party under coverage with respect to any interest transferred or succeeded to under this Article. *(c)* Coverage issued outside of Ecuador with respect to a project or activity within Ecuador shall be governed by the law of the place the coverage was issued. *(d)* The Issuer shall enjoy those tax exemptions and exonerations in Ecuador granted to foreign financial institutions operating in Ecuador."

> other Contracting Party agrees that the first Contracting Party or its designated agency is entitled by virtue of subrogation to exercise the rights and assert the claims of those investors. The subrogated rights or claims shall not exceed the original rights or claims of such investors." [329]

Italian BITs provide that payments due to the insurance agency shall be transferred in accordance with BIT's articles on repatriation of investment and returns, compensation for losses and expropriations [330]. On the other hand, United Kingdom BITs provide that "any payments received in non-convertible currency by the Contracting Party (entitled to subrogation) in pursuance to the rights and claims acquired shall be freely available" to such a contracting party "for the purpose of meeting any official expenditure incurred in the territory of the other Contracting Party" [331].

The local use of non-convertible currency paid as compensation is a device found also in MIGA's corresponding provision that alleviates the foreign exchange burden of the host country.

Since the United States still relies on *ad hoc* investment guarantee agreements [332] United States BITs are an exception in this respect, since they do not include any specific disposition on subrogation. They just provide that

> "in any proceeding involving an investment dispute, a Party shall not assert, as a defense, counterclaim, right of set-off or otherwise, that the national or company concerned has received or will receive, pursuant to an insurance or guarantee contract, indemnification or other compensation for all or part of its alleged damages" [333].

329. See United Kingdom-India (1994), Art. 8 (1). See also Germany-Poland (1989), Art. 6 (1); Australia-Viet Nam (1991), Art. 14; Switzerland-Peru (1991), Art. 8; France-Mongolia (1991), Art. 9 (which also specifies that subrogation shall not affect "les droits du bénéficiaire de la garantie à recourir au CIRDI ou à poursuivre les actions introduites devant lui jusqu'à l'aboutissement de la procedure"); Netherlands-Jamaica (1991), Art. 8; Italy-Cuba (1993), Art. 7; Australia-Romania (1993), Art. 10; China-Uruguay (1993), Art. 7; China-Slovenia (1993), Art. 6; Italy-Ukraine (1995), Art. 7; Poland-United Arab Emirates (1993), Art. 8 (1); Austria-Estonia (1994), Art. 6; Netherlands-Lithuania (1994), Art. 8; Germany-Barbados (1994), Art. 6; Italy-Brazil (1995), Art. VII (1); Italy-Russia (1996), Art. 7 (1).

330. See Italy-Brazil (1995), Art. VII (1), and Italy-Russia (1996), Art. 7 (2).

331. See United Kingdom-India (1994), Art. 8 (2).

332. See R. Dolzer and M. Stevens, *op. cit.*, 157.

333. See United States-Argentina (1992), Art. VII (7); United States-Russia (1992), Art. VI (4); United States-Nicaragua (1995), Art. IX (7)

CHAPTER VI

THE SETTLEMENT OF FOREIGN INVESTMENT DISPUTES

Summary : 1. Introduction. 2. Recourse to international commercial arbitration. 3. ICSID arbitration. 4. Bilateral and multilateral investment dispute settlement mechanisms : (a) *The Iran-United States Claims Tribunal ;* (b) *The North American Free Trade Agreement (NAFTA) ;* (c) *The Energy Charter Treaty ;* (d) *The Mercosur Protocols. 5. Interstate dispute settlement in BITs :* (a) *The appointment of arbitrators ;* (b) *The procedural rules ;* (c) *The law applicable to the merits ;* (d) *The time factor ;* (e) *The apportionment of costs ;* (f) *The relation between interstate and host State-foreign investor arbitration. 6. Host State-foreign investor dispute settlement in BITs : standard patterns and differences :* (a) *Eligible disputes ;* (b) *The time factor ;* (c) *Consent of the contracting parties ;* (d) *Applicable law ;* (e) *Procedural applicable rules ;* (f) *Recognition and enforcement of awards ;* (g) *Effect of indemnity under investment insurance ;* (h) *Exercise of diplomatic protection ;* (i) *Consent under Article 25 (2)* (b) *of the ICSID Convention. 7. Conclusions.*

1. Introduction

The disputes concerning foreign investments which have raised more conflicts and attracted more interest are those which arise as a consequence of acts of deprivation of wealth by the host State against foreign investors, although disputes incidental to the normal carrying out of business operations are surely more frequent.

The possibility of subjecting such disputes to an impartial dispute settlement procedure of an international nature depends on the existence of a previous agreement either with the investor affected or with its home State, as provided generally in BITs. When this is not the case, in the absence of an arbitral agreement between the host State and the foreign investor, or when the host State has revoked its consent by changing its relevant legislation or otherwise, those matters have turned to interstate disputes in the exercise of diplomatic protection.

Acute economic and political conflicts have developed as a consequence. While the overt use of force has been banished in the last decades, friendly solutions have often required years if not decades; global settlements, by lump-sum agreements or through Mixed Commissions, have rarely satisfied the foreign investors, while host States have more than once complained of inadmissible pressures and encroachment upon their sovereignty by the home States.

Home countries have consistently upheld the view that the acceptance of the exclusive competence of the host State courts by their investors and any waiver of diplomatic protection on their part could not be opposed to them when international rights and obligation were at stake. They have also opposed these views when they were exposed as a part of the "new international economic order" advocated by developing countries in the 1970s at the United Nations and in other fora [334].

On the other hand foreigners subject themselves to the law of the host country once they have entered its market and established themselves there. Local courts are in principle competent to pass upon disputes involving the treatment of their investment by application of the local law, except if agreed otherwise through appropriate

334. See Article 2 (2) *(c)* of Charter of Economic Rights and Duties of States of 1974, GA resolution A/3281 (XXIX), according to which

> "in any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalising 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".

Article 4 of the GA resolution on Permanent Sovereignty over Natural Resources of 1962, resolution A/1803 (XVIII), adopted by consensus provided differently that

> "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 the dispute should be made through arbitration or international adjudication."

In 1986, the ILA addressed in its Seoul Declaration on the progressive development of principles of public international law relating to a new international economic order the controversial question, raised by the above General Assembly resolutions by indicating that

> "disputes on questions related to international economic relations have to be settled by peaceful means chosen by the parties concerned, in particular by recourse to international adjudication, international or transnational arbitration, or other international procedures for the settlement of disputes. The principle of exhaustion of local remedies shall be observed, where applicable" (para. 13.1); see ILA, *Report of the 62nd Conference*, 1987, 1 *et seq.*

choice-of-law or choice-of-forum clauses, without prejudice for the respect of any applicable international rule or obligation.

This means of settlement may be unsatisfactory for the foreign investor when major disputes arise, especially when the application of international law rules, typically those on expropriation, is at issue. When the host State is itself a party to the dispute the local judiciary may not always be relied upon as being independent from the political power. Furthermore in the past judicial systems in many countries were not sophisticated enough to handle such disputes and did not guarantee impartiality towards foreigners.

As a consequence, the practice of concluding agreements between foreign investors and host States was advocated as an effective method of avoiding such problems. In order to define impartially rights and duties and in order to afford due process to the foreign investors these agreements provided for stabilization or delocalization clauses, choice of foreign law or of international principles as applicable in the merit, the competence of a third country forum or independent arbitration there in case of dispute [335].

Notwithstanding the fact that in recent times host States (especially developing countries) have affirmed their jurisdiction in principle in matters of investment as an expression of their economic sovereignty, arbitration has gained recognition as an impartial dispute settlement method in this area, as in transnational private economic relations generally.

Since private investors are not subject of international law, "classic" international (interstate) arbitration is inapplicable, except, possibly, in those rare situations of "economic development agreements" where a large multinational company succeeds in being recognized on an equal footing with the State partner. On the other hand, international commercial arbitration may sometimes be unsuitable for deciding this kind of dispute : the very participation of a sovereign State as a party to an investment dispute (to be distinguished from litigation arising from other State contracts) may point to the dispute not being "commercial" depending on the subject matter [336]. States'

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335. On these developments also in a historical perspective see generally A. Fatouros, *Government Guarantees to Foreign Investors*, 1962; G. Sacerdoti, *I contratti tra Stati e stranieri nel diritto internazionale*, 1972; I. Shihata, *The World Bank in a Changing World*, I, 1991, 237 *et seq.*

336. See P. Lalive, "Arbitrage international et ordre public suisse", *Revue de droit suisse,* 1978, 529 *et seq.*

immunity from execution may hinder moreover the effective enforcement of awards in other countries, besides limiting it possibly also in the State party to the dispute itself.

2. Recourse to International Commercial Arbitration

International commercial arbitration, governed by the 1958 New York Convention and by the 1961 European Geneva Convention, is available and is being used [337]. It can be conducted under the auspices of permanent arbitral institutions and can be governed by the arbitral rules of procedure of these institutions, such as the International Chamber of Commerce, or by the UNCITRAL Rules [338]. States and State-owned companies have often resorted to this kind of arbitration against foreign contractual parties, held to be in breach of their obligations [339].

On the other hand a number of important agreements include complex arbitration clauses which provide for completely autonomous arbitration, independent from the *lex loci arbitratus*, modelled on the practice between States; the choice of arbitrators has been referred sometimes to the President of the ICJ [340]. This model has been defined as "quasi-international" arbitration: its binding nature derives from the international principles which recognizes the legality of the entering into such an agreement by a State as an exercise of its sovereignty [341].

337. See generally R. Luzzatto, "International Commercial Arbitration and the Municipal Law of States", *Recueil des cours*, Vol. 157 (1977), 87 *et seq.*; R. David, *Arbitration in International Trade*, 1985; A. Van den Berg, *The New York Convention of 1958*, 1994; P. Fouchard, E. Gaillard and B. Goldman, *Traité de l'arbitrage commercial international*, 1996.

338. For an example of an arbitration of this kind before the ICC see *Framatome* v. *Atomic Energy of Iran* (1982), *JDI*, 1984, 58 *et seq.* with comment by B. Oppetit, *ibid.*, 37 *et seq.* In general see W. Craig, W. Park and L. Paulsson, *ICC Arbitration*, 2nd ed., 1990; I. Dore, *Arbitration and Conciliation under the Uncitral Rules*, 1986.

339. See generally, K. Böckstiegel, "Arbitration of Disputes between States and Private Enterprises in the ICC", 59 *AJIL*, 1965, 579 *et seq.*

340. Cf. Z. Kahn "The Appointment of Arbitrators by the President of ICJ", *Comunicazione e Studi*, 1975, 1021 *et seq.*

341. G. Vedel, "Le problème de l'arbitrage entre gouvernements ou personnes de droit public et personnes de droit privé", *Revue de l'arbitrage,* 1961, p. 116 *et seq.*; E. Jiménez de Aréchaga, "L'arbitrage privé entre Etats et sociétés étrangères", *Mélanges Gidel,* Paris, 1961, 361 *et seq.*; F. A. Mann, "State Contracts and International Arbitration", *Studies of International Law*, London, 1973, 256 *et seq.*; K. Böckstiegel, *Der Staat als Vertragspartner ausländischer Privatunternehmemen,* 1974; F. Rigaux, "Souveraineté des Etats et arbitrage

The distinction between the two types of arbitration is not simple in practice; commercial arbitration can also be for the most part delocalized and carried out independently from a particular local legal system and out of its control, based on the intention of the parties that it be self-regulated. Recent arbitration statutes in many countries have limited the intervention of municipal law and courts in respect of international arbitration. Thus the definition of commercial arbitration and awards as international (private law) is amply justified; the previous approach of attributing a specific nationality to foreign awards does not reflect current practice as to arbitration in international commercial relations.

However, for purposes of recognition of foreign awards in a contracting State, the New York Convention (Art. V *(a)*) provides that recognition can be refused if the arbitration clause is not valid under the law chosen by parties or, lacking such designation, under the law of the State where the decision was rendered. Annulment of the award in the country where it was rendered may preclude its recognition in other States under Article V (1) *(e)* and, in selected instances, under Article IX of the Geneva Convention [342]. The competence of State law and jurisdiction cannot therefore be completely avoided by the parties in international commercial arbitration, except in so far as this competence is restricted by the laws of the competent State itself.

The clauses mentioned above, establishing an independent international arbitration between States and foreign parties, aim on the other hand at preventing the intervention of, or recourse to, national law in respect of the agreed-upon arbitration; in some cases these clauses have been held to entail application of international law even as regards procedure [343].

International arbitration of such disputes may therefore still be

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transnational", *Le droit des relations économiques internationales* (Etudes B. Goldman), 1982, 261 *et seq.*; P. Lalive, "Contrats entre Etats ou entreprises publiques et personnes privées", *Recueil des cours*, Vol. 181 (1983), 21 *et seq.*; G. Sacerdoti, "State Contracts and International Law: A Reappraisal" 7 *Italian YB Int. Law*, 1986-1987, 26 *et seq.*

342. Article VII of the New York Convention allows recognition under the law of the forum if more favourable. Courts in some countries have relied recently on this provision with reference to domestic statutes, see G. Delaume, "Recognition and Enforcement of State Contract Awards in the US: A Restatement", 91 *AJIL*, 1997, 476 *et seq.*, at 482.

343. See *Aramco* award (1958), 27 *Int. LR* 17 *et seq.* at 155; *Libya-Topco and Calasiatic,* Interim decision, 83 *Int LR*, 1979, 389.

usefully distinguished from international commercial arbitration in general.

Recognition of such awards in third countries (apart from questions of immunity) is liable to encounter the difficulty of being held to be neither a domestic decision, nor a decision whose recognition is mandatory under the New York or Geneva Conventions. Various precedents illustrate this point. Where the nature of the award (international-commercial or international-public) has not been clarified by the arbitrators, it may have to be determined in subsequent judicial proceedings under State law. Arbitrators who have expressly addressed the issue have taken different positions in similar cases: thus the single arbitrator Lagergren in the *Libya-BP* case decided, following the precedent set in the *Sapphire* case, that procedure was governed by local Danish law, while the single arbitrator Dupuy in the *Libya-Topco and Calasiatic* case decided that international law also governed procedure. The difficulties encountered in the execution of such arbitral decisions have often been reviewed in the literature [344].

In all cases, however, the principle applies according to which consent to arbitration may not be revoked, not even by a subsequent statute of the contracting State that annuls the contract, given the universally recognized independence of arbitration clauses in respect of the rest of the contract and the jurisdiction of the arbitrators themselves over their own competence [345]. Another problem concerns the possibility that the State may successfully claim immunity from execution, by reason of the non-private nature of the relation, besides in view of the type of assets against which the execution has been levied. Recent national legislation on the immunity of foreign States as well as case-law tend however to limit the availability of this immu-

344. See G. Delaume, "State Contracts and Transnational Arbitration", 75 *AJIL*, 1981, 809 *et seq.*; *Id.*, "L'arbitrage transnational et les tribunaux", *JDI*, 1984, 521 *et seq.*; F. Rigaux, "Souveraineté", *cit.*, 261 *et seq.*

345. Cf. Art. 8, para. 4, of the ICC Rules of 1988; Art. 21, para. 2, of the UNCITRAL Rules; Art. V, para. 3, of the Geneva Convention; Art. 41 of the ICSID Convention; P. Weil, "Problèmes rélatifs aux contrats passés entre un Etat et un particulier", 128 *Recueil des cours*, Vol. 128 (1969), 222; P. Sanders, "L'autonomie de la clause compromissoire", *Hommage à F. Eisemann*, Paris, 1978, 33 *et seq.*; P. Mayer, "L'autonomie de l'arbitrage international dans l'appréciation de sa propre compétence", *Recueil des cours*, Vol. 217 (1979), 323 *et seq.*; *Libya-Topco and Calasiatic,* Interim decision, *cit.*, 404 *et seq.* See also H. Fox, "States and the Undertaking to Arbitrate", 37 *ICLQ*, 1988, I *et seq.*; G. Delaume, "The Finality of Arbitration Involving States", 5 *Arb. Int.*, 1989, 21 *et seq.*

nity when a State does not execute an award issued in an arbitration with a private foreign party to which the State has consented [346].

We may conclude that BITs' provisions admitting and regulating beforehand recourse to arbitration in disputes between a foreign investor and the host State and the binding effect of any award rendered are appropriate in order to avoid most of the problems reviewed above, that recourse to *lex mercatoria* or public international law may not fully solve.

3. ICSID Arbitration

In order to overcome difficulties while guaranteeing the effectiveness of arbitration the World Bank promoted the 1965 Washington Convention, ratified by more than 120 States, on arbitration of disputes arising out of a foreign investment between a contracting State (or one of its subdivisions or agencies) and a national of another contracting State. A contractual arbitration clause is not required as long as there is written consent to such a procedure by the private party and by the State; the latter's consent may be expressed in a law on foreign investments or in a multilateral or bilateral treaty, such as a BIT, made with a contracting State of which the investor is a national. The intention was to facilitate the flow of private investments to the Third World by offering the means for non-controversial settlement of disputes arising in connection with them, balancing the interests of host States with those of the foreign investors. The wide scope of the Convention is underlined by the fact that while the dispute must have a "legal" character, there is no definition of "investment" in the text. This was felt to be unnecessary since the consent of the parties supplies a decisive criterion, so that any type of investment in whatever form may qualify [347].

346. Cf. I. Seidl-Hohenveldern, "Commercial Arbitration and State Immunity", *International Trade Arbitration,* 1958, 87; J. Crawford, "Execution of Judgements and Foreign Sovereign Immunity", 75 *AJIL*, 1981, 820 *et seq.*; P. Trooboff, "Foreign State Immunity: Emerging Consensus on Principles", *Recueil des cours*, Vol. 200 (1986), 239 *et seq.*; A. Van den Berg, "Recent Enforcement Problems under the New York and ICSID Conventions", 5 *Arb. Int.*, 1989, 2 *et seq.*; G. Delaume, "Contractual Waivers of Sovereign Immunity", *ICSID Rev.*, 1990, 232 *et seq.*

347. See the Official Report of the Executive Directors of the World Bank accompanying its text, reprinted 5 *ILM*, 1966, 820 *et seq.*, para. 27. Member States can notify to the Centre classes of disputes which they would or would not consider submitting to the jurisdiction of the Centre (Art. 25 (4)). The

Arbitration at ICSID under the Convention is well known. It suffices here to recall its most important features thanks to which typical problems affecting arbitration between States and foreign parties are being avoided.

The Centre does not arbitrate but performs the function of an arbitral institution. It guarantees that proceedings may be conducted in all cases where arbitration at ICSID has been agreed upon and has been requested by a party who has consented to it. Arbitration is exclusive of any other solution except if otherwise agreed by the parties (Art. 26); consent may not be unilaterally withdrawn (Art. 25, para. 1); procedure is governed by the arbitration rules adopted by ICSID; in the absence of contractual agreement, the applicable law is that of the contracting State party to the dispute, including its rules on the conflict of laws, and the relevant rules of international law (Art. 42, para. 1); the decision is binding on the parties (Art. 53).

Of particular importance is the regulation of the relationship between interstate disputes stemming from the granting of diplomatic protection on the one hand and arbitration including recognition and execution of awards on the other hand. The arbitration clause and arbitration proceedings bar diplomatic protection and the bringing of an international claim in favour of the private party (Art. 27), except where the State party to the dispute does not comply with the award. Contracting States must recognize the awards as binding and must enforce the pecuniary obligations imposed by them within their territories, as if they were a final judgment of their own courts (Art. 54, para. 1), that is without subjecting them to any *exequations* procedure. The only issue left open is that of immunity, which is governed by the law of each State (Art. 55).

The Convention provides a new system of international arbitration between States and foreign parties for all types of legal relationships, be they subject to national law or internationalized, in the matter of investments. The guarantees as to availability of the procedure, exclusivity, execution and recognition of decisions have been shown to be effective in the various disputes resolved under it so far. The purpose has been attained to "depoliticize" investment disputes by

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"Additional Facility", established in 1979, is a separate set of rules to which parties can refer when the conventional basis for jurisdiction is lacking because one of the States involved is not a member of ICSID.

offering an impartial settlement mechanism based on due process and the rule of law whose provision arbitrators have to take fully into account [348].

This is to be attributed to the separation made by the Convention between procedural aspects governed by it and substantive matters left to the legal discipline governing the specific investment. The dispute settlement procedure has been inserted in an international legal framework (ICSID is an international organization and the arbitration is conducted by international tribunals), guaranteed as to its impartiality and effectiveness by an international treaty binding upon the contracting States.

On the other hand the substantive investment relationship has, as a rule, a domestic private or administrative law character and is subject to the law of the State party to it (that is the host country), except for a different choice by the parties, with the limit of respect for international law [349]. The strict obligation for arbitrators to apply this national law has been underlined by the case law of *Ad hoc* Committees in annulment proceedings under Article 52 [350].

4. Bilateral and Multilateral Investment Dispute Settlement Mechanisms

Ad hoc third party settlement procedures established by bilateral agreement, such as Mixed Commissions or Tribunals, have frequently been resorted to in the past in order to settle investment disputes arising out of certain mass expropriations and nationalizations [351].

The Iran-United States Claims Tribunal follows in some respects

348. On the Convention, see *Investissements étrangers et arbitrage entre Etats et personnes privées. La Convention BIRD,* Paris, 1969 ; A. Broches, "The Convention on the Settlement of Investment Disputes", *Recueil des cours*, Vol. 136 (1972), 337 *et seq.* ; G. Sacerdoti, "La Convenzione di Washington per la soluzione delle controversie fra Stati e nazionali di altri Stati in materia di investimenti", *Riv. dir. int. priv. proc.*, 1969, 614 *et seq.* ; M. Hirsch, *The Arbitration Mechanism of the ICSID*, 1993.

349. See I. Shihata and A. Parra, "Applicable Substantive Law in Disputes between States and Private Foreign Parties : The Case of Arbitration under the ICSID Convention", *ICSID Rev.*, 1994, 183 *et seq.*

350. See *Klöckner* v. *Cameroon* (1986), *ICSID Rev.*, 1986, 89 *et seq.*

351. See generally R. Lillich, *International Claims : Their Adjudication by National Commissions*, 1962. For a detailed overview see A. Parra, "Provisions on the Settlement of Investment Disputes in Modern Investment Laws, BITs and Multilateral Instruments on Investment", *ICSID Rev.*, 1997, 287 *et seq.*

this model in establishing an *ad hoc* tribunal for such disputes, rather than relying on pre-existing institutions and procedures, established to serve (also) this purpose, such as international commercial arbitration and ICSID.

(a) *The Iran-United States Claims Tribunal*

The Iran-United States Claims Tribunal established by the Algiers Agreements of 1981 is a standing international tribunal which has been given by the two States parties to the Algiers Agreements the exclusive competence to pass upon disputes, mainly those of United States private investors against Iran, arising out of the action taken by Iranian authorities in the context and aftermath of the Iranian revolution of 1978-1979[352]. In particular the Tribunal has had to address the issue of lawfulness under international law of measures taken by Iran in respect of commercial property in that context, which has led to claims of unlawful taking and creeping expropriation by Iran.

Differently from the Mixed Claims Commissions, where individual claims were espoused by the Government, proceedings can and must be initiated directly by the affected investors.

Article II (1) of the Claims Settlement Declaration (which is one of the three Declarations constituting the Algiers Agreements) gives jurisdiction to the Tribunal over

> "claims of a national of the United States against Iran and claims of a national of Iran against the United States, and any counterclaim which arises out of the same contract, transaction or occurrence that constitutes the subject matter of that national's claims, if such claims and counterclaims are outstanding on the date of this agreement, whether or not filed with any court, and arise out of debts, contracts (including transactions which are the subject of letters of credit or bank guarantees), expropriations or other measures affecting property rights".

352. See generally C. Brower, "The Iran-United States Claims Tribunal", *Recueil des cours*, Vol. 224 (1990), 123 *et seq.*; R. Khan, *The Iran-United States Claims Tribunal: Controversies, Cases and Contribution*, 1990, 171 *et seq.*; A. Avanessian, *Iran-United States Claims Tribunal in Action*, 1993; P. T. Muchlinski, *Multinational Enterprises and the Law*, 1995, 502; G. H. Aldrich, *The Jurisprudence of the Iran-United States Claims Tribunal*, 1996; C. Brower and J. Brueschke, *The Iran-United States Claims Tribunal*, 1998.

According to Article II (2)

> "the Tribunal shall also have jurisdiction over official claims of the United States and Iran against each other arising out of contractual arrangements between them for the purpose and sale of goods and services".

Finally, according to Article II (3) "the Tribunal shall have jurisdiction over any dispute as to the interpretation or performance of any provision of the General Declaration" [353]. The Tribunal serves, therefore, a multiplicity of functions, encompassing both private investor disputes against the host State and interstate disputes relating to the Algiers Agreements themselves, whereas BITs refer them to different arbitral organs and procedures [354].

According to Article IV, paragraph 1, "all decisions and awards of the Tribunal shall be final and binding" and according to Article IV, paragraph 3, "any award which the Tribunal may render against either government shall be enforceable against such government in the courts of any nation in accordance with its laws". In practice the escrow and security accounts established by the Algiers Agreements serve the purpose to satisfy judgments rendered against Iran.

The Tribunal "conducts its business in accordance with the arbitration rules of the UNCITRAL" [355] and applies

> "such choice of law rules and principles of commercial and international law as the Tribunal determines to be applicable, taking into account relevant usages of the trade, contract provisions and changed circumstances" [356].

353. Actually, Article II (1) excludes from the Tribunal's jurisdiction, *inter alia*, "claims arising under a binding contract between the parties specially providing that any dispute thereunder shall be within the sole jurisdiction of the competent Iranian courts . . .". In the light of such an exclusion Iran contested the jurisdiction of the Tribunal in cases of expropriation of the oil industry in Iran. Chamber Two dismissed that Iran's objection to the Tribunal's jurisdiction in two identically interlocutory awards issued on 30 December 1982. See *Phillips Petroleum Co., Iran* v. *Iran* (1 *Iran-US CTR*, at 487) and *Amoco Iran Oil Co.* v. *Iran* (1 *Iran-US CTR*, at 493).

Certain other claims of a higher political character (such as those relating to the seizure of the US "hostages" in the US Embassy in Tehran) are also excluded.

354. However, individual claims are decided by one of the Tribunal's three Chambers, while other disputes are decided by the Full Tribunal. See Article II (1) (2) and (3) of the Declaration.

355. Art. III (2) of the Claims Settlement Declaration.

356. Art. V of the Claims Settlement Declaration.

In the light of the above, the prevailing opinion is that, as to their effects, the judgments issued by the Tribunal on private claims can be equated to those of international commercial arbitral tribunals and that they can be enforced accordingly [357].

(b) *The North American Free Trade Agreement (NAFTA)*

As to means of settlement provided by recent multilateral agreements [358], the NAFTA Treaty provides for elaborate disputes settle-

357. As to the particular question whether or not the New York Convention of 1958 applies to the awards of the Iran-United States Claims Tribunal see generally W. T. Lake and J. T. Dana, "Judicial Review of Awards of the Iran-United States Claims Tribunal: Are the Tribunal's Awards Dutch?", in *Law and Policy in International Business*, 1984, 755 *et seq.*; R. Kahn, *op. cit.*, 101; A. Avanessian, "The New York Convention and Denationalised Arbitral Awards (with Emphasis on the Iran-United States Claims Tribunal)", *J. Int. Arb.*, 1991, 5 *et seq.*; G. Delaume, "Recognition and Enforcement of State Contract Awards in the United States: A Restatement", in 91 *AJIL*, 1997, 478 (with particular reference to the case *Ministry of Defense of Iran* v. *Gould*).

It has, on the other hand, been argued that awards of the Iran-United States Claims Tribunal are to be equated — as to their effects — to those of national tribunals rather than to those of international commercial arbitral tribunals. See F. Lattanzi, "Il tribunale Iran-Stati Uniti: nazionalizzazione di beni stranieri e *standard* dell'indennizzo", in *Rivista dell'arbitrato*, 1991, p. 889.

358. APEC Non-Binding Investment Principles of 1994, provide that

> "Member economies accept that disputes arising in connection with a foreign investment will be settled promptly through consultations and negotiations between the parties to the dispute or, failing this, through procedures for arbitration in accordance with Members' international commitments or through other arbitration procedures acceptable to both parties."

On APEC's means of dispute settlement see generally M. Gerardi, "Jumpstarting APEC in the Race to 'Open Regionalism': A Proposal for the Multilateral Adoption of UNCITRAL's Model Law on International Commercial Arbitration", *Northwestern J. of Int'l Law & Business*, 1995, 668 *et seq.*

The Guideline V of the World Bank Guidelines on the treatment of foreign direct investment of 1992 provides that

> "disputes between private foreign investors and the host State will normally be settled through negotiations between them and failing this, through national courts or through other agreed mechanisms including conciliation and binding independent arbitration".

In this respect it is specified that

> "independent arbitration for the purpose of this Guideline will include any *ad hoc* or institutional arbitration agreed upon in writing by the State and the investor or between the State and the investor's home State where the majority of the arbitrators are not solely appointed by one party to the dispute"

and that

> "in case of agreement on independent arbitration, each State is encouraged to accept the settlement of such disputes through arbitration under the Convention establishing the International Centre for Settlement of Investment Disputes (ICSID) if it is a party to the ICSID Convention or through the 'ICSID Additional Facility' if it is not a party to the ICSID Convention".

ment mechanisms, regulated by different substantial and procedural rules, depending upon whether the dispute concerns (i) the treatment of an investment between a party and an investor of another party (Chap. 11); (ii) disputes under the antidumping and countervailing duty laws (Chap. 19); and (iii) disputes between the parties (Chap. 20)[359].

Chapter 11 provisions permit investors of one NAFTA party as defined therein[360] to resort to binding international arbitration against a host member Government which violates the investment provisions of the NAFTA, such as those concerning the national treatment commitment and in the area of specific performance requirements and expropriation. These provisions do not establish new mechanisms but permit investors to seek arbitration under either the ICSID Convention or its Additional Facility, or international commercial arbitration in accordance with the UNCITRAL Rules.

Several preconditions must be met before an investor may resort to such procedures, as a treaty-agreed alternative to the competence of national courts. Prior consultations and negotiations must be attempted, so that resorting to arbitration cannot be immediate. Moreover, it is not enough that a treaty obligation has been violated; Article 1116 requires further that the investor must have suffered a loss or damage by reason of the breach.

Various provisions supplement or replace rules which would be otherwise applicable under the relevant arbitration mechanisms. Thus, Article 1135 provides that a tribunal may only award pecuniary damages (with the exclusion of punitive damages) or the restitution of property; in the latter case the State involved may, however, pay damages instead[361].

359. See generally Horlick and Debusk, "Dispute Resolution under Nafta", *J. World Trade*, 1993, 21 *et seq.*; R. G. Dearden, "Arbitration of Expropriation Disputes between an Investor and the State under the NAFTA", *J. World Trade*, 1995, 1, 113 *et seq.*

360. See *supra* Chap. II, section 6.

361. Article 1133 authorizes the arbitration tribunals, without prejudice for the comparable provisions of the applicable arbitration rules, upon request of a party or at its own initiative, if the parties do not object, to seek the opinion of experts on questions of facts in environment, health, security or other scientific matters. It is not clear what addition, if any, Article 1133 makes to rules and practice concerning recourse to experts in international commercial arbitration (cfr. Art. 27 of UNCITRAL Rules). In any case Article 1133 is not as open as Article 13 of the WTO Understanding on Settlement of Disputes, according to which panels have the right to seek information and technical advice from any individual or body as they deem appropriate, possibly also on questions of law.

As to the effect of an award, this is binding for the parties only and is limited to the case at issue. The decision must rest on the NAFTA Treaty and international law (Art. 1131 (1)). Any award may be enforced only after a given time period after it has been rendered, provided that revision or annulment procedures available under the specific procedure have not been resorted to or have been concluded.

Member States must ensure the execution of the awards in their territories; should this not be the case, a panel to solve the ensuing interstate dispute may be established in accordance with Chapter 20[362]. Investors may also request enforcement of the award in accordance with the ICSID Convention or the New York Convention or the Inter-American Convention on International Commercial Arbitration, whichever is applicable, the award being conclusively considered commercial for this purpose (Arts. 1136 (6), (7)).

Protection of foreign (NAFTA) investors in contentious proceedings has thus been referred to existing procedural devices, either specialized in investments matters or generally provided for international commercial disputes. Any review of such decisions can be sought within the limits in which such remedies are provided, either under the ICSID Convention or within international commercial arbitration.

Though awards are binding and final according to the rules governing the applicable procedure, it is interesting to note that the NAFTA Treaty bars their immediate enforcement. In order to facilitate spontaneous carrying out or negotiations to this effect a delay of three or four months is mandated by Article 1135.

362. This panel is not an appellate body but is called upon to pass upon the non-execution of the first panel's decision. It might conceivably be faced by a defence based on the first panel's decision being void or in violation of applicable rules. The subject matter of the dispute would entail issues such as those passed upon by the International Court of Justice in the cases: *Honduras* v. *Nicaragua* (Arbitral Award made by the King of Spain of 23.12.1906, *ICJ Reports 1960*, 192, at 214) and *Guinea-Bissau* v. *Senegal* (Arbitral Award of 31.7.1989, *ICJ Reports 1991*, 53 *et seq.*, in particular paragraphs 24-25).

See generally G. Sacerdoti, "Appeal and Judicial Review in International Arbitration and Adjudication: The Case of the W.T.O. Appellate Review", E.-U. Petersmann (ed.), *International Trade Law and the GATT/WTO Dispute Settlement System*, 1997, 247 *et seq.* Under Chapter 20, interstate disputes are submitted to an *ad hoc* panel which does not pronounce binding decisions but issues reports. Upon receipt the parties shall agree on the resolution of the disputes, which "normally" will conform with the panel's determination and recommendations.

(c) *The Energy Charter Treaty*

Under Article 26 of the Energy Charter Treaty, in case of investment disputes (which must concern an alleged breach of an obligation of one contracting party under Part III of the Treaty) investors, and only investors, may choose to submit such disputes either to national courts of the contracting party to the dispute, or to a previously agreed dispute settlement procedure, or to arbitration under ICSID, UNCITRAL or Stockholm Chamber of Commerce arbitration rules. Submission to either of these arbitration is admissible without the need for a prior arbitral agreement[363].

According to Article 26 (6) those arbitral tribunals "shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law".

It is indeed clear from Article 26 that only disputes of an international character would be subject to the settlement mechanism provided in the Treaty.

As to disputes concerning the application or interpretation of the Treaty which may arise between contracting parties, Article 27 provides that, if not amicably settled, such disputes may be submitted to an *ad ho*c tribunal constituted according to Article 27 (3)[364].

(d) *The Mercosur Protocols*

Article 9 of the Mercosur Protocol on reciprocal promotion and protection of investments of 1994 provides that disputes between an investor national of one contracting party and another contracting

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363. According to Article 26 (3) *(a)*, "each Contracting Party hereby gives its unconditional consent to the submission of a dispute to international arbitration . . . in accordance with the provisions of this Article". However, there are some limitations: under Article 26 (3) *(c)*, countries can opt out of the mandatory investment arbitration for "sanctity of contract" disputes — presumably mainly mineral concessions. It is not surprising that Norway, Canada and Australia have exercised this opt-out as listed in Annex IA. Annex ID countries — seventeen are named in the Annex — will not allow an investor having embarked on contractually provided arbitration or litigation with national courts to switch to Article 26 (4) investment arbitration. See T. W. Wälde, "International Investment under the 1994 Energy Charter Treaty", *J. World Trade*, 1995, 5, 56 *et seq.* Article 26 (4) provides that any investor who chooses to submit a dispute to international arbitration "shall further provide its consent in writing".

364. According to Article 27 (3) *(f)*, "in the absence of an agreement to the contrary between the Contracting Parties, the Arbitration Rules of UNCITRAL shall govern, except to the extent modified by the Contracting Parties, parties to the dispute or by the arbitrators".

party, if not amicably settled, may be submitted by the investor to national tribunals of the contracting party where the investment has been made, or to an international arbitration, or to the permanent mechanism of dispute settlement which may be created under the Treaty of Asunción establishing Mercosur.

Paragraph 4 of Article 9 specifies that in case the investor chooses international arbitration the dispute may be submitted to ICSID — when each contracting State of the Protocol has become member of the Washington Convention, unless reference is made to the ICSID Additional Facility — or to an *ad hoc* arbitral tribunal constituted according to the UNCITRAL rules[365].

According to Article 8 disputes which may arise between contracting States relating to the interpretation and the application of the Protocol shall be submitted to mechanisms of dispute settlement created under the Brasilia Protocol of 1991 or to the mechanism which may be established in the future under the Treaty of Asunción.

Article 2 (H) of the Mercosur Protocol on promotion and protection of investments from non-member States of 1994 provides that disputes between an investor national of a non-member State of Mercosur and a member State (of Mercosur), relating to the interpretation and application of a BIT (concluded between such two States), if not amicably settled, may be submitted by the investor to the national tribunals of the host State, or to international arbitration, which may be an *ad hoc* arbitral tribunal, or to "an international arbitral institution". In either case, the international arbitration tribunal shall apply provisions of the BIT in question, the law of the contracting party in dispute (included its conflict of laws provisions), any particular agreement relating to the investment and any relevant principle of international law. This provision is peculiar because it purports to lay down common disputes settlement rules for investment disputes which may already be covered by procedural provisions (besides substantive rules) agreed with a third State, namely the home State of the non-Mercosur investor. This provision and this Protocol in general appear to be especially relevant where they provide for substantive standards and advanced consent to arbitration

365. In this case Article 9 (4) *(b)* specifies that the arbitral tribunal shall decide, in the light of the Protocol, the law of the contracting party in dispute (included its conflict of laws provisions), any particular agreement relating to the investment and any relevant principle of international law.

with reference to third States investors which are not protected by a BIT, or where the Protocol is more favourable [366].

Article 2 (G) provides that disputes which may arise between a State member of Mercosur and a non-member State concerning the interpretation and application of "any agreement they shall conclude", if not diplomatically settled, shall be submitted to an international arbitration. Nothing is provided as to the establishment of such an arbitration, nor it is clear to which agreement the Protocol refers [367].

5. *Interstate Dispute Settlement in BITs*

Settlement of disputes concerning foreign investments is a matter specifically addressed by BITs in order to avoid legal insecurity and political conflicts and with a view to providing for a predetermined forum for the direct application of the treaty in case of disputes, so as to promote a general favourable climate for covered investments.

BITs generally provide for two different types of dispute settlement procedures: for interstate disputes (i.e., disputes between contracting parties concerning the interpretation or the application of the BIT) and for host State-foreign investor disputes [368].

As to both types of disputes BITs prescribe first of all that the parties shall initially try to settle the matter between them amicably, before instituting formal proceedings, but analogies cease here.

State to State disputes are almost invariably subject to binding *ad hoc* arbitration, according to standard clauses generally used in this respect.

366. The Protocol may be viewed as a treaty in favour of third States, governed by Articles 36 and 37 of the Vienna Convention on the Law of Treaties of 1969, at least where it grants rights to third States and not just to third States' investors.

367. The Spanish text of Article 2 (G) reads as follows:

> "1. Las controversias que surgieren entre un Estado Parte y el Tercer Estado a la interpretación del convenio que celebren serán, en lo posible, soluciónadas por la via diplomática;
> 2. Si dicha controversia no pudiera ser dirimida de esa manera en un plazo prudencial a determinar, será sometida al arbitraje internacional."

368. However, the BIT between Thailand and Bangladesh of 1988 does not provide for any particular dispute settlement mechanism for investment disputes between one contracting party and an investor national of the other contracting party. Its Article 10 only provides for solution of disputes between the contracting States concerning the interpretation and application of the BIT.

The procedure can be initiated by either contracting party, if an amicably settlement by diplomatic channels has not been reached[369].

These clauses are very similar, "but there are hardly any two of them which are identical"[370]. The similarity is without exceptions as to the eligible disputes: BITs invariably refer to disputes or divergencies concerning the "interpretation and/or application" of the treaty generally.

However, several basic features differ, in respect of various typical elements of the relevant clause. These include the appointment of arbitrators; the procedural applicable rules; the law applicable to the merits; the time factor (i.e., the period of time within which the arbitral tribunal must be constituted and the decision must be rendered); the apportionment of costs and finally the relation between interstate and host State-foreign investor arbitration.

(a) *The appointment of arbitrators*

The arbitral tribunal is always composed of three arbitrators, in accordance with the prevailing model of international *ad hoc* arbitration between States.

Two members of the arbitral tribunal are chosen by the parties, each of them appointing one arbitrator[371]. These party-appointed arbitrators then appoint the third one, who acts as chairman.

The relevant clauses provide that the third arbitrator must be a national of a third State. A few BITs also specify that the third State shall be a State "which maintains diplomatic relations with both Contracting Parties"[372].

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369. Some BITs indicate a time-limit for reaching an amicable solution as a bar to the initiation of arbitration. See for instance six months in Sweden-Poland (1989), Art. 7 (2); Norway-Hungary (1991), Art. X (2); United Kingdom-India (1994), Art. 10 (2).

Some BITs include a separate provision on consultations also in order to review implementation of the Treaty. These clauses are particularly developed in some Chinese BITs: see for instance China-Viet Nam (1992), Art. 11. On the other hand, Israel's BITs refer the diplomatic negotiations to a bilateral commission composed of representatives of both contracting parties to be formed for this purpose. See Israel-Estonia (1994), Art. 9 (1); Israel-Ukraine (1994), Art. 9 (1); Israel-Turkey (1996), Art. 9 (1).

370. See P. Peters, "Dispute Settlement Arrangements in Investment Treaties", in *Nether. Year. Int'l L.*, 1991, 102.

371. Specifically as to the impartiality of the parties' appointed arbitrators in the disputes at issue see Peters, *op. cit.*, 107 *et seq.*

372. See Sweden-Poland (1989), Art. 7 (3); Australia-Viet Nam (1991), Annex A, Art. 1 *(b)*; China-Slovenia (1993), Art. 7 (3); China-Uruguay (1993), Art. 8 (3).

Should the two arbitrators be unable to reach an agreement on the third arbitrator in a given time BITs entrust this task to an impartial appointing authority. The same mechanism applies in case one contracting party does not appoint "its" arbitrator, in order to avoid that the constitution of the arbitral tribunal be delayed or hindered by such a contracting party, once the other one has submitted its request.

Recent BITs are consistent in relying on authorities such as the President of the ICJ[373], the Chairman of the ICC[374], the Secretary-General of the Permanent Court of Arbitration[375] or the Secretary-General of the United Nations[376], who may be approached to this end by either party.

Netherlands-Lithuania (1994), Article 13, may be mentioned as a particularly detailed example. Paragraph 2 provides that

> "if one of the Contracting Parties fails to appoint its arbitrator and has not proceeded to do so within two months after an invitation from the other Contracting Party to make such an appointment, the latter Contracting Party may invite the President of the International Court of Justice to make the necessary appointment".

Paragraph 3 provides that:

> "if the two arbitrators are unable to reach agreement, in the two months following their appointment, on the choice of the third arbitrator, either Contracting Party may invite the President of

373. See China-Japan (1988), Art. 13 (3); Germany-Poland (1989), Art. 10 (4); Sweden-Poland (1989), Art. 7 (4); Switzerland-Poland (1989), Art. 10 (3), (4); Canada-Poland (1990), Art. XI (4); Australia-Viet Nam (1991), Annex A, Art. 3; Switzerland-Peru (1991), Art. 10 (3) (4); Netherlands-Poland (1992), Art. 12 (4); Argentina-Venezuela (1993), Art. 10 (4); Bolivia-Peru (1993), Art. 12 (4); Czech Republic-Hungary (1993), Art. 9 (4); China-Slovenia (1993), Art. 7 (4); China-Uruguay (1993), Art. 8 (4); United Kingdom-Honduras (1993), Art. 9 (4); United Arab Emirates-Poland (1993), Art. 10 (4); Germany-Barbados (1994), Art. 10 (4); United Kingdom-India (1994), Art. 10 (4); Canada-Trinidad and Tobago (1995), Art. XV (4); Colombia-Spain (1995), Art. X (4); Norway-Peru (1995), Art. 10 (2); Italy-Brazil (1995), Art. IX (4); United Kingdom-Turkmenistan (1995), Art. 9 (4); Italy-Russia (1996), Art. 10 (4).

374. See Israel-Estonia (1994), Art. 9 (4); Israel-Ukraine (1994), Art. 9 (4).

375. See United States-Argentina (1991), Art. VIII (2); United States-Russia (1992), Art. VII (2); Italy-Cuba (1993), Art. 10 (4); Israel-India (1996), Art. 10 (4); Israel-Turkey (1996), Art. 9 (4).

376. See France-Mongolia (1991), Art. 11 (4); Argentina-Egypt (1992), Art. IX (4); France-Viet Nam (1992), Art. 11 (4).

the International Court of Justice to make the necessary appointment".

United States-Nicaragua (1995), Article X (2), does not directly regulate the matter; it provides instead that

> "The UNCITRAL Arbitration Rules applicable to appointing members of three member panels shall apply *mutatis mutandis* to the appointment of the arbitral panel except that the appointing authority referenced in those rules shall be the Secretary General of the Centre."

(b) *The procedural rules*

Most BITs clauses are rather vague on this point. They just specify that "the arbitration tribunal shall reach its decision by a majority of votes, the decision being final and binding on the Contracting Parties" and that "the procedure of the arbitration tribunal shall be determined by the tribunal itself" [377].

United States BITs are an exception in this respect since they provide that "in the absence of an agreement by the Parties to the contrary, the arbitration rules of the UNCITRAL, except to the extent modified by the Parties or by the arbitrators, shall govern" [378].

An elaborate clause is found in the BIT between Israel and Turkey of 1996. Article 9 (6) provides that

> "the tribunal shall have three months from the date of the selection of the chairman to agree upon rules of procedure, consistent with the other provisions of this Agreement. In the absence

377. See China-Japan (1988), Art. 13 (4), (5); Thailand-Bangladesh (1988), Art. 10 (5) *(a)*, *(c)*; Sweden-Poland (1989), Art. 7 (6); Switzerland-Poland (1989), Art. 10 (6), (7); France-Mongolia (1991), Art. 11 (5); Argentina-Egypt (1992), Art. IX (5), (6); France-Viet Nam (1992), Art. 11 (5); Netherlands-Poland (1992), Art. 12 (7), (8); Argentina-Venezuela (1993), Art. 10 (5); Czech Republic-Hungary (1993), Art. 9 (5); China-Slovenia (1993), Art. 7 (5), (6); China-Uruguay (1993), Art. 8 (5), (6); Italy-Cuba (1993), Art. 10 (5); Germany-Barbados (1994), Art. 10 (5); Israel-Estonia (1994), Art. 9 (5); Israel-Ukraine (1994), Art. 9 (5); Netherlands-Lithuania (1994), Art. 13 (6), (7); United Kingdom-India (1994), Art. 10 (5); Canada-Trinidad and Tobago (1995), Art. XV (5); Colombia-Spain (1995), Art. X (7), (8); Norway-Peru (1995), Art. 10 (5); Italy-Brazil (1995), Art. IX (5); Israel-Turkey (1996), Art. 9 (7); Italy-Russia (1996), Art. 10 (5).

378. See United States-Argentina (1991), Art. VIII (1); United States-Russia (1992), Art. VII (1); United States-Nicaragua (1995), Art. X (1).

> of such agreement, the tribunal shall request the Secretary-General of the Permanent Court of Arbitration to designate rules of procedure taking into account generally recognized rules of international arbitral procedure."

(c) *The law applicable to the merits*

The law applicable to the merits of an interstate dispute is basically public international law.

United States BITs follow this rule by referring to "applicable rules of international law" [379]. Chinese BITs state that "the tribunal shall reach its award in accordance with the provisions of this Agreement and the rules of international law generally recognized" [380]. Dutch BITs follow a different pattern, in providing that

> "the tribunal shall decide on the basis of respect for the law. Before the tribunal decides, it may at any stage of the proceedings propose to the Contracting Parties that the dispute be settled amicably. The foregoing provisions shall not prejudice the power of the tribunal to decide the dispute *ex aequo et bono* if the Contracting Parties so agree." [381]

Australia-Viet Nam (1991), Annex A, Article 7, may be mentioned as a compromise between those two approaches. According to it:

> "before the Arbitral Tribunal makes a decision, it may at any stage of the proceedings propose to the Contracting Parties that the dispute be settled amicably. The Arbitral Tribunal shall

379. See United States-Argentina (1991), Art. VIII (1). See also United States-Russia (1992), Art. VII (1); United States-Nicaragua (1995), Art. X (1).

380. See China-Uruguay (1993), Art. 8 (5). China-Slovenia (1993), Article 7 (5), refers to "the provisions of this Agreement and the principles of international law recognized by both Contracting States". See also Norway-Peru (1995), Article 10 (4), which provides that "the arbitral tribunal reaches its decision on the basis of the provisions of this Agreement and of the general principles and rules of international law".

381. See Netherlands-Lithuania (1994), Art. 13 (5). Netherlands-Poland (1992), Article 12 (6), also provides that "the tribunal shall decide on the basis of respect for the law", but it further specifies ". . . including particularly this Agreement and other relevant agreements existing between the two Contracting Parties and the universally acknowledged rules and principles of international law". On international arbitral decisions *"ex aequo et bono"* see G. Broggini, "L'equità nell'arbitrato commerciale internazionale", *Scritti Mengoni*, 1995, II, 1385 *et seq.*; C. Schreuer, "Decisions Ex Aequo et Bono under the ICSID Convention", *ICSID Rev.*, 1996, 37 *et seq.*

reach its award by majority vote taking into account the provisions of this Agreement, the international agreements both Contracting Parties have concluded and the generally recognized principles of international law." [382]

(d) *The time factor*

The settlement of an international dispute may take a considerable time because of procedural requirements and may be subject to delays due to the tactics of an unwilling defendant. In order to avoid these shortcomings some BITs set a limited period of time within which the parties should make the appointment of the two arbitrators and the latter should appoint the third one.

According to Italy-Cuba (1993), Article 10 (3), for instance, each party shall appoint one member of the arbitral tribunal within two months from the date of the request of arbitration. Then, those two arbitrators shall appoint the chairman of the tribunal within three months [383].

United States BITs provide for the time within which the arbitration tribunal should make its decision. However, this time-limit should be considered as simple guidance to the tribunal, since, "there is no way in practice whereby the claimant party could enforce it", given the silence of such BITs on this point [384]. These BITs state that

382. See also Australia-Romania (1993), Annex A, Art. 7; Colombia-Spain (1995), Art. X (6).

383. See also Czech Republic-Hungary (1993), Art. 9 (3); Germany-Barbados (1994), Art. 10 (3); Italy-Brazil (1995), Art. IX (3); Italy-Russia (1996), Art. 10 (3). United Kingdom BITs provide that the chairman of the arbitral tribunal shall be appointed within two months from the date of appointment of the other two members. See, for instance, United Kingdom-Honduras (1993), Art. 9 (3); United Kingdom-India (1994), Art. 10 (3); United Kingdom-Turkmenistan (1995), Art. 9 (3). In this respect see also Israel-Ukraine (1994), Art. 9 (3); Israel-India (1996), Art. 10 (3); Israel-Turkey (1996), Art. 9 (3). China-Japan (1988), Article 13 (2), is even more restrictive since it provides that

> "each Contracting Party shall appoint one arbitrator within a period of sixty days from the date of receipt by either Contracting Party from the other Contracting Party of a note requesting arbitration of the dispute, and the third arbitrator to be agreed upon as the President by the two arbitrators so chosen within a further period of ninety days . . .".

384. See P. Peters, *op. cit.*, 116. On the other hand, as he points out, there is still not "a single case where the arbitration clause has ever been invoked by States which are parties to a BIT". This may be due to the preference shown by States for informal methods of dispute settlement, see P. Behrens, "Alternative Methods of Dispute Settlement in International Economic Relations", in E.-U. Petersmann, G. Jaenicke (eds.), *Adjudication of International Trade Disputes in International and National Economic Law*, 1992, 1 *et seq.*

> "unless otherwise agreed, all submissions shall be made and all hearings shall be completed within six months of the date of selection of the third arbitrator, and the Tribunal shall render its decisions within two months of the date of the final submissions or the date of the closing of the hearings, whichever is later" [385].

A similar provision is included in Canada-Trinidad and Tobago (1995), Article XV (5), which provides that "unless otherwise agreed, the decision of the arbitral panel shall be rendered within six months of the appointment of the Chairman . . . ". This BIT is peculiar in not declaring the decision (which is entrusted to a "panel" rather than to a tribunal) binding and final, but in allowing some flexibility to the parties as to its enforcement, following the GATT/WTO panel system model [386]. Article XV (6) provides that

> "the Contracting Parties shall, within sixty days of the decision of a panel, reach agreement on the manner in which to resolve their dispute. Such agreement shall normally implement the decision of the panel. If the Contracting Parties fail to reach agreement, the Contracting Party in whose favour the decision was made shall be entitled to compensation or to suspend benefits of equivalent value to those awarded by the panel."

(e) *The apportionment of costs*

Usually BITs deal with apportionment of costs by stating that they shall be borne in equal parts by each party [387]. However, a few BITs empower the arbitral tribunal to apportion them between the parties according to its discretion or appreciation.

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385. See United States-Argentina (1991), Art. VIII (3); United States-Russia (1992), Art. VII (3); United States-Nicaragua (1995), Art. X (3).

386. As to the GATT/WTO panel system see generally A. Ligustro, *Le controversie tra Stati nel diritto del commercio internazionale : dal GATT all'OMC*, 1996; E.-U. Petersmann (ed.), *International Trade Law and the GATT/WTO Dispute Settlement System*, 1997.

387. As to BITs which only state that costs shall be borne in equal parts by each party see China-Japan (1988), Art. 13 (6); United States-Argentina (1991), Art. VIII (4); Argentina-Egypt (1992), Art. IX (7); Netherlands-Poland (1992), Art. 12 (9); Bolivia-Peru (1993), Art. 12 (5); Czech Republic-Hungary (1993), Art. 9 (5); China-Slovenia (1993), Art. 7 (7); China-Uruguay (1993), Art. 8 (7); Italy-Cuba (1993), Art. 10 (5); United Arab Emirates-Poland (1993), Art. 10 (5); Israel-Estonia (1994), Art. 9 (5); Israel-Ukraine (1994), Art. 9 (5); Colombia-Spain (1995), Art. X (9); Italy-Brazil (1995), Art. IX (5); Norway-Peru (1995), Art. 10 (3); Israel-Turkey (1996), Art. 9 (7); Italy-Russia (1996), Art. 10 (5).

In this regard, a typical clause is that included in Sweden-Poland (1989), Article 7 (6), according to which

> "each Contracting Party shall bear the cost of the member appointed by that party as well as the costs of its representation in the arbitration proceedings; the cost of the Chairman as well as any other costs shall be borne in equal parts by the two Contracting Parties. The arbitration tribunal may, however, in its decision direct that a higher proportion of costs shall be borne by one of the Contracting Parties." [388]

(f) *The relation between interstate and host State-foreign investor arbitration*

A specific question addressed by a few BITs concerns the relation between interstate arbitration and host State-foreign investor arbitration. When ICSID arbitration is provided for the second type of disputes, Article 27 of the Convention [389] regulates the matter, by making ICSID arbitration exclusive. The home State cannot submit to arbitration a dispute pertaining to a specific right or treatment of one of its investors as long as the ICSID arbitration has not been completed, as well as, thereafter, except if the host State (party to the dispute) has not complied with the ICSID award.

388. See also Thailand-Bangladesh (1988), Art. 10 (5) *(b)*; Germany-Poland (1989), Art. 10 (5); Switzerland-Poland (1989), Art. 10 (8); Canada-Poland (1990), Art. XI (5); Australia-Viet Nam (1991), Annex A, Art. 8; France-Mongolia (1991), Art. 11 (5); France-Viet Nam (1992), Art. 11 (5); United States-Russia (1992), Art. VII (4); Argentina-Venezuela (1993), Art. 10 (5); Australia-Romania (1993), Annex A, Art. 8; United Kingdom-Honduras (1993), Art. 9 (5); Germany-Barbados (1994), Art. 10 (5); Netherlands-Lithuania (1994), Art. 13 (6); United Kingdom-India (1994), Art. 10 (5); Canada-Trinidad and Tobago (1995), Art. XV (6); United Kingdom-Turkmenistan (1995), Art. 9 (5); United States-Nicaragua (1995), Art. X (4).

389. Article 27 of the ICSID Convention runs as follows:

> "(1) No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.
>
> (2) Diplomatic protection, for the purposes of paragraph (1), shall not include informal diplomatic exchanges for the sole purpose of facilitating a settlement of the dispute."

Cf. A. Broches, "The Convention", *op. cit*., at 367.

Germany-Barbados (1994), Article 10 (6), is typical of the formulation of German BITs in this respect:

> "if both Contracting Parties are Contracting Parties to the Convention of 18 March 1965 on the Settlement of Investment Disputes between States and Nationals of Other States the arbitration tribunal provided for above may in consideration of the provisions of Article 27 (1) of the said Convention not be appealed to insofar as agreement has been reached between the national or company of one Contracting Party and the other Contracting Party under Article 25 of the said Convention. This shall not affect the possibility of appealing to such arbitration tribunal in the event that a decision of the Arbitration Tribunal established under the said Convention is not complied with (Article 27) or in the case of an assignment under a law or pursuant to a legal transaction as provided for in Article 6 of this Treaty." [390]

Article 27 of the ICSID Convention does not of course apply if this arbitration is not provided for in the BIT. In view of the specific function of the host State-foreign investor dispute settlement mechanism, that to provide a direct impartial third-party settlement procedure for the aggrieved investor, this mechanism should, in our opinion, prevail over the interstate arbitration when specific instances of treatment of an individual investor are at issue. This is indeed specified generally in many BITs when dealing with arbitration between the host State and a foreign investor [391].

On the other hand should the direct arbitration encounter difficulties the provision of interstate arbitration in BITs provides a guarantee "of last resort" for the protection of foreign investors which in the absence of a treaty has often been problematic.

6. Host State-Foreign Investor Dispute Settlement in BITs: Standard Patterns and Differences

The clauses providing for host State-foreign investor arbitration are among the fundamental and typical provisions of BITs. They innovate substantially in respect of classic international law in

390. See also Germany-Bolivia (1987), Art. 10 (6); Germany-Poland (1989), Art. 10 (6); Germany-Estonia (1992), Art. 10 (6).
391. See *infra*, section 5 *(h)* of this chapter.

affording private parties the right to pursue claims against a foreign State in direct arbitration under an international treaty by application both of domestic and international law.

By this type of arbitration the traditional requirements that local remedies be exhausted and that recourse be made to the home State diplomatic protection in order to expose internationally its national's claims are being eliminated[392].

However, not all BITs provisions for arbitration eliminate completely the otherwise natural competence of the domestic courts of the host State to decide investment disputes nor do they always relieve the investor from pursuing his case first before domestic courts. Some BITs require that the private investor does so first, though allowing recourse to arbitration whenever domestic courts have not decided the matter within a certain period[393]. Other (few)

392. Early bilateral treaties aimed *inter alia* at protecting foreign investments (i.e. the FCN Treaties) did not provide for any foreign investor-host State dispute settlement mechanisms. Such disputes could be brought to interstate adjudication mechanisms in accordance with the relevant treaty clause, requiring exhaustion of local remedies under general international law. Cf. see the *ELSI* case (*United States* v. *Italy*), *ICJ Reports 1989*, where the alleged non-exhaustion of local remedies was raised by Italy but was rejected by the Court. As to a BIT which expressly refers to the exhaustion of local remedies requirement see United Arab Emirates-Poland (1993), Art. 9 (2) *(c)*. In general, however, such a reference is quite uncommon in recent BITs.

393. See Italy-Argentina (1990), Article 8 (3), according to which any investment dispute, if not amicably settled, may be submitted to the competent tribunal of the contracting party where the investment has been made. However, if the dispute has not been decided after 18 months from the date on which it was submitted to the national competent tribunal, such a dispute may be submitted to international arbitration; Switzerland-Peru (1991), Article 9 (2), according to which if an amicable settlement of a dispute between one contracting party and an investor of the other contracting party is not possible, the dispute may be submitted to national tribunals of the contracting party where the investment has been made. However, if within 18 months the competent national tribunal does not make any judgment, or if, in case of a judgment, a party to the dispute deems that such a judgment violates a clause of the BIT, the dispute may be submitted to arbitration; Bolivia-Peru (1993), Article 11 (2), provides that a dispute between a contracting party and an investor national of the other contracting party relating to the investment, if not amicably settled, may be submitted on request of either party to the competent national tribunal of the contracting party where the investment has been made. However, paragraph 3 provides that such a dispute may be submitted to an international arbitration if either the national tribunal does not make a judgment within six months from the request *ex* paragraph 1 (or if the dispute continues although such a judgment has been made), or if both parties to the dispute agree in this respect; Israel-Turkey (1996), Article 8 (3), provides that the investor may submit the dispute to the ICSID if "a final judgment has not been rendered by the court of first instance within eight months". Some of these clauses appear confusing, see the critical remarks by P. Juillard with reference to France-Equador (1994), "Chronique de droit international économique — Investissements", *AFDI*, 1995, 608.

treaties allow arbitration only for disputes concerning the amount of compensation in case of expropriation [394].

Finally, many BITs provide for arbitration at the option of the foreign investor, who may instead pursue his case before the courts of the host State [395]. Arbitral mechanisms provided for in BITs vary. We may distinguish between those agreements which provide for just a single arbitral procedure and those which offer, usually to the private investor, an alternative between two or more procedures.

The first type of approach is that of the BITs providing only either for ICSID arbitration [396] or for one based on the UNCITRAL Rules [397], and of those agreements (not many among recent agreements) which organize an *ad hoc* arbitration for investor(s)-State disputes.

Agreements providing for a choice between different procedures include among them ICSID (sometimes also its Additional Facility), international commercial arbitration according to UNCITRAL [398] and/or ICC and/or certain named arbitral institutions rules.

394. This is especially the case of China's BITs, see *infra*, subsection *(c)*.

395. Article 8 of Italy-Algeria (1991) is peculiar in that the investor may choose between the host State's courts, ICSID (provided both contracting members are parties to it) and *an hoc* Tribunal established in accordance with Article 9 on interstate disputes. It is not clear how this procedure may be applied to a dispute involving a private party.

396. For an express reference only to ICSID see France-Mongolia (1991), Art. 8; Netherlands-Lithuania (1994), Art. 9; Israel-Estonia (1994), Art. 8; Israel-Ukraine (1994), Art. 8; Israel-Turkey (1996), Art. 8.

397. See Sweden-Poland (1989), Art. 8 (5); Canada-Poland (1990), Article IX (2), according to which if an amicable settlement has not occurred "within a period of six months from the date on which the dispute was initiated, it may be submitted by the investor to arbitration". Paragraph 3 specifies that "in that case, the dispute shall then be settled in conformity with the Arbitration Rules of the UNCITRAL, as then in force".

398. Among BITs referring to competent tribunals of the contracting State where the investment has been made — either as an alternative choice or as the first choice — or either to the UNCITRAL Rules or to the ICSID, in case both contracting parties have become members of the Convention, see Italy-Argentina (1990), Art. 8 (5); Switzerland-Peru (1991), Art. 9; Argentina-Egypt (1992), Art. X (3); Argentina-Venezuela (1993), Art. 11 (3) (which specifies that if within three months from the submission to arbitration the parties do not choose between an *ad hoc* arbitration under the UNCITRAL Rules and one according to the ICSID Convention, the dispute shall be submitted to the ICSID, or to its Additional Facility); Czech Republic-Hungary (1993), Art. 8 (2); Italy-Brazil (1995), Art. VIII (2), (4); Italy-Ukraine (1995), Art. 9 (3); Colombia-Spain (1995), Art. XI (2).

Instead, Norway-Peru (1995), Article 9, provides only for ICSID arbitration or an *ad hoc* arbitration under the UNCITRAL Rules. France-Viet Nam (1992), Article 8, provides for arbitration under the UNCITRAL Rules of 1976, to be replaced by ICSID arbitration when both contracting parties become parties to the Washington Convention.

In addition, some agreements even allow the parties to a dispute to select another procedure of their choice [399].

Although most recent BITs allow for the possibility of a choice by the claimant investor between different arbitral régimes, reference to ICSID arbitration tends nowadays to be in any case included, in view of wide membership of both home and host countries to the Convention. Some examples of clauses may illustrate the point.

According to Article IX (2) of the BIT between the United States and Nicaragua of 1995 :

> "A national or company that is a party to an investment dispute may submit the dispute for resolution under one of the following alternatives : *(a)* to the courts or administrative tribunals of the Party that is a party to the dispute ; or *(b)* in accordance with any applicable, previously agreed dispute-settlement procedures ; or *(c)* in accordance with the terms of paragraph 3."

Paragraph 3 *(a)* reads as follows :

> "Provided that the national or company concerned has not submitted the dispute for resolution under para. 2 *(a)* or *(b)*, and that three months have elapsed from the date on which the dispute arose, the national or company concerned may submit the dispute for settlement by binding arbitration : (i) to the Centre, if the Centre is available ; or (ii) to the Additional Facility of the Centre, if the Centre is not available ; or (iii) in accordance with the UNCITRAL Arbitration Rules ; or (iv) if agreed by both parties to the dispute, to any other arbitration institution or in accordance with any other arbitration rules." [400]

Article XIII (4) of the BIT between Canada and Trinidad and Tobago of 1995 provides that a dispute between one contracting party and an investor of the other contracting party, if not amicably settled, may be submitted by the investor to arbitration under the ICSID (provided that both contracting parties are members of the

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399. See Argentina-Venezuela (1993), Art. 11 (8). United Kingdom-India (1994), Article 9 (3) *(c)*, is peculiar in that it includes an *ad hoc* arbitral tribunal under the UNCITRAL Rules of 1976 as an alternative arbitration to which parties may refer if the dispute is not amicably settled, but it also provides that in respect of such arbitral proceedings special procedural rules shall apply, such as to the selection and the appointment of arbitrators and the apportionment of costs.

400. See also United States-Argentina (1991), Art. VII ; United States-Russia (1992), Art. VI (3) *(a)*.

ICSID), or under the Additional Facility Rules of ICSID, or to an *ad hoc* arbitration tribunal established under the UNCITRAL Rules. However, according to Article XIII (3) an investor may submit a dispute to arbitration

> "only if: *(a)* the investor has consented in writing thereto; *(b)* the investor has waived its right to initiate or continue any other proceedings in relation to the measure that is alleged to be in breach of this Agreement before the courts or tribunals of this Contracting Party concerned or in a dispute settlement procedure of any kind; *(c)* if the matter involves taxation, the conditions specified in para. 3 of Article XI have been fulfilled; and *(d)* not more than three years have elapsed from the date on which the investor first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor has incurred loss or damage".

Article 8 of the BIT between the United Kingdom and Turkmenistan of 1995 provides that an investment dispute, if not amicably settled, (1) "shall be submitted to international arbitration if the national or company concerned so wishes"; in this case the parties to the dispute (2)

> ". . . may agree to refer the dispute either to *(a)* the ICSID, or *(b)* the Court of Arbitration of the ICC, or *(c)* an international arbitrator or *ad hoc* arbitration tribunal to be appointed by a special agreement or established under the Arbitration Rules of the UNCITRAL".

It finally specifies that

> "if after a period of four months from written notification of the claim there is no agreement to one of the above alternative procedures, the dispute shall at the request in writing of the national or company concerned be submitted to arbitration under the UNCITRAL Rules as then in force"

and that "the parties to the dispute may agree in writing to modify these Rules" [401].

BITs provisions on settlement of investment disputes are, therefore, not at all uniform contrary to what may appear at a first glance.

401. See also United Kingdom-Honduras (1993), Art. 8.

Several basic features differ, in respect of various typical elements of the relevant clause. Not all clauses found in BITs in this respect appear as clear as one would wish. Their application in case of actual dispute may create doubts and prompt the raising of procedural and jurisdictional exceptions.

These include the minimum period of time that must elapse before a dispute may be submitted to arbitration; the question whether or not reference in a BIT to binding international arbitration instead of competent national tribunals of the contracting State party to the dispute may be qualified as an advance and definitive consent to resort to such means of settlement; the eligible disputes; the procedural applicable rules; the law applicable to the merits; the recognition and enforcement of awards; the effect of indemnification under investment insurance; the exercise of diplomatic protection; and, finally, the question of consent under the Article 25 (2) *(b)* of the ICSID Convention.

(a) *Eligible disputes*

The scope of BITs in this respect is to cover all disputes pertaining to investments as defined in the treaty. BITs tend to do so by the use of general clauses [402], although in some cases a detailed list is found of disputes which qualify for settlement by arbitration.

402. Italy-Argentina (1990), Article 8 (1), refers to any investment dispute (between one contracting party and an investor national of the other contracting party) concerning issues covered by the BIT. See also Argentina-Egypt (1992), Art. X (1); Argentina-Venezuela (1993), Art. 11 (1); United Kingdom-Honduras (1993), Art. 8 (1); United Kingdom-India (1994), Art. 9 (1); Colombia-Spain (1995), Art. XI (1); United Kingdom-Turkmenistan (1995), Art. 8 (1); Israel-India (1996), Art. 9 (1).

Israel-Ukraine (1994), Article 8 (1), refers instead to "any legal dispute concerning an investment of a national or company of one Contracting Party in the territory of the other Contracting Party". See also Sweden-Poland (1989), Art. 8 (1); Czech Republic-Hungary (1993), Art. 8 (1); Israel-Estonia (1994), Art. 8 (1); Israel-Ukraine (1994), Art. 8 (1); Netherlands-Lithuania (1994), Art. 9; Norway-Peru (1995), Art. 9 (1); Israel-Turkey (1996), Art. 8 (1). Italy-Ukraine (1995), Article 9 (1), and Italy-Russia (1996), Article 9 (1), refer to any dispute which may arise between a contracting party and an investor national of the other contracting party in relation to investments, including disputes relating to the amount of compensation.

Canada-Trinidad and Tobago (1995), Article XIII, is more precise in covering any

> "dispute between one Contracting Party and an investor of the other Contracting Party, relating to a claim by the investor that a measure taken or not taken by the former Contracting Party is in breach of this Agreement, and that the investor has incurred loss or damage by reason of, or arising out of, that breach".

United States-Argentina (1991), Article VII (1), specifies that

> "for purposes of this Treaty, an investment dispute is a dispute between a Party and a national or company of the other Party arising out of or relating to *(a)* an investment agreement between that Party and such national or company; *(b)* an investment authorisation granted by that Party's foreign investment authority (if any such authorisation exists) to such national or company; or *(c)* an alleged breach of any right conferred or created by this Treaty with respect to an investment" [403].

Netherlands-Poland (1992), Article 8 (1), refers instead to any dispute between one contracting party and an investor of the other contracting party relating to

> "the effects of a measure taken by the former Contracting Party with respect to the essential aspects pertaining to the conduct of business, such as the measures mentioned in Art. 5 [which refers to 'measures depriving, directly or indirectly, investors of the other Contracting Party of their investments'] or transfer of funds mentioned in Art. 4" [404].

Some BITs, notably those of China, admit arbitration only as to some types of disputes, basically those pertaining to the amount of compensation in case of expropriation. These BITs safeguard the competence of the courts of the host State to pass upon other disputes if the parties have not agreed otherwise by a specific agreement [405].

(b) *The time factor*

In BITs the minimum period of time that must elapse before a dispute may be submitted to arbitration ranges from three to eighteen months. During this minimum period the parties should attempt to settle amicably the dispute.

BITs tend not to be uniform as to the starting point for determining whether or not the minimum period of time has elapsed. Usually,

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403. See also Canada-Poland (1990), Art. IX (1); United States-Russia (1992), Art. VI (1); United States-Nicaragua (1995), Art. IX (1). Italy-Cuba (1993), Article 9 (1), refers instead only to disputes relating to capital investments.

404. See also Canada-Poland (1990), Art. IX (1).

405. See China-Japan (1988), Art. 11 (2); China-Slovenia (1993), Art. 8 (3); China-Uruguay (1993), Art. 9 (3).

the period is to be taken from the date of notification or from the date when the claimant requested amicable settlement. The consequences, if any, as to substance or procedure of submitting a claim before the deadline would depend on the text of the treaty and on the applicable procedural rules.

(c) *Consent of the contracting parties*

Not all BITs expressly address the question whether or not reference in a BIT to binding international arbitration may be qualified as an advance and definitive consent by the contracting States to resort to such a mean of settlement. Since arbitration is based on mutual agreement, it is important to determine whether the State has thereby expressed its consent to arbitration, which is then binding and non-revocable. The mutual agreement to resort to arbitration will result from the subsequent initiation of an arbitral proceeding by an investor, who is thus entitled to do so unilaterally.

Recent BITs follow the model just described, though using variable language.

Norway-Lithuania (1992), Article IX, for instance, runs as follows: ". . . if any dispute between an investor of one Contracting Party and the other Contracting Party continues to exist after a period of three months, the investor shall be entitled to submit the case" to the ICSID having regard to its applicable provisions. The entitlement of the investor means that the above provision implies the consent of the contracting party involved. In this respect, United Kingdom-Turkmenistan (1995), Article 8 (1), may also be quoted:

> ". . . disputes between a national or company of one Contracting Party and the other Contracting Party concerning an obligation of the latter under this agreement in relation to an investment of the former which have not been amicably settled shall, after a period of four months from written notification of a claim, be submitted to international arbitration if the national or company concerned so wishes".

Other BITs, however, do not leave the State's consent to be inferred in this way, but rather set it out expressly[406].

406. See Italy-Argentina (1990), Art. 8 (3); United States-Argentina (1991), Art VII (4); Netherlands-Nigeria (1992), Article 9, which reads as follows

In the past, instead, there were BITs that contained only a generic undertaking by the State to consider to submit to arbitration a future investment dispute[407].

The current approach to this issue conforms to the interpretation and application of Article 25 (1) of the ICSID Convention, under which consent to ICSID arbitration by a party may be expressed in treaties or investments laws, besides the possibility that it be contractually agreed with a foreign investor.

Finally, some BITs referring to ICSID specify that also the foreign investor must consent in writing to the arbitration[408].

(d) *Applicable law*

Some BITs include specific provisions on the law to be applied by the arbitral tribunal to the merits of the case.

Most of such BITs provide for the application of the law of the host country (including its conflict rules), the BIT's provisions and rules and/or principles of international law[409].

In addition, a few BITs also provide for the application of any

> "each Contracting Party hereby consents to submit any legal dispute arising between that Contracting Party and a national of the other Contracting Party concerning an investment of that national in the territory of the former Contracting Party to the ICSID for settlement by conciliation or arbitration under the Convention of 1965".

See also United States-Argentina (1991), Art. VII (4); United States-Russia (1992), Art. VI (3) *(b)*; Argentina-Venezuela (1993), Art. 11 (3) *(a)*; Germany-Barbados (1994), Art. 11 (4); Israel-Estonia (1994), Art. 8 (1); Israel-Ukraine (1994), Art. 8 (1); Netherlands-Lithuania (1994), Art. 9; United States-Nicaragua (1995), Art. IX (4); Canada-Trinidad and Tobago (1995), Art. XIII (5); Israel-Turkey (1996), Art. 8 (1).

407. See generally A. Broches, "Bilateral Investment Protection Treaties and Arbitration of Investment Disputes", in J. Schultsz and A. J. Van den Berg (eds.), *The Art of Arbitration, Essays on International Arbitration, Liber Amicorum Pieter Sanders*, 1982, 64 *et seq.*; M. Sornarajah, *The International Law on Foreign Investment*, 1994, 266 *et seq.*; P. Muchlinski, *Multinational Enterprises and the Law*, 1995, 633; R. Dolzer and M. Stevens, *Bilateral Investment Treaties*, 1995, 132 *et seq.*

408. See United States-Argentina (1991), Art. VII (4); United States-Russia (1992), Art. VI (3) *(a)*; United Kingdom-India (1994), Art. 9 (3) *(a)*; Israel-India (1996), Art. 9 (3) *(a)*. In the *AMT-Zaire* ICSID award, *cit.*, at 21, the tribunal held that the BIT clause providing for ICSID arbitration did not eliminate the need for the investor's consent. Consent was inferred from the initiation of the proceedings by AMT.

409. See China-Slovenia (1993), Art. 8 (7); China-Uruguay (1993), Art. 9 (8); United Arab Emirates-Poland (1993), Art. 9 (3) *(d)*; Canada-Trinidad and Tobago (1995), Art. XIII (7); Israel-India (1996), Art. 9 (3) *(b)* (ii).

investment contract and/or any treaty other than the BIT in force between the States concerned[410].

However, several if not most BITs are silent on applicable law. By referring to ICSID, ICC, UNCITRAL or other institutional arbitration mechanisms these agreements imply that the provisions of the ICSID Convention, the ICC or the UNCITRAL Arbitration Rules in this respect will apply.

While Article 42 (1) of the ICSID Convention indicates the rules applicable to the merits when the parties have not agreed on the matter, UNCITRAL and ICC rules only indicate how the tribunal is supposed to determine the applicable law, either by a direct evaluation of which is the proper law or by using a conflict of laws method[411].

BITs' clauses that direct the tribunal to apply both domestic and international law indicate (as can be inferred also for BITs which are silent in this respect) that the arbitral dispute settlement procedure is not only applicable to disputes concerning an alleged breach of international law (including the BITs' provisions) by the host State. Depending upon the language of the text as to the type of disputes covered, arbitration may be available for other disputes between the investor and the host State arising under its domestic law with respect to a covered investment. This approach has the advantage of avoiding splitting the competence as to investors-host States disputes between domestic courts and arbitration depending on the course of action. On the other hand the ensuing limitation to national courts' competence would be extended also to administrative disputes and to offers not involving the use of governmental authority, thus expanding considerably the purview of the special treaty-based dispute settlement régime.

(e) *Procedural applicable rules*

When the provision on arbitration refers to institutionalized arbitration based on a well-determined set of rules, such as those of

410. See Italy-Argentina (1990), Art. 8 (7); Australia-Viet Nam (1991), Annex, Art. 7; Switzerland-Peru (1991), Art. 9 (7); Argentina-Egypt (1992), Art. X (4); Argentina-Venezuela (1993), Art. 11 (4); Colombia-Spain (1995), Art. XI (3); Italy-Brazil (1995), Art. VIII (5); Italy-Russia (1996), Art. 9 (4).

411. See Article 13 (3) of the 1988 ICC Rules of Arbitration and Article 28 of the UNCITRAL Model Law on International Commercial Arbitration of 1985. See generally H. Grigera Naón, *Choice of Law Problems in International Commercial Arbitration*, 1992; I. Dore, *Arbitration and Conciliation under the UNCITRAL Rules*, 1996.

ICSID, UNCITRAL or ICC, there is no need to include in the treaty specific clauses in matter of procedure or concerning the effect of any award.

This is instead necessary when *ad hoc* arbitration is provided. In fact, BITs which rely on this type of procedure include specific provisions in matters such as the selection of arbitrators[412], the place of arbitration, time limits and apportionment of costs[413]. As appointing authorities the President of the ICJ[414], of the International Court of Arbitration of the ICC[415], of the Chamber of Commerce of Stok-

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412. See, for instance, China-Japan (1988), Art. 11 (3), (4); Sweden-Poland (1994), Art. 8 (3); China-Slovenia (1993), Art. 8 (4); China-Uruguay (1993), Art. 9 (5). Italy-Argentina (1990), Article 8 (5) *(b)*, provides that the investor party to the dispute may choose an *ad hoc* arbitration under the UNCITRAL Rules of 1976; the arbitrators shall be three and they shall, if not nationals of the contracting parties, be nationals of States which enjoy diplomatic relations with both contracting parties. In this respect see also Italy-Brazil (1995), Art. VIII (4) *(b)*.

United Kingdom-India (1994), Article 9 (3) *(c)* (ii), provides that

> "if necessary appointments are not made within the period specified in subpar. *(c)* (i) [within two months from the date when one of the parties to the dispute informs the other of its intention to submit the dispute to arbitrators within the period of six months within which parties may find an amicable settlement], either party may, in the absence of any other agreement, request the President of the ICJ to make the necessary appointment".

413. See China-Japan (1988), Art. 11 (7); China-Slovenia (1993), Art. 8 (8); China-Uruguay (1993), Art. 9 (9); United Arab Emirates-Poland (1993), Art. 9 (3) *(e)*; United Kingdom-India (1994), Art. 9 (3) *(c)* (vii).

414. See Sweden-Poland (1989), Art. 8 (4); United Kingdom-India (1994), Art. 9 (3) *(c)* (ii).

415. See Germany-Barbados (1994), Art. 11 (2). Article 11 (4), however, provides that

> "in the event both Contracting parties having become Contracting States of the ICSID Convention, divergencies under this Article between the parties in dispute shall be submitted for arbitration under the aforementioned Convention, unless the parties in dispute agree otherwise";

Italy-Brazil (1995), Art. VIII (4) *(b)*: if the two arbitrators appointed by the parties to the dispute do not appoint the chairman of the arbitral tribunal within 30 days from their appointment, the chairman shall be appointed by the President of the Arbitral Tribunal of the ICC.

See also Switzerland-Poland (1989), Article 9 (4), which provides that if parties in dispute do not appoint arbitrators within two months from the date either party requests arbitration and do not nominate the president within the two successive months, either party may request the President of the Arbitral Tribunal of the ICC to make such appointments. Article 9 (5) provides that in case the President of the Arbitral Tribunal of the ICC cannot make such appointments, Article 10 (5) on settlement of interstates disputes shall apply. According to the latter provision if the President of the ICJ does not appoint the arbitral tribunal, this task shall be carried out by the Vice-President. If he fails, or if he is a national of one of the contracting parties, appointments shall be made by the oldest member of the ICJ provided that he is not a national of one of the con-

holm[416], the Secretary-General of the Permanent Court of Arbitration[417], the Secretary-General of the ICSID[418] are variously mentioned. Many BITs provide that as to points not dealt with explicitly in the relevant clauses the arbitral tribunal shall determine its pro-

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tracting parties. Furthermore, Article 9 (8) provides that in case both contracting parties have become members of the ICSID Convention disputes between either contracting party and the investor of the other contracting party shall be submitted for settlement by conciliation or arbitration to the ICSID.

416. See Italy-Russia (1996), Art. 9 (3). Netherlands-Poland (1992), Article 8 (2), provides in this respect that if a dispute between one contracting party and an investor of the other contracting party "cannot be settled within six months from the date either party request amicable settlement, it shall upon request of the investor be submitted to an arbitral tribunal" (which should be established according to paragraphs 3-9 of Article 12 that relates to settlement of disputes between the two contracting parties, although here "the President of the Arbitration Institute of the Arbitral Tribunal of the Chamber of Commerce in Stockholm shall be invited to make the necessary appointments"). However, Article 8 (3) also provides that

> "in case both Contracting Parties have become members of the ICSID Convention, disputes between either Contracting Party and the investor of the other Contracting Party . . . shall be submitted for settlement by conciliation or arbitration to the ICSID".

As to Poland's BITs, see also United Arab Emirates-Poland (1993), Art. 9 (3) *(a)*; Germany-Poland (1989), Article 11 (4), according to which

> "unless otherwise agreed by the parties to the dispute, the provision of Art. 10 para. 3 to 5 [i.e. provisions on settlement of interstates disputes, which, in case the parties do not appoint the members of the arbitral tribunal within two months, and the chairman within three months, as of the date a Contracting Party has informed the other of its request to submit the dispute to an arbitral tribunal, provide that either Contracting Party may, in the absence of any other agreement, invite the President of the ICJ to make the necessary appointments] shall apply *mutatis mutandi* with the provision that the members of the arbitral tribunal shall be appointed by the parties in dispute and that, if the time limits provided for under Art. 10 (3) have not been complied with, each of the parties may, in the absence of other agreements, invite the chairman of the Institute of arbitration at the Stockholm Chamber of Commerce to make the necessary appointments".

417. See Italy-Cuba (1993), Art. 9 (2) *(b)*; Israel-India (1996), Article 9, provides that "any dispute between an investor of one Contracting Party and the other Contracting Party in relation to an investment of the former under this Agreement" may, if not amicably settled or if "referred to conciliation, conciliation proceedings are terminated other than by signing of a settlement agreement", be referred to Arbitration of ICSID (if the contracting parties are both parties to the Washington Convention and the investor consents in writing to submit the dispute to the ICSID), or "to an *ad hoc* arbitral tribunal by either party to the dispute". It is further provided that

> "if the necessary appointments are not made within two months from the date on which one of the parties to the dispute informed the other of its intention to submit the disputes to arbitration, either party may, in the absence of any other agreement, request the Secretary General of the Permanent Court of Arbitration to make the necessary appointments".

418. See China-Slovenia (1993), Art. 8 (4); China-Uruguay (1993), Art. 9 (5).

cedure, if the parties have not specifically provided. Some BITs even deal with interim measures in case of arbitration, an issue which is regulated differently in domestic laws on arbitration.

Thus, Article XIII (8) of the BIT between Canada and Trinidad and Tobago of 1995 provides that

> "A tribunal may order an interim measure of protection to preserve the rights of a disputing party, or to ensure that the tribunal's jurisdiction is made fully effective, including an order to preserve evidence in the possession or control of a disputing party or to protect the tribunal's jurisdiction. A tribunal may not order attachment or enjoin the application of the measure alleged to constitute a breach of this Agreement. For purposes of this paragraph, an order includes a recommendation."

Article IX (3) *(b)* of the 1995 BIT between the United States and Nicaragua follows a different approach. It provides that:

> "a national or company, notwithstanding that it may have submitted a dispute to binding arbitration . . ., may seek interim injunctive relief, not involving the payment of damages, before the judicial or administrative tribunals of the Party that is a party to the dispute, prior to the institution of the arbitral proceeding or during the proceeding, for the preservation of its rights and interests".

(f) *Recognition and enforcement of awards*

Although recognition and enforcement of arbitral awards rendered pursuant to BITs' provisions on settlement of investment disputes is regulated by international conventions applicable to them, such as the 1958 New York Convention and the ICSID Convention, and by domestic law, several BITs expressly include (additional) specific provisions in this respect.

They provide for instance that contracting States undertake to recognize and enforce such awards in their respective territories according to their domestic law[419]. In particular, United States BITs prescribe that "each Party shall carry out without delay the provisions

419. See Argentina-Venezuela (1993), Art. 11 (6); China-Slovenia (1993), Art. 8 (6); China-Uruguay (1993), Art. 9 (7); United Kingdom-India (1994), Art. 9 (3) *(c)* (v); Italy-Brazil (1995), Art. VIII (6).

of any such award and provide in its territory for the enforcement of such award" [420].

Some BITs specify that enforcement must be granted in accordance with the 1958 New York Convention [421].

Undertakings found in BITs as to this matter may be considered superfluous when the effect of a final award is already specified in the instrument dealing with the relevant procedure, such as the ICSID Convention and the New York Convention.

(g) *Effect of indemnity under investment insurance*

When an investor has been indemnified for the losses incurred because of an expropriation, war, revolution or insurrection and civil strife, the agency of the home country that has provided the indemnification is as a rule subrogated to his rights and BITs' clauses on subrogation recognize this transfer [422]. The agency is, therefore, entitled to make a claim against the host State in accordance with the dispute settlement procedure.

Some BITs specify, however, that the investor may pursue the claim, notwithstanding the indemnification. Some BITs aim at the same rule, dealing with the matter differently. They provide that the contracting party to a dispute submitted to arbitration shall abstain from counterclaiming that the investor party to the dispute has, partially or totally, been indemnified under an investment insurance mechanism [423].

420. See United States-Argentina (1991), Art. VII (6); Argentina-Egypt (1992), Art. X (5); United States-Russia (1992), Art. VI (3) *(e)*; Bolivia-Peru (1993), Art. 11 (5); Canada-Trinidad and Tobago (1995), Art. XIII (10); Spain-Colombia (1995), Art. XI (4); United States-Nicaragua (1995), Art. IX (6); Israel-Turkey (1996), Art. 8 (5); Israel-India (1996), Art. 9 (3) *(b)* (v) (which specifies that "the award shall be enforced in accordance with national laws of the Contracting Party where the investment has been made").

421. See Germany-Poland (1989), Art. 11 (4); United States-Argentina (1991), Art. VII (5); Canada-Trinidad and Tobago (1995), Art. XIII (6); Norway-Peru (1995), Art. 9 (3); United States-Nicaragua (1995), Art. IX (5).

422. See generally Chap. V, section 7.

423. See Germany-Poland (1989), Art. 11 (5); Switzerland-Poland (1989), Art. 9 (7); Italy-Argentina (1990), Art. 8 (6); Australia-Viet Nam (1991), Art. 12 (4); Switzerland-Peru (1991), Art. 9 (5); France-Mongolia (1991), Art. 9; United States-Argentina (1991), Art. VII (7); France-Viet Nam (1992), Art. 9; United States-Russia (1992), Art. VI (4); Australia-Romania (1993), Art. 9 (5); Italy-Cuba (1993), Art. 9 (3); United Arab Emirates-Poland (1993), Art. 9 (5); Germany-Barbados (1994), Art. 11 (3); Israel-Estonia (1994), Art. 8 (3); Israel-Ukraine (1994), Art. 8 (2); United States-Nicaragua (1995), Art. IX (7); Israel-Turkey (1996), Art. 8 (3); Israel-India (1996), Art. 9 (3) *(b)* (viii).

(h) *Exercise of diplomatic protection*

Article 27 of the ICSID Convention prohibits contracting States from giving diplomatic protection, or bringing an international claim,

> "in respect of a dispute which one of their nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under the Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute".

Although such a prohibition is automatically binding as a consequence of reference to the ICSID Convention, some BITs include a clause which, with slight differences, provides that the States concerned will abstain from pursuing through diplomatic channels or by bringing an international claim any dispute referred to an ICSID arbitration, unless the dispute is outside ICSID's jurisdiction or the host State fails to abide by or comply with the award [424].

Some clauses are not limited in their scope to ICSID arbitration. They lay down instead the general rule that the home State shall not bring an international claim in respect of the rights of one of its investors, including through the interstate arbitration provided in the BIT, when the dispute is subject to the direct host State-foreign investor settlement procedure of the BIT [425].

(i) *Consent under Article 25 (2)* (b) *of the ICSID Convention*

Article 25 (2) *(b)* of the ICSID Convention spells out that an investor can be a party in ICSID proceedings not only if it is

> "a juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on

424. Actually, some of these clauses use language different from that of Article 27 of the ICSID Convention, where they do not also prohibit the bringing of an international claim or use slightly different language. See Australia-Viet Nam (1991), Art. 12 (3) *(b)*; Australia-Romania (1993), Art. 9 (4) *(b)*; United Arab Emirates-Poland (1993), Art. 9 (6); Israel-Estonia (1994), Art. 8 (4) *(b)*; Israel-Ukraine (1994), Art. 8 (4) *(b)*; Israel-Turkey 1996, Art. 8 (4) *(b)*. See also Switzerland-Peru (1991), Art. 9 (6).

425. See Italy-Argentina (1990), Art. 8 (9); Argentina-Venezuela (1993), Art. 11 (7); Bolivia-Peru (1993), Art. 12 (6); Italy-Brazil (1995), Art. VIII (7); Italy-Ukraine (1995), Art. 9 (4).

> which the parties consented to submit such dispute to conciliation or arbitration",

but also if it is a

> "juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention" [426].

As to the second case, many BITs include a provision whereby each host State contracting party agrees to treat generally for this purpose as national of the other party local companies which are under the control of an investor having the nationality of such a party. This provision endows such companies with the status of a foreign investor of the other party for purpose of submitting a claim, regardless of the definition of foreign investments and investors in the article of the BIT generally dealing with this issue. In some BITs this expansive provision is not limited to ICSID proceedings [427].

A typical provision in this respect is Article IX (8) of the 1995 BIT between the United States and Nicaragua according to which

> "for purposes of Article 25 (2) *(b)* of the ICSID Convention and this Article, a company of a Party that, immediately before the occurrence of the event or events giving rise to an investment dispute, was a covered investment, shall be treated as a company of the other Party" [428].

Article 8 (2) of the 1994 BIT between Israel and Ukraine is even more precise:

> "a company which is incorporated or constituted under the law or legislation in force in the territory of one Contracting Party and in which, before such a dispute arises, the majority of shares are owned by investors of the other Contracting Party shall, in accordance with Article 25 (2) *(b)* of the ICSID Con-

426. See C. F. Amerasinghe, "Interpretation of Article 25 (2) *(b)* of the ICSID Convention", in R. Lillich and C. N. Brower (eds.), *International Arbitration in the Twenty-First Century*, 1994, 223 *et seq.*
427. See United States-Russia (1992), Protocol Article 7.
428. See also United States-Argentina (1991), Art. VII (8).

vention, be treated for the purposes of the Convention as a company of the other Contracting Party" [429].

The practical result of such a provision is that the protection of treaty rights can be claimed by the local subsidiary of the foreign investor, and not just by the latter, provided that rights pertaining to the subsidiary as a foreign investment are affected. Article 25 (2) *(b)* has a clear function to make recourse to ICSID possible by a foreign-owned company when arbitration has been contractually agreed or is available under statutory or treaty provisions. Reference to this provision does not add much however within a BIT. The foreign investor would be in any case entitled to invoke arbitration as provided in the treaty in order to protect its rights in respect to the treatment of its investment, which under BITs include as a rule the foreign company owned or controlled by it.

7. Conclusions

BITs clauses providing for direct international arbitration of disputes between a contracting party and an investor national of the other contracting party show that home and host States consider this mechanism as the most appropriate means of settlement of such disputes.

This indicates, in a way, that an equilibrium has been reached between the safeguard of national sovereignty and domestic jurisdiction of the host State on one hand, and the protection and flexibility advocated by business in the international market on the other hand in order to invest abroad.

Arbitration of a private law character, but guaranteed by an international procedure sanctioned by a treaty, corresponds, as to dispute settlement, to the régime applicable in the merits, i.e. domestic law safeguarded by treaty as to the respect of general and specific fair treatment principles.

This approach is reinforced by the fact that the vast majority of BITs do not require recourse to local remedies at all, or restrict it to a limited period after which the dispute may be submitted to arbitration. In BITs the non-applicability of one of the traditional rules of

429. See also Israel-Estonia (1994), Art. 8 (2); Netherlands-Lithuania (1994), Art. 9.

international disputes settlement when private interests are involved, i.e. the requirement of previous exhaustion of host State's local remedies, becomes the standard pattern as is the case in the ICSID Convention[430].

International arbitration of these disputes, especially in view of the systematic reference made to ICSID arbitration by recent BITs clauses and other instruments, may lead to the *de facto* establishment of an international "jurisdiction" for these disputes at ICSID. This would require participation by all major home and host countries and full coverage of all investment related disputes subject to BITs[431]. This has been envisaged within the MAI negotiations, but doubts have been raised whether displacing States' jurisdiction in favour of arbitration at the investor's option is really appropriate among industrialized countries.

Indeed most investments are made between developed countries. Since they do not enjoy the coverage of BITs, ensuing disputes are not amenable *"ex ante"* to direct arbitration. They are subject to normal State jurisdiction, as is open to national investors, except for special arbitration agreements and recourse to diplomatic protection. The lack of this international remedy does not seem to represent a shortcoming here. Providing for it generally, in the absence of a specific agreement, would represent a preference for foreign investors which is not easily justified in this context if it were applied generally[432].

On the other hand, one must stress that the number of arbitrations held under BITs and in accordance to their disputes settlement clauses has been irrelevant. Moreover, only in very few ICSID cases until now was jurisdiction based on a BIT clause[433].

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430. See P. Peters, *op. cit.*, 133 *et seq.*

431. Some disputes that may arise under a BIT, such as concerning the right of access (pre-investment dispute) may not be covered under ICSID, cf. the comments by A. Escobar, "Towards an Effective International Investment Régime ?", *ASIL Proceedings*, 1997, 485 *et seq.* at 490.

432. On the other hand interstate disputes concerning the agreed treatment of investors under WTO Agreements and specific liberalization undertakings (such as GATS and the undertakings as to financial services of 1997) are subject to the more stringent WTO dispute settlement system, on which see generally E.-U. Petersmann (ed.), *International Trade Law and the GATT/WTO Dispute Settlement System*, 1997.

433. See the ICSID awards in the case *AAPL* v. *Sri Lanka* of 27 June 1990 *ICSID Rev.*, 1991, 526 *et seq.* brought under the BIT between the United Kingdom and Sri Lanka of 1980, and in the case *AMT* v. *Zaire* of 21 February 1997 (*ICSID Rev.*, 1997, 1531 *et seq.*) brought under United States-Zaire BIT of 1984.

We venture the conclusion that major conflicts between host States and foreign investors tend to be rare, which may be attributable to various factors: respect of the law by the host State; preference for amicable settlement; recourse to local jurisdiction by the foreign investors instead of availing themselves of international arbitration.

On the other hand the recent increase of disputes which have been brought to ICSID[434] and the number and variety of States open lately to foreign investment and where such investments are indeed carried out confirm the opinion that the existence of a generally available framework such as ICSID represents a fundamental element of security for international investments.

434. In the period July 1996 to June 1997 six new cases were brought to ICSID arbitration, bringing the total number of cases registered to 44, and resulting in a record number of cases pending before the Centre. Four of these new cases have been brought to the Centre on the basis of provisions in treaties dealing with investments (two of them were brought to the Additional Facility under NAFTA, Canada and Mexico not being parties to the ICSID Convention), see ICSID, *1997 Annual Report*, at 4.

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