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INVESTOR-STATE DISPUTES AND THE DEVELOPMENT OF INTERNATIONAL LAW

THE INFLUENCE OF BILATERAL INVESTMENT TREATIES ON CUSTOMARY INTERNATIONAL LAW

*by Stephen M. Schwebel**

My simple thesis, which I hope that this sophisticated audience will not find simplistic, is this: Customary international law governing the treatment of foreign investment has been reshaped to embody the principles of law found in more than two thousand concordant bilateral investment treaties. With the conclusion of such a cascade of parallel treaties, the international community has vaulted over the traditional divide between capital-exporting and capital-importing states and fashioned an essentially unified law of foreign investment.

For some two hundred years, the international community was divided over what law governed the treatment of foreign investment and over the content of that law. In large and loose terms, capital-exporting countries maintained that international law, which indisputably related to the treatment of aliens, related to the treatment and taking of their property as well. The standard of that treatment could not lawfully fall below the minimum standard of international law. If the property of a foreigner was expropriated by a state, the expropriation was lawful only if it was for a public purpose, not discriminatory, and accompanied by the payment of prompt, adequate, and effective compensation.

Capital-importing countries tended to have another perspective. The foreign investor was governed by the law of the host state and the remedies afforded by that law alone; he was entitled to no more than national treatment, the treatment accorded by the host state to the investments of its own nationals.

This fundamental doctrinal division, illustrated by the Calvo Clause, the Russian Revolution, and the famous exchanges between Cordell Hull and the Mexican Foreign Minister over Mexican oil expropriations, was carried into the post–World War II world—so much so that when the Supreme Court of the United States in the *Sabbatino* case in 1964 invoked the act of state doctrine to decline to pass upon Cuban expropriation of American property, it stated that:

> There are few if any issues in international law today on which opinion seems to be so divided as the limitations on a state's power to expropriate the property of aliens. . . . The disagreement as to relevant international law standards reflects an even more basic divergence between the national interests of capital importing and capital exporting nations and between the social ideologies of those countries that favor state control of a considerable portion of the means of production and those that adhere to a free enterprise system.[1]

Attempts to restate or rework the law for the most part correspondingly divided the United Nations. While Resolution 1803 (XVII) of the General Assembly on Permanent Sovereignty over Natural Resources in 1962 brought together a large majority of the organization in recognition of the place of international law in the treatment of foreign investment, subsequent resolutions asserted the dominance, indeed the exclusivity, of national law. So did General Assembly resolutions on the New International Economic Order and the Charter of Economic Rights and Duties of States. The latter resolution of December 12, 1974, provides that:

> Every State has and shall freely exercise full permanent sovereignty, including possession, use and disposal, over all its wealth, natural resources and economic activities.

* Former President, International Court of Justice, The Hague. Arbitrator, Counselor, Washington, DC.

[1] Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 428–30 (1964).

Each State has the right:. . .

> . . . to nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals.[2]

Thus that charter excluded international law and directed that national law be taken into account. Major capital-exporting states voted against it. As a General Assembly resolution not adopted as declaratory of international law, which plainly was not declaratory of international law, and terms of which were vigorously contested, the charter could neither make nor reflect international law. Nevertheless, it demonstrated that the majority of the states of the international community were not, collectively, then prepared to sustain the more traditional rules of international law respecting the treatment and taking of foreign property. The numerical majority did not equate with economic power. It evidenced bloc voting rather than sovereign decision making. But it was sufficient to raise a question: If the UN General Assembly cannot make international law, can it unmake it?

The Charter of Economic Rights and Duties was the high water mark of disregard, if not denigration, of the international law relating to foreign investment. At the time, much was made of it and of the so-called New International Economic Order; for years, the latter was invoked unendingly in UN resolution after resolution. But today one hardly hears of either; relatively little of them seems to be said in the rhetoric of United Nations debate, and my impression is that virtually nothing is said in exchanges between states, in the negotiation of treaties of related subject matter, and in judgments of international courts and arbitral tribunals.

For not long after 1974, the tide turned. Universal, multilateral agreement, expressed in a single international instrument, on which law governs foreign investment and on the content of that law remained unachievable, not only in the United Nations, but through the Organisation for Economic Cooperation and Development. What is remarkable is that, in the last quarter century, more than 2000 bilateral investment treaties (BITs) have been concluded.

These BITs were initially negotiated with developing countries by European states like Germany, Switzerland, the United Kingdom and the Netherlands, and later by the United States and Japan. Today, they are found not only between north and south but with and between states of the former second and third worlds. The extent of participation in them is extraordinary, as are their provisions.

BITs specify in terms more explicit, detailed, and far-reaching than was ever advanced under what was customary international law in the time of Cordell Hull what may be described as an ideal law of international investment. They reflect the fact that states round the world seek to attract rather than to repel foreign investment.

By the terms of these treaties, foreign investment is assured of fair and equitable treatment and full security and protection, as well as no less than national and most-favored–nation treatment. Foreign investment is assured of management authority and control. The terms of contracts governing the investment are to be respected. If there is a taking by the state of foreign investment, direct or indirect, it must pay prompt, adequate, and effective compensation reflecting the full market value of the investment before the taking. If there is a dispute, the investor is authorized to pursue a direct, binding international arbitral remedy against the host government. Diplomatic interposition is not debarred by the Calvo Clause; it is displaced by affording the foreign investor standing to invoke an international arbitral remedy without the

[2] United Nations General Assembly Resolution 3281 (XXIX) of December 12, 1974, Article 2.

uncertain and sometimes politicized espousal of his own government. A few multilateral treaties of regional reach, like the European Energy Charter and the North American Free Trade Agreement, contain comparable provisions.

As it was articulated in an international arbitral award of March 13, 2003:

> The requirement of compensation to be "just" and representative of the "genuine value of the investment affected" evokes the famous Hull Formula, which provided for the payment of prompt, adequate and effective compensation for the taking of foreign owned property. That formula was controversial. Capital exporting countries viewed it as an expression of customary international law. Developing countries and the Communist States maintained that the foreign investor was entitled to no more compensation than provided by the law of the host government however and whenever amended and applied. The controversy came to a head with the adoption by the General Assembly of the United Nations of the "Charter of Economic Rights and Duties of States." The major capital exporting States voted against the Charter. But in the end, the international community put aside this controversy, surmounting it by the conclusion of more than 2,200 bilateral (and a few multilateral) investment treaties. Today these treaties are truly universal in their reach and essential provisions. They concordantly provide for payment of "just compensation," representing the "genuine" or "fair market" value of the property taken. . . .
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> The possibility of payment of compensation determined by the law of the host State or by the circumstances of the host State has disappeared from contemporary international law as it is expressed in investment treaties in such extraordinary numbers, and with such concordant provisions, as to have reshaped the body of customary international law itself.[3]

This award went on to quote the NAFTA Award of October 11, 2002, in *Mondev International v. United States of America:*

> [T]he vast number of bilateral and regional investment treaties (more than 2000) almost uniformly provide for fair and equitable treatment of foreign investments, and largely provide for full security and protection of investments. Investment treaties run between North and South, and East and West, and between States in these spheres inter se. On a remarkably widespread basis, States have repeatedly obliged themselves to accord foreign investment such treatment. In the Tribunal's view, such a body of concordant practice will necessarily have influenced the content of rules governing the treatment of foreign investment in current international law.[4]

The process by which provisions of treaties binding only the parties to those treaties may seep into general international law and thus bind the international community as a whole is subtle and elusive. It is nevertheless a real process known to international law. As the UN International Law Commission put it:

> An international convention admittedly establishes rules binding the contracting States only, and based on reciprocity; but it must be remembered that these rules become generalized through the conclusion of other similar conventions containing identical or similar provisions.[5]

It is submitted that this is a process of which more than 2,000 BITs are the contemporary exemplar.

The result is that, when BITs prescribe treating the foreign investor in accordance with customary international law, they should be understood to mean the standard of international law

[3] CME Czech Republic B.V. v. Czech Republic, Final Award of March 14, 2003, paras. 497–98.

[4] Mondev International Ltd. v. United States of America, ICSID Case No. ARB(AF) 99/2, para. 117 (Oct. 11, 2002).

[5] Report of the International Law Commission covering the work of its twelfth session, 2 YEARBOOK OF THE INTERNATIONAL LAW COMMISSION 145, UN Doc. A/4425 (1960). "Bilateral consular treaties have exercised a most important influence on the development of customary international law on consuls, now codified in the Vienna Convention on Consular Relations." (R.R. Baxter, *Treaties and Custom*, 129 RECUEIL DES COURS 1970 (I) 25, 87.)

embodied in the terms of some two thousand concordant BITs. The minimum standard of international law is the contemporary standard.

At the same time, BITs, and the European Energy Charter and NAFTA, not only prescribe concordant principles for the treatment of foreign investment but also authorize the individual or corporate foreign investor to maintain direct arbitral suit against the host state in pursuance of those principles. In view of the treaty-specific nature of grants of international jurisdiction, and the presumption that states are not amenable to international adjudication unless they consent to it, it would not be tenable to suggest that BIT provisions that afford arbitral recourse have themselves found their way into the body of customary international law.

All this said, in the last few years elements of opinion in the United States, evidencing an antipathy to foreign investment comparable to that shown at the time of the American Revolution, seem intent on crippling a U.S. policy that has endured for more than one hundred fifty years. The new model BIT embodies regressive changes that are deplorable. They have the further deficiency of prejudicing my thesis.

INVESTOR-STATE DISPUTES AND INTERNATIONAL LAW: FROM THE FAR SIDE

*by Nudrat Majeed**

I would like to invite you on a journey to a land which is, at the same time, very far away and right here. It is the land of a civilization that is over two thousand years old, a land where, when people talk of their grandfather, they are referring to an ancestor of five hundred years ago, a land where the past is ever-present. In a room in this land is a gathering. The men are dressed in long white gowns with ornate belts, handmade in gold and silver threads, housing delicately crafted ceremonial daggers. The women are dressed in long black gowns, revealing only their almond-shaped eyes.

The land is Yemen. The gathering, three weeks ago, was a workshop on international arbitration.

The gathering, though unfamiliar in appearance, was analyzing the same issues that we are gathered here today to discuss. But the unfamiliarity is not just in appearance. It lies in the entire approach to the subject of arbitration, whether under a treaty or pursuant to a contract. Between the perceptions of that gathering and this there is a wide gap.

That is the subject of my talk today: an examination of the gaps not just in substantive law but also in the perception of treaty arbitration and the conduct of the process itself. The wider this gap becomes, the more vulnerable the process.

The core of modern treaty arbitration is, of course, the bilateral investment treaty (BIT), the treaty that was designed to promote trade between the developed and developing world, to ensure that there is a protected environment of trust in which investments can safely be made.

We have seen, in the last twenty years or so, a huge increase in BITs. The fact, for instance, that Pakistan has signed over forty BITs and Egypt thirty-four reflects the political will in such countries to develop their economies.

That is reinforced by the fact that some of the largest investments in the world in recent years have been made in developing countries, such as Hubco in Pakistan and Dhabol in India.

Along with this rise in the number of BITs, there has been, no longer unexpectedly, a corresponding increase in treaty arbitration. This is direct recourse under the BIT.

Treaty arbitration has also become an indirect recourse in cases where the contractual arbitration process has failed. In Dhabol, a large number of contractual arbitrations arose out of one

* Department of Law, School of Oriental and African Studies, London University.

project, each coming to a controversial ending that involved local courts. In an attempt to disentangle the dispute from the local courts, the investors have now sought recourse to treaty arbitration, which is pending.

Consequently, as treaty arbitration takes center stage in international investment, it becomes essential that the process be watertight and that failures that have occurred at the contract level not be repeated at the treaty level.

The truth is that the process may not be watertight. Along with this phenomenal growth of BITs there is a developing and fundamental paradox: the process is expanding and is designed to protect investors most particularly in developing countries, and yet it is precisely in those countries that there is a genuine lack of understanding and a growing suspicion of the process.

This is manifested in concerns that because international arbitration is a product of many years of experience in Western countries, it is alien to local culture. Host governments feel that they are being made to participate in a process they do not understand. They feel the system is one-sided because the lawyers who negotiate and draft international rules and conventions on arbitration turn out to be the same lawyers who act as counsel and arbitrators, who do not understand the local language, culture, and legal traditions. Host states feel marginalized, on the one hand, and entirely reliant on foreign lawyers to represent them, on the other. The result is that they often try to get out of the arbitration any way they can.

The suspicion and lack of understanding is further compounded by the current global political situation, which is increasingly polarizing Islamic versus non-Islamic countries, so that the dimension now is not just developed versus developing but is in effect acquiring a specific identity of Shari'ah versus non-Shari'ah.

The political implications of this new phenomenon are beyond the subject of my discussion. For our purposes, it is important to note that the rise in anti-Islamic sentiment is matched by a corresponding rise in Islamic teaching and practice. This has a direct impact on international trade and investment in countries adhering to the Shari'ah.

As an example, recent years have shown a marked increase in Islamic financial services. Islamic banks have fostered a rapidly growing market and are active both in commercial and investment banking. Last year, it was reported that an estimated $200 billion were invested according to Shari'ah principles of banking. Islamic banking has shown an annual growth rate of 5 to 15 percent. This reflects, first, the influence on choices now made by investors and, second, radical developments in judicial practice, such as the decision by the Supreme Court of Pakistan in 2000 prohibiting interest.

The effect of this polarization is that there is slowly but surely being embedded in developing countries and Islamic countries a suspicion of international arbitration. Without going into the merits of whether the suspicion is legitimate, and it may not be, the truth is that it exists. I exclude suspicion that is motivated by bad faith or a desire to obstruct. What I am addressing is a genuine, bona fide, increasing disquiet in developing countries.

Suspicion puts tensions on the system itself, which in turn may threaten a breakdown in the process. This has already been evidenced in private international arbitration. The same countries mentioned earlier as having opened their doors to foreign investment, Pakistan and India, are now better known as countries where arbitration will inevitably end up in courts. The results in the arbitrations of Hubco, Dhabol, and Himpurna are poignant examples.

This may well happen in BIT arbitration. Already, there has been a glimpse of it in *Société Générale de Surveillance SA v. Islamic Republic of Pakistan* (*SGS v. Pakistan*), where the treaty arbitration was enjoined by the Supreme Court of Pakistan because Pakistan had not implemented the International Centre for Settlement of Investment Disputes (ICSID) Convention in its domestic law. The case itself survived because the government of Pakistan decided to abide by its treaty commitment, but the judgment may be a foretaste of things to come.