

# INTERNATIONAL LAW ASSOCIATION

## TORONTO CONFERENCE (2006)

### INTERNATIONAL LAW ON FOREIGN INVESTMENT

#### *Members of the Committee:*

Professor Christoph Schreuer (Austria): *Chair*  
Professor Peter Muchlinski (UK): *Co-Rapporteur*

Professor Pia Acconci (Italy)  
Dr Amazu A Asouzu (HQ)  
Professor Jeffrey Atik (USA)  
Dr Vladimir Balas (Czech Republic)  
Mr Milos Barutciski (Canada)  
*Alternate:* Professor Robert Paterson  
Ms Vivienne Bath (Australia)  
Professor Andrea Bjorklund (USA)  
Ms Joachim Frances Delaney (Australia)  
Professor Rudolf Dolzer (Germany)  
Professor Emmanuel Gaillard (France)  
Professor Ignacio Gomez-Palacio (Mexico)  
Dr Moshe Hirsch (Israel)  
Professor Kaj Hober (Sweden)  
Advocate General Juliane Kokott (Germany)  
Professor Akira Kotera (Japan)  
Professor Jose Carlos de Magalhaes (Brazil)  
*Alternate:* Dr Maria Regina Ribeiro Do Valle  
Mr Daniel Magraw, Jr (USA)  
Mme Loretta Malintoppi (Italy)  
Mr P H Parekh (India)

Mr Hugo Manuel Perezcano Diaz (Mexico)  
Mr Hilmar Raeschke-Kessler (Germany)  
Professor August Reinisch (Austria)  
Professor Engela Schlemmer (South Africa)  
Professor Nicolaas J Schrijver (Netherlands)  
Mr Audley Sheppard (UK)  
*Alternate:* Matthew Weiniger  
Professor Ole Spiermann (Denmark)  
*Alternate:* Mr Stefan Amarasinha  
Mr Ignacio Suarez Anzorena (Argentina)  
Dr J J barones van Haersolte-van Hof (Netherlands)  
Mr Robert Volterra (UK)  
*Alternate:* Professor Asif Hasan Qureshi  
Professor T Walde (UK)  
*Alternate:* Dr Federico Ortino (UK)  
Professor Todd Weiler (Canada)  
*Alternate:* Alan Alexandroff  
Professor Friedl Weiss (Netherlands)  
Mr David Williams QC (New Zealand)  
Ms Katia Yannaca-Small (Hellenic)  
Professor Andreas R Ziegler (Switzerland)

#### FIRST REPORT

##### **Introduction**

This is the first report of the International Committee on the International Law on Foreign Investment. The purpose of this report is to set out the mandate of the committee, to outline the underlying legal issues that the committee is seeking to develop and to offer a summary of the initial research undertaken by committee members both individually and as a whole.

The committee was formed in April 2004 with Professor Christoph Schreuer as Chair and Professor Peter Muchlinski and Dr Amazu Asouzu as Co-Rapporteurs. Due to personal circumstances, Dr Asouzu has had to stand down in 2006 and has been replaced by Dr Federico Ortino.

Members were appointed during 2004, with additional members joining in 2005. The first meeting of the committee occurred in London on 17 April 2004. The initial work programme was discussed and Liaison Officers were appointed from among the members to fulfil the coordination tasks foreseen at the ILA Executive Council Meeting on 17 May 2003. These are Engela Schlemmer (Monetary Law), Audley Sheppard (International Commercial Arbitration) and Friedl Weiss (International Trade Law). An initial work plan was agreed. This work plan was divided into two main projects:

##### **(a) A Final Committee Report**

With regard to the form of a final Committee report, no formal decision was taken. However, the prevailing opinion of the Committee was that its work should not lead to a draft Convention or restatement of the law, but rather take the form of guidelines plus commentary, which should include 'normative' language.

### **(b) Committee Publications**

Agreement was reached on a 'dual approach' according to which Committee members would submit papers to the Rapporteurs. These papers will serve as input for their reports and at the same time constitute contributions to a collective publication of the Committee. This collective publication will consist of articles by identified authors who are members of the Committee.

To date a number of draft papers have been received. Those at an advanced stage of preparation have been posted on the website of the electronic journal *Transnational Dispute Management* (TDM).<sup>1</sup> These advanced drafts will be referred to in Part B as appropriate. The final versions of the Committee Members' papers will form the basis of the Committee's Final Report.

The mandate of the committee was further developed at the first ILA Conference meeting of the Committee in Berlin in August 2004. Most recently, the committee met again in Prague on the 28<sup>th</sup> of September 2005. There draft papers, already prepared by committee members, were discussed and the range of topics to be researched by the committee was further refined, building on the initial lists finalised at the 2004 meetings. Those topics will be described in Part A of this report. Part B of the report will then go on to set the background to the work of the committee, and to lay the foundations of the work to be undertaken in preparation for the Final Report. It shall concentrate on the major policy questions raised by the development of the international law on foreign investment looking specifically at the main actors, ideological influences and technical legal issues that this evolving field raises.

### **Part A: Major Research Topics**

The committee has divided the major topics arising in its field of work into three main areas. First, there are the fundamental common issues that inform the policy and technical legal context of the subject. The latter concern, in particular, issues of the scope and definition of the subject matter of the international law on foreign investment, issues of applicable law and the interaction of national and international law in the area. This area also includes a discussion of whether a multilateral investment agreement is needed, notwithstanding the lack of success in the recent attempts at concluding such an agreement.

The second and third areas are divided between substantive and procedural issues. The substantive issues relate to the main standards of protection found in international investment agreements (IIAs) and in customary international law, as well as new issue areas such as the avoidance of corruption and competition law and policy. Corporate social responsibility issues are not included, though they are discussed, in the present report, in relation to the policy and objectives in this field. The procedural issues relate to the developing system of investor-State arbitration. Such arbitration has grown significantly since the turn of this century. According to recent UNCTAD figures, at least 42 new cases were launched in the first 11 months of 2005. This brings the cumulative number of known treaty based investor-State arbitrations to 219 by November 2005. Prior to 1999 there were fewer than 10 such cases brought in any year, even though the principal treaty based dispute settlement system the International Centre for Settlement of Investment Disputes (ICSID) has been in existence since 1966. Against this background the committee will analyse, in some detail, the procedural implications of investor-State arbitration.

To summarise, the following topics comprise the basis of the work programme of the committee and will form the organising concepts for the Final Report:

#### **(a) Fundamental Issues**

- 1) *Policy and Objectives* (including development, labour, human rights, environment, corporate social responsibility, intellectual property, competition, investor protection, investor's duties);
- 2) *Scope and definition* (including investment, investor, nationality, eligibility, shareholders' rights);
- 3) *Applicable Law*
- 4) *Interaction of National & International Standards*
- 5) *Do we need a Multilateral Investment Agreement?*

#### **(b) Substantive Issues:**

- 1) *Admission of Investment and Right of Establishment* (including performance requirements, incentives)

---

<sup>1</sup> See at <http://www.transnational-dispute-management.com/ila>. The draft papers are published in TDM 5 (2005).

- 2) *Standards of Treatment* (national treatment, fair and equitable, full protection and security)
- 3) *Money Transfers & Taxation*
- 4) *Most-Favoured-Nation Treatment*
- 5) *Expropriation* (including indirect takings)
- 6) *Emergency Exceptions and Safeguards*
- 7) *Investment Insurance*
- 8) *Trade and Investment*
- 9) *State Responsibility* (including liability, attribution)
- 10) *Corruption*
- 11) *Competition Law and Policy*
- 12) *Transparency*

**(c) Procedural Issues:**

- 1) *Methods of Dispute Resolution* (including State-to-State dispute settlement, diplomatic protection, mediation, conciliation, pros and cons of arbitration, composition of panels)
- 2) *Transparency and the Public Interest* (including amicus briefs, third parties, publication, confidentiality)
- 3) *Independence, Impartiality and Duty of Disclosure of Arbitrators*
- 4) *Consent to Arbitration*
- 5) *Jurisdiction and Admissibility other than Consent*
- 6) *Relationship between International Arbitral Tribunals and Domestic Courts* (including competing jurisdiction and exhaustion of local remedies)
- 7) *Parallel International Proceedings* (including *lis pendens* and *res judicata*)
- 8) *Remedies and Damages*
- 9) *Review of Awards*
- 10) *Compliance and Enforcement*
- 11) *Precedent, Continuity and Legitimacy*
- 12) *Relationship between Investment Treaties and other Treaties*

**Part B: International Foreign Investment Law: Policy Issues:**

There can be no understanding of law, whether national or international, without a prior understanding of the policy issues that it seeks to deal with. In these circumstances, it is essential that the Committee's study of the international law relating to foreign investment is placed in its proper policy and political context. This is all the more necessary, given the long history of dispute over applicable rules and standards in this field. It is not proposed, nor is it necessary, to go over that history here. It has been done elsewhere.<sup>2</sup> For present purposes it is enough to point out that the regulation of relations between States and foreign investors may be said to have begun with the development, by the major powers, of international norms relating to the treatment of aliens and their property, including expropriation, in the first half of the 20<sup>th</sup> Century. In addition, it should be noted that there have always been challenges to such norms, in particular, from socialist States, which opposed norms based on notions of private property, and newly independent post-colonial states, especially during the period of African and Asian de-colonisation after World War II. This culminated, in the mid-1970s, with the adoption of UN Resolutions calling for the establishment of a New International Economic Order (NIEO), with its emphasis on sovereign rights to regulate and control foreign investors and their investments, and on the recognition of permanent national sovereignty over natural wealth and resources.

More recently, such sovereignty-oriented challenges appear to have been mitigated and replaced by an acceptance of international standards of treatment, at least as treaty-based standards. This can be explained by a number of factors: first, the demise of the Socialist Bloc, which brought to an end the Cold War, with its attendant clash of ideologies and alliances, and which gave rise to the process of transition to market based economies in the States of the former Soviet Union and Central and Eastern Europe; secondly, the effects of the debt crisis of the early 1980s upon the availability of public and private sector loan capital, which rendered

---

<sup>2</sup> See Peter Muchlinski "A Brief History of Business Regulation" in Sol Picciotto and Ruth Mayne *Regulating International Business: Beyond Liberalization* (Basingstoke, MacMillan Press, 1999) p.47; M. Sornarajah *The International Law on Foreign Investment* (Cambridge, Cambridge University Press, 2<sup>nd</sup> Ed 2004) ch.2. Charles Lipson *Standing Guard: Protecting Capital in the Nineteenth and Twentieth Centuries* (University of California Press, 1985). I. Brownlie *Principles of Public International Law* (Oxford, Oxford University Press, 6<sup>th</sup> Ed, 2003) ch 24.

foreign direct investment (FDI) the major source of capital especially in developing countries<sup>3</sup>; thirdly, the increased acceptance by governments, through the 1980s and 1990s, of market-based approaches to economic development, in both developed and developing countries, resulting in the processes of liberalisation, privatisation and gradual deregulation of national economies.<sup>4</sup> This last factor may be said to arise directly out of the underlying process of economic globalisation that is being driven by increased transnational economic integration through the growth of transnational production chains dominated by multinational enterprises (MNEs, also referred to as transnational corporations or TNCs in UN parlance) or through interlinked alliances of free-standing firms.<sup>5</sup> To be successful, such modes of production will require large areas of economic and regulatory uniformity across national boundaries. Hence it may be said that economic globalisation contains a built-in “bias” in favour of liberalised national economic policies and pro-investor approaches to international business regulation. It may also require limits upon the sovereign right of States to regulate, as they please, economic activity within their borders.

Against this, albeit brief, sketch of how we have arrived in the present phase of international legal concern over foreign investment, the remainder of this report will delve further into the details of the policy environment within which contemporary norms are evolving. This will be done, first, by considering the principal actors in the FDI process and their policy priorities: MNEs, home and host States. To these may now be added non-governmental organisations (NGOs), as the apparent voices of so-called “civil society”,<sup>6</sup> and intergovernmental organisations (IGOs) as possible locations for the further development of international standards and procedures. Secondly, the current ideological background to international foreign investment law needs to be more closely examined. In particular the above mentioned “bias” must be considered in more depth so that it may be properly understood, and in addition, it must be examined against the background of the influence, upon international law, of other evolving non-economic standards such as human rights, the right to development and environmental and labour standards. To these should be added the established and more recent calls for greater international corporate social responsibility emanating from NGOs, IGOs and industry groups themselves. Thirdly, and in the light of the preceding background factors, the more technical aspects of international investment law will be analysed from a policy perspective. Here three main issue areas arise: how the sources of international investment law may be influenced by policy factors; what types of substantive standards will evolve and to whom will they be addressed; and how are standards to be enforced and disputes resolved?

#### **(a) The Principal Actors**

The earliest international legal rules concerning foreign investors and investment assumed a tripartite set of actors: the home State, the host State and the investor, of whom only the first two had legal standing. This situation arises out of the fact that States have traditionally been seen as the principal subjects of international law. Typically, legal issues arising out of the treatment of a foreign investment would be dealt with as instances of diplomatic protection, whereby the home State of the investor would make direct representations to the host State, without the active participation of the investor, whose property and/or rights were alleged to have been infringed by the host. In this process the investor, as a non-State actor, would not be recognised as a subject of international law. Yet its claim could be taken up by the protecting State, the home State of the investor. This would take the form of an international claim for compensation, to which the claim of the investor would be assimilated, on the grounds that, by its actions towards the foreign investor, the host State had committed a

<sup>3</sup> See UNCTAD *World Investment Report 1992* (New York, United Nations, 1992) at p.101; see further J.H.Dunning *Multinational Enterprises and the Global Economy* (Wokingham, Addison-Wesley Publishing, 1993) Ch.2.

<sup>4</sup> See generally Robert Gilpin *The Challenge of Global Capitalism* (Princeton, Princeton University Press, 2000) Ch.2 “The Second Great Age of Capitalism”.

<sup>5</sup> See Peter Dicken *Global Shift* (London, Sage Publications, 4<sup>th</sup> Ed, 2003) especially Ch.2. “A New Geo-economy”. See too Francis Snyder “Governing Economic Globalisation: Legal Pluralism and EU Law” in Francis Snyder (Ed) *Regional and Global Regulation of International Trade* (Oxford, Hart Publishing, 2002) p.1. for a discussion of the regulatory needs of such systems of production.

<sup>6</sup> “Civil society” may be defined as, “the space for uncoerced human association and also the set of relational networks - formed for the sake of family, faith, interest and ideology – that fill this space”: M.Walzer (ed) *Toward a Global Civil Society* (providence, Rhode Island, Berghahn Books, 2<sup>nd</sup> Ed, 1998) at p.7. adopted by Daphne Josselin and William Wallace (Eds) *Non-State Actors in World Politics* (Basingstoke, Palgrave Publishers, 2001) at p.20 n.5. On “international civil society” see Holly Curren and Karen Morrow “International Civil Society in International Law: The Growth of NGO Participation” 1 *Non-State Actors and International Law* 7 (2001).

breach of international law against the home State. This would be subject to the proviso that the domestic remedies rule had been exhausted, and that the investor did in fact possess the nationality of the home State.<sup>7</sup>

While this situation still represents the formal limits, *ratione personae*, of international law it does not fully explain recent developments in the field of foreign investment. It is not suggested here that investors, whether natural or legal persons, are acquiring international legal personality.<sup>8</sup> Rather, as the protection of investors and their investments has become an established goal of many capital-importing States, they have been prepared to accept the obligation, in international law, to observe certain standards of treatment and, in most cases, to provide for the effective implementation of such obligations through the extension of direct treaty-based dispute settlement rights to investors, allowing them to use international dispute settlement procedures against the host State and/or its agents and entities.<sup>9</sup> Thus investors, be they natural or legal persons, enjoy a measure of international *locus standi* before international tribunals in relation to investor protection obligations in investment agreements. However, the nature of the host State's obligation remains somewhat ambiguous. It may be seen as a classical international obligation, owed in principle to the home State of the investor as a contracting party to the investment agreement. On the other hand, it may be said that, by agreement with the home State, diplomatic protection is replaced by investor held rights of action against the host State. Such rights are new and independent of any rights held by the investor's home State under the IIA. The national State of the investor has no residual interest in these new rights and obligations.<sup>10</sup> This is in line with developments in other areas of international law, notably the law of human rights, where the individual may be granted treaty-based rights of action against the State.

In addition, investor rights, both substantive and procedural, will not only be contained in treaties but also in investor/State agreements. These agreements will form the legal "constitution" of the investment project and will determine the respective functions, contributions and operational duties of the investor and the host State and/or its agents. Such agreements, referred to as State contracts, are governed by their proper law, usually the law of the host country, but will also give rise to obligations rooted in international law, regarding the treatment of the investor.<sup>11</sup>

The role of investors as actors in international investment law cannot be confined simply to the making of legal claims. The major investors, in particular MNEs, are at the heart of legal developments in this field, even if they are not formally its subjects. Their role as a special interest group, that seeks to influence the development of the law in a manner conducive to the furtherance of investor interests, cannot be ignored. There is little doubt that MNEs lobby governments and IGOs to ensure that normative development is business friendly.<sup>12</sup> How successful they may be is another issue, as the case of the failure of the MAI, or of the adoption of investment rules in the WTO, may suggest. Nonetheless, it is not possible to see the development of this area without taking account of the role of these important actors as a formative influence in the law. In addition, given the increased calls for the extension of legally binding international standards of corporate social responsibility, MNEs may become subject to new duties under international instruments. The legal nature of such instruments will be further discussed below. However, even where such instruments are non-binding they help to create a climate in which binding obligations may follow.

<sup>7</sup> See further Lipson and Brownlie note 2. See too UNCTAD *Dispute Settlement: Investor-State* (New York and Geneva, United Nations, 2003) at pp.32-4 where it is doubted that the local remedies rule applies to investment agreements containing an investor-State dispute settlement provision.

<sup>8</sup> On which see further D. Ijalaye *The Extension of Corporate Personality in International Law* (Dobbs Ferry, New York, Oceana, 1978).

<sup>9</sup> On the issue of attribution of responsibility for acts of State agents or entities see further the draft paper by Kaj Hober "State Responsibility and Investment Arbitration" on the TDM website *op.cit.* note 1.

<sup>10</sup> See further Zachary Douglas "The Hybrid Foundations of Investment Treaty Arbitration" 74 BYIL 150 at p.282 (2003). But see, for an argument that investors may acquire a degree of international personality as holders of rights under investment treaties, Ole Spierman "Twentieth Century Internationalism in Law" inaugural lecture delivered at the University of Copenhagen on 20 January 2006.

<sup>11</sup> See further UNCTAD *State Contracts Series* on issues in international investment agreements (New York and Geneva, United Nations, 2004); Charles Leben *La Theorie du Contrat d'Etat et l'Evolution du Droit International des Investissements* (Leiden, Martinus Nijhoff Publishers, 2004). The issue of applicable law is covered by the draft paper of Professor Ole Spierman available at the TDM website *op.cit.* note 1.

<sup>12</sup> See for example Ian H. Rowlands "Transnational Corporations and Global Environmental Politics" in Josselin and Wallace (Eds) *op.cit.* note 6 p.133 and Andrew Walter "Unravelling the Faustian Bargain: Non-state Actors and the Multilateral Agreement on Investment" in *ibid.* p.150.

In addition to investors, other non-state actors need to be considered. In particular, NGOs that seek to influence the development of rules and procedures in this area must be taken into account. While the activities of such organisations are, perhaps, best known to lawyers in the field of human rights protection,<sup>13</sup> NGOs have been increasingly active in the field of international business regulation. With the growth of economic globalisation, the activities of such bodies, whether as critics and monitors of corporate excesses, or as advocates of further economic liberalisation and facilitation for business interests, can be expected to grow. Indeed, in a global economic system where the transnational integration of business activities has forged ahead of regulatory developments that can effectively control the market in the public interest, the opportunities for informal action by so-called "civil society" are considerable. It may be said that NGOs are filling a gap in regulatory order by placing certain issues on the political agenda, and contesting the very future of that regulatory order, by their actions.

In addition to States and non-state actors, the IGOs comprise a further set of influential participants in the development of international investment law and policy. IGOs are organised around the constitutive instrument establishing the organisation to which the member States have consented. They have an existence rooted in the sovereign acts of States, but they exist over and outside those States. Equally, each IGO creates a legal sub-system based on its constituent instrument, which, in turn will also be governed by a sub-system of public international law, the law of international institutions.<sup>14</sup> Furthermore, an IGO may have a quasi-legislative power to develop substantive international rules and procedures governing its substantive field of activity. This specialised legal order may be said to constitute a tool for the pragmatic development of responses to the regulation of the phenomena of globalisation.<sup>15</sup> That this power has been used in relation to the development of norms of international investment law cannot be doubted, notwithstanding the history of frequent failure in relation to the adoption of international rules in this area. In particular the contributions of the OECD<sup>16</sup>, the ILO<sup>17</sup> the UN Sub-Commission on Human Rights<sup>18</sup> and UNCTAD<sup>19</sup> should be taken into account as regards standard setting and research in this area, while the World Bank has, through the ICSID, established the leading investor-State dispute settlement body, which is handling an increased case-load<sup>20</sup> that has an increasingly significant influence on the development of norms in this area.<sup>21</sup> In addition the World Bank's Multilateral Investment Guarantee Agency (MIGA) has contributed to the creation of investment opportunities in developing countries by offering a specific, development oriented, investment insurance system that complements existing national investment insurance schemes.<sup>22</sup> The range of organisations now involved in the foreign investment field points to a need for greater coordination and cooperation in order to further a more holistic approach to the regulation of foreign investment.<sup>23</sup> Furthermore, it will be necessary to ensure that there is proper co-ordination

<sup>13</sup> See A.Cassese *Human Rights in a Changing World* (Cambridge, Polity Press, 1994) pp.171-174; Henry J. Steiner and Philip Alston *International Human Rights in Context: Law Politics Morals* (Oxford, Oxford University Press, 2<sup>nd</sup> Ed, 2000) Ch.11.

<sup>14</sup> See Philippe Sands and Pierre Klein *Bowett's Law of International Institutions* (London, Sweet & Maxwell, 5<sup>th</sup> Ed, 2001) para. 1-030 at p.17.

<sup>15</sup> See Peter Thomas Muchlinski "Globalisation and Legal Research" 37 Int'l.Law 221 at p.226 (2003)

<sup>16</sup> See the OECD: *Guidelines for Multinational Enterprises* (OECD, Paris, 2000) *Codes on Liberalisation of Capital Movements and Invisibles* (OECD, Paris, periodically revised), the *Convention on Bribery 1997* and *Principles of Corporate Governance* (OECD, Paris 2004) available at [www.oecd.org](http://www.oecd.org)

<sup>17</sup> See the ILO Labour Conventions and specifically the ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy 2000: 41 ILM 184 (2002) and the Declaration on Fundamental Principles and Rights at Work: 37 ILM 1233 (1998).

<sup>18</sup> UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with regard to Human Rights UN Doc.E/CN.4/Sub.2/2003/12/Rev.2 (2003); comment by D. Weissbrodt and M.Kruger in 97 AJIL 901 (2003).

<sup>19</sup> See UNCTAD Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices 1980: 19 ILM 813 (1980) as revised see: [www.unctad.org/en/subsites/cpolicy/docs/CPSet/cpset.htm](http://www.unctad.org/en/subsites/cpolicy/docs/CPSet/cpset.htm) . More widely UNCTAD has performed a significant research and education function in this area and published the annual World Investment Report: see further Torbjorn Fredriksson and Zbygniew Zimny "Foreign Direct Investment and Transnational Corporations" in UNCTAD *Beyond Conventional Wisdom in Development Policy: An intellectual history of UNCTAD 1964-2004* (New York and Geneva, United Nations, 2004) p.257.

<sup>20</sup> This arises both through direct use of the conciliation and arbitration procedures by nationals of Contracting Parties and also through the ICSID Additional Facility, which is of particular importance in relation to the NAFTA dispute settlement system.

<sup>21</sup> This is evidenced by the considerable increase in the number of disputes submitted to ICSID in recent years under the Arbitration Rules and the Additional Facility Rules, which are used for NAFTA cases in particular.

<sup>22</sup> See further the draft paper by Andreas Ziegler and Louis-Philippe Graton "Investment Guarantee: From a National to an International Perspective" available at the TDM website *op.cit.* note 1.

<sup>23</sup> See F.Ortino "The Social Dimension of International Investment Agreements" 7 International Law FORUM du droit

between international obligations in investment agreements and non-investment obligations arising out of other international treaties and legal standards.<sup>24</sup>

Finally, this section needs to consider more fully the role of home States as actors in international investment law. To date, home States have not been the subjects of any direct international obligations, in relation to investment abroad, undertaken by their nationals. However, it is arguable that these countries ought to accept certain new obligations, so as to make the balance of rights and duties between the three main participants in the investment relationship more balanced. As noted above, the bulk of international obligations has hitherto fallen upon host States. By contrast, investors and home States have few, if any, international obligations. It has already been shown that increasing attention is being paid to the duties of investors towards the countries in which they invest. Equally, it is possible to expect home States to undertake certain responsibilities. In particular, given that the majority of home States are developed, while many host States are developing or less developed, it may be valuable, as a stimulus for investment, to extend certain duties on home States to facilitate outward investment to developing countries, such as the provision of incentives or the encouragement of technology transfer.<sup>25</sup> In addition, the home States' legal and regulatory system might be used to ensure that MNEs based there conform to certain standards of good corporate citizenship through the sanction of home country laws and regulations, and through the provision of legal redress for claimants from outside the home country who are in dispute with the parent company for the acts of its overseas subsidiaries.<sup>26</sup>

### (b) Ideological Factors

The central issues surrounding the evolution of international legal policy on foreign investment cannot be understood without at least a preliminary route-map displaying the main ideological perspectives that help to form the debate in this field. In the introduction, a "bias" in favour of a liberal regime for FDI was mentioned. This will be examined first, followed by a review of alternative positions. Throughout it must be remembered that an international legal order cannot display the same level of policy consensus that a more localised order may be capable of achieving. The degree of variation between the economic and social positions of the many countries that participate in this order will inevitably lead to compromise over strongly held policy positions, unless the system is to descend into hegemony and the forcible domination of any particular world view. Such a coercive perspective is not impossible, of course, and the history of international business regulation is as much a history of force as it is of moderation.<sup>27</sup> However, if international investment law is to be a system based on a genuine respect for norms and rules it must command a degree of consensus. This will be impossible to achieve without a measure of compromise over strongly held positions.

Against this background, why should it be said that the current approach to norm formation may be "biased" towards a liberal approach to FDI regulation and towards an emphasis on protection of investors and their investments? The main answer lies in the dominant forms of production that an increasingly integrated global economy creates.<sup>28</sup> Specifically, the activities of MNEs are said to give rise to the emergence of what Peter Dicken calls a "new geo-economy", characterised by changes in the geographical distribution of economic activity away from relatively self-contained national economies towards globally integrated cross-national production and distribution chains organised by MNEs.<sup>29</sup> Such economic changes leading to increased cross-border economic integration are said to be *qualitatively* different from earlier stages of international economic activity.<sup>30</sup> Thus a distinction is to be made between *internationalisation* – the process of increasing economic activity across national borders, which has been going on for centuries – and true *globalisation* which involves not only an increase in such activities but their transformation into systems of integrated global economic

---

international 243 (2005).

<sup>24</sup> See Moshe Hirsh "Interactions between Investment and Non-Investment Obligations in International Investment Law" forthcoming at TDM *op.cit.* note 1.

<sup>25</sup> See UNCTAD *World Investment Report 2003* (New York and Geneva, United Nations) at pp.161-3.

<sup>26</sup> *Ibid.* at p.156. See further Peter Muchlinski "Corporations in International Litigation: Problems of Jurisdiction and the United Kingdom Asbestos Case" 50 ICLQ 1 (2001) Philip Blumberg "Asserting Human Rights Against Multinational Corporations Under United States Law: Conceptual and Procedural Problems" 50 AJCL 493 (2002) and M.Kamma and S. Zia-Zarifi (Eds) *Liability of Multinational Corporations Under International Law* (The Hague, Kluwer Law International, 2001) esp. Section III.

<sup>27</sup> See J. Braithwaite and P. Drahos *Global Business Regulation* (CUP 2000) Ch.22.

<sup>28</sup> The following paragraphs are adapted from Muchlinski "Globalisation and Legal Research" *op.cit.* note 15 at p.222-3

<sup>29</sup> See Dicken *op.cit.* note 5 Ch.2. See too *World Investment Report 1993* Part II "Integrated International Production"; and on the phenomenon of outsourcing of services activity *World Investment Report 2004* Part II "The Shift Towards Services".

<sup>30</sup> See generally David Held et.al. *Global Transformations: Politics Economics and Culture* (Cambridge, Polity Press, 1999).

activity, in the way described by Dicken above. The rise of global corporations, in effect, creates new vehicles for the global integration of trade and production.<sup>31</sup> The major policy implication of this development is the need for a regulatory order that allows for untrammelled productive integration to take place. Hence the so-called “bias” towards liberal economic policies and investor protection that, together, will stimulate increased cross-border investment flows and allow for deeper integration. Such integration, it is said, will allow for the further growth of the global economy and will ensure the increased participation within that economy of developing as well as developed countries.<sup>32</sup>

This approach is open to challenge. First, the significance of global patterns of economic integration has been doubted by research showing that MNEs remain highly embedded in national economic and regulatory systems and that few corporations can be seen as truly “global”.<sup>33</sup> Secondly, it concentrates exclusively on economic factors, ignoring the implications of certain sociological effects of increased global integration. Here the emphasis is on greater cultural interchange and on the development of global social phenomena such as global consumption patterns, transnational class formation and what can be termed the global/local cultural paradox,<sup>34</sup> as well as upon the economic manifestations of globalisation.<sup>35</sup> This perspective therefore adds a more comprehensive set of issues to be examined as evidence of globalisation and as subject-matter for transnational legal processes. Furthermore, it raises the question whether we are creating some kind of global ethical system, possibly based on respect for fundamental human rights, which can be seen as a constitutional dimension of globalisation, an issue that, as will be seen below, plays an increasingly important part in the substantive legal discussion of international investment law.

In the light of the foregoing, it is clear that while there are significant indicators that a process of increasing global economic integration is under way, how wide and how far it develops is unclear and open to speculation. In the light of such uncertainty, it is perhaps not surprising that the debate surrounding the term globalisation has acquired an ideological content. The parameters of the debate on globalisation have distinct echoes in the debate over the content and future direction of international investment law. Held et.al. have identified three major positions in the globalisation debate:<sup>36</sup> first, the “*hyperglobalists*” who stress the displacement of national economies by transnational production, trade and financial networks, operating in an increasingly liberal global market order;<sup>37</sup> secondly the “*sceptics*” who doubt whether the economic evidence shows any real increase in international economic activity as compared with the period up to 1914, or that production chains are as global as some have asserted,<sup>38</sup> and, thirdly, the “*transformationalists*” who see the levels of transnational economic integration as unprecedented, and who feel that globalisation is giving rise to a fundamental restructuring of power in a world where there is no longer a clear distinction between local, national or international affairs. However, they do not share the “hyperglobalist” view that this is leading inexorably towards a global free market. A further distinction should be drawn between those who see globalisation as a real phenomenon, whether they agree with the “hyperglobalist” faith in global free markets or not (as in the case of the so called “anti-globalisation” movement<sup>39</sup>) - the “*globalists*” - and those who deny the reality of globalisation - the “*anti-*

<sup>31</sup> Kenichi Ohmae *The Borderless World* (London, Fontana, 1991). C.A. Bartlett, and S. Ghoshal *Managing Across Borders: the Transnational Solution* (London, Random House Books, 2<sup>nd</sup> ed, 1998).

<sup>32</sup> See Martin Wolf *Why Globalization Works* (New Haven and London, Yale University Press, 2004).

<sup>33</sup> See P.N. Doremus P.N. et.al. *The Myth of the Global Corporation* (Princeton University Press, 1998); See too Alan Rugman *UK Competitiveness and the Performance of Multinational Companies* (Report funded by the Economic and Social Research Council (ESRC), September 2002) see ESRC Press Release “Strategies and Performance of Worlds Biggest 500 Multinationals Expose the Myth of Globalisation” 2 September 2002 [www.esrc.ac.uk](http://www.esrc.ac.uk). and Larry Elliott “Big business isn’t really that big” *The Guardian* 2 September 2002 p.23.

<sup>34</sup> For example, the local adoption of globalised cultural activities such as the playing of global sports, or the consumption of universally available fast foods, and the globalisation of local customs and products such as the global trade in local cultural artefacts and the development of “multiculturalism”.

<sup>35</sup> See, for example, Anthony Giddens *The Third Way* (Cambridge, Polity Press, 1998); Malcolm Waters *Globalisation* (London, Routledge, 1995); Leslie Sklair *The Transnational Capitalist Class* (Oxford, Blackwell Publishers, 2001) and *Globalisation Capitalism and its Alternatives* (Oxford, Oxford University Press, 2002).

<sup>36</sup> Held et.al. *op.cit.* note 30 at pp.2-10.

<sup>37</sup> See for example Kenichi Ohmae *The End of the Nation-State* (New York, Free Press, 1995).

<sup>38</sup> See David Hurst and Grahame Thompson *Globalisation in Question* (Cambridge, Polity Press, 2<sup>nd</sup> Ed, 1999). Held et.al. dispute the empirical basis of Hurst and Thompson’s thesis, arguing that the changes in productive processes that MNEs have instituted do enhance the structural power of corporate capital at the expense of the nation-state creating new issues of governance: see Held et.al. *op.cit.* note 30 at pp. 281-2.

<sup>39</sup> See for example Naomi Klein *No Logo* (London, Flamingo, 2000) that does not reject the notion global integration of production as such, but rather calls for stronger regulation, by IGOs, of corporate abuses. By contrast some do reject the very

*globalists*".<sup>40</sup> Views belonging to the latter group can range from the abovementioned "sceptics", who assert that globalisation is a myth generated to support neo-liberal policies, aimed at the deregulation of trade, investment and financial flows, to outright nationalists, or religious fundamentalists, who reject the very notion of an integrating global economy as "a good thing".<sup>41</sup>

From this brief review of positions on globalisation, the major strands in the debate on foreign investment law can be identified. Thus a "hyperglobalist" perspective can be seen among those who favour the full liberalisation of investment barriers, leading to a more open and competitive global market for FDI, and the application of state-of-the-art protection for investors in IIAs. Such a perspective may be said to have informed the general development of FDI policy on the part of the NAFTA countries, both in their regional and bilateral dealings over FDI, and the policy preferences of MNEs. On the other hand, a "sceptical" position is taken by those who remain to be convinced that full liberalisation is necessary, and who wish to retain a high degree of State discretion in IIAs. It may be said that a number of leading developing countries take such a position, as is evidenced by discussions in the WTO Working Group on Trade and Investment, and by the opposition, on the part of such countries to the commencement of negotiations over investment issues at Cancun in 2003.<sup>42</sup> In addition some, but by no means all, civil society groups and NGOs, that are concerned about the adverse effects of economic globalisation, may follow this position.

A middle way between these positions may be said to be emerging from the work of UNCTAD. This may be said to have elements of a "transformationalist" perspective, in that the reality of globalisation is accepted and the need for some fundamental reconsideration of its regulatory consequences is required. In relation to investment issues, the fundamental starting point is an acceptance that FDI is, in general, beneficial to national economies, including those of developing countries.<sup>43</sup> Thus, on the whole, a policy of liberalisation and protection of investors can be welcomed and appropriate obligations in IIAs can be undertaken. On the other hand, such an approach may have to be mitigated in IIAs to allow for the preservation of "national policy space" in the development of national economic policy, and the "right to regulate" economic activity within national borders.<sup>44</sup> This is especially the case for developing countries that may have greater difficulties than developed countries in opening up their economies to the full force of global competition.

According to UNCTAD, in order to reap the full benefits from FDI, the developing host country may need to supplement an open approach to inward investment with further policies. In particular, it may need positive measures to increase the contribution of foreign affiliates to the host country through mandatory measures such as, for example, performance requirements and through the encouragement of desired action by affiliates through, for example, incentives to transfer technology and to create local R&D capacity. Such policy measures entail a degree of regulation. This may involve some measure of intervention in the freedom of action of the foreign investor and controls over the manner in which the investment can evolve. In this, the host country may encounter an inconsistency between its desired policy goals, as enacted through regulatory measures, and the obligations to protect investors and their investments under the terms of the IIA. From a development perspective this requires a balance to be struck between the legitimate interests of investors to enjoy their investments in a settled, transparent and predictable investment policy environment and the legitimate interests of the host country to pursue its development goals. This can be achieved through recognition of the need, in an IIA, to preserve a degree of national policy space for the host country and for an acceptance of a "right to regulate" for legitimate policy purposes alongside the host country's commitments to protect investors and their investments.

---

process of global economic integration and wish to reverse it see Colin Hines *Localization: A Global Manifesto* (London, Eathscan, 2000).

<sup>40</sup> Jan Aart Scholte *Globalization: A Critical Introduction* (Basingstoke, Palgrave, 2000) at pp.17-18.

<sup>41</sup> See V. Cable *Globalization and Global Governance* (London, RIIA, 1999) ch.7. The ideas of the late Sir James Goldsmith, founder of the UK Referendum Party perhaps come closest to exemplifying the nationalist perspective: See his book *The Trap* (London, MacMillan, 1996). Equally, the politics of ethnic identity can act as a spur to anti-globalist perspectives. See for example the effect of the rise of Islamic fundamentalism discussed by Ankie Hoogvelt in *Globalization and the Postcolonial World* (Basingstoke, Palgrave, 2<sup>nd</sup> Ed, 2001) ch.9."Islamic Revolt".

<sup>42</sup> On the wider issues behind this scepticism see S.Young and A.T.Tavares "Multilateral rules on FDI: do we need them? Will we get them? A developing country perspective" 13 *Transnational Corporations* 1 (2004).

<sup>43</sup> See *World Investment Report 2003 op.cit.* note 25pp.85-8. The UN Global Compact is also in essence pro investment see [www.globalcompact.org](http://www.globalcompact.org)

<sup>44</sup> See *World Investment Report 2003 ibid* Ch.V.

In addition, an IIA should display a commitment to flexibility for development. In this context, flexibility denotes:

“an instrument’s ability to serve, and to be adapted to, several differing uses and functions. The flexibility considered here relates to a particular set of objectives, those that concern the promotion of the development of developing countries parties to IIAs, without losing sight of the need for stability, predictability and transparency for investors. More specifically, the function of flexibility is to adapt IIAs to the particular conditions prevailing in developing countries and to the realities of the economic asymmetries between those countries and developed countries, which act as home to most TNCs.”<sup>45</sup>

Flexibility in IIAs, can be approached from four main angles<sup>46</sup> First, IIAs may include preambular statements or general principles referring broadly to development as an overall objective, outlining specific development objectives or introducing the concept of flexibility. Secondly, a degree of special and differential treatment for developing country parties to the agreement may be required, as through different rights and obligations related to the level of development, the limitation of obligations or the use of separate instruments for certain obligations. Thirdly, substantive provisions can be drafted in a manner that allows for the recognition of special considerations for developing countries. Parties to a treaty can, for example, use a definition of investment protected by the agreement that allows for greater control over certain types of investment by excluding these from the definition or the use of exclusions from non-discrimination provisions, carve out a right to regulate in an expropriation provision, or take a reservation to dispute settlement provisions. Finally, the application of an IIA may allow for variations in the normative force of certain obligations and for the introduction of mechanisms through which development concerns can be articulated, such as intergovernmental commissions and interpretative mechanisms.

The above classification of major approaches to the field of international foreign investment law is no more than a guide. Inevitably practice will not conform in pure terms to any particular perspective. Indeed, even the US and Canada are concerned, in the light of their experiences of litigation under NAFTA, not to allow too much freedom for investors to bring claims that may undermine vital national policy goals. As the work of UNCTAD suggests, the challenge is to develop the law in a manner that ensures the fullest possible benefits from FDI while also allowing for the retention of a degree of national sovereignty in the development and application of economic policy. In addition, as emphasised by the so-called “anti-globalisation” movement, private corporations must be accountable for their activities, especially if these are central to the economic development of the communities in which they operate. Finally, it should also be borne in mind that governmental abuses of power, which impact adversely on investors and their assets, cannot be ignored. Indeed, the issue of “good governance” is in itself a key question underlying the development of international investment law. Thus notions of judicial review of administrative action may well take on a stronger role in this field, as will be further discussed below in relation to enforcement and dispute settlement.

### **(c) Technical Issues**

Against the foregoing background, this part of the report will now consider the more technical issues of international foreign investment law, dividing the discussion between sources and institutional factors, the development of substantive standards and, finally, enforcement and dispute settlement.

### **(i) Sources and Institutional Factors**

The development of this area of international law is significantly influenced by issues pertaining to the sources of international law and of the institutional factors that influence this question. From an historical perspective, it is fair to say that the persistent disagreement between States over the precise form and content of customary law standards relating to the treatment of aliens and their property has ensured that the major source of norms in this field will be found in international treaties and other forms of binding and non-binding instrument. Some international legal publicists have argued that the extensive, and growing, system of IIAs at the bilateral and regional levels has reinforced the normative significance of traditional international legal standards for protection of aliens and their property, and has undermined the call for increased national sovereignty over foreign investors contained,

<sup>45</sup> UNCTAD *International Investment Agreements: Flexibility for Development* (United Nations, New York and Geneva, 2000) at p.15.

<sup>46</sup> See further UNCTAD *World Investment Report 2003* chapter V and UNCTAD *Flexibility for Development* Part Two.

for example, in UN Declarations establishing the NIEO.<sup>47</sup> Though compelling, this view has itself been subjected to strong criticism, not least because such treaties are the outcome of individual bargaining relationships that cannot act as a source of general legal obligation and there exist too many variations between treaty provisions to show evidence of consensus over the content of the relevant standards.<sup>48</sup> Bilateral Investment Treaties (BITs), the most numerous type of IIA, can be said to constitute a special juridical regime designed to restate, in treaty form, international minimum standards of treatment of foreign investors as accepted by the capital-exporting states, and to merge these with established, treaty-based, standards of commercial conduct that do not possess the character of customary international law, despite their widespread usage over many centuries, notably, the most-favoured-nation (MFN) standard and the national treatment standard. The result is an integrated system of norms for the delocalised regulation of a bilateral investment relationship between a developed capital-exporting state and a less developed capital-importing state, in a manner conducive to efficient capital accumulation by investors from the capital-exporting state.<sup>49</sup> On the other hand, it could be argued that the increased use of BITs between developing countries themselves<sup>50</sup> shows that they have an impact upon the legal regime now favoured by the traditional opponents of binding international minimum standards of treatment. Perhaps the key question is what might be gained by elevating treaty-based standards to customary law? In effect, it would bind all countries to what may remain contested international minimum standards of treatment, regardless of whether such countries have signed IIAs. This would prevent freedom of choice for countries as to the extent and nature of their commitments in relation to foreign investment law. Given the widespread application of otherwise contested standards as treaty based obligations, it would appear unnecessary to do so and, in this very sensitive policy area, it could produce an unfavourable political response, retarding economic integration and development. In this connection it can be noted that the NAFTA Free Trade Commission's Interpretation of July 2001 on NAFTA 1105 (as well as recent US and Canadian BITs, and Free Trade Agreements entered into by these countries and also Mexico) attempt to reduce the most important standard of treatment, fair and equitable treatment, to the international minimum standard under customary international law.<sup>51</sup>

A further area of concern under this heading is the precise legal status of the instruments from which international investment law may be said to emanate. In the first place, it is not entirely clear how many of the IIAs that have been signed are actually ratified and legally binding. The answer to this question may be central to resolving the issue of whether these agreements show a sufficient consensus to be treated as evidence of customary law. Secondly, many instruments that are commonly referred to as sources of international investment law standards are non-binding, such as for example, industry codes or the OECD Guidelines for Multinational Enterprises. Thus the field contains not only "hard" but "soft law" sources. As a rough guide, it can be said that "soft" law standards are more common at the level of corporate, industry, NGO or IGO activity, particularly in relation to corporate social responsibility issues, while "hard" law standards tend to prevail in IIA practice. This does not, however, lead to the conclusion that these different levels of legal force cannot have significant and, indeed, complementary effects on the development of this field of international law and of corporate responsibility standards in particular. Indeed, the balanced development of substantive standards in this area may depend on such a process.

"Soft" law standards are based essentially on moral force, in that the major method of enforcement is through the shame of non-adherence.<sup>52</sup> At the international level "soft law" can "harden" into positive law, where it is

<sup>47</sup> See e.g. F.A.Mann "British Treaties for the Promotion and Protection of Investment" 52 BYIL 241 (1981); Juillard "Les Conventions Bilaterales d'Investissement Conclues par la France" 2 JDI 274 (1979); *ibid.* "Les Conventions Bilaterales d'Investissement Conclues par la France Avec les Pays n'Appartenant pas a la Zone Franc" AFDI (1982) 760. For a more recent restatement of this position see: S.Hindelang "Bilateral Investment Treaties, Custom and a Healthy Investment Climate – The Question of Whether BITs Influence Customary International Law Revisited" 5 JWIT 789 (2004), S. Schwebel, "The Influence of Bilateral Investment Treaties on Customary International Law" 98 ASIL Proceedings 27-30 (2004).

<sup>48</sup> See Sornarajah *op.cit.* note 2 at pp.204-8. See too the award in *UPS v Canada* para.97 available on [www.naftalaw.org](http://www.naftalaw.org)

<sup>49</sup> P.T. Muchlinski *Multinational Enterprises and the Law* (Oxford, Blackwell Publishers, revised paperback ed, 1999) at p.639.

<sup>50</sup> See *World Investment report 2003 op.cit.* note 25 at p.89

<sup>51</sup> See: NAFTA Free Trade Commission Clarifications Related to NAFTA Chapter 11, Decision of 31 July 2001, available at <http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp>; Art 5(2) of the US-Uruguay BIT of 25 October 2004, 44 ILM 265 (2005); Canada Foreign Investment Protection Agreement Model of 2004 Article 5(2) available at [www.unctad.org/iiia](http://www.unctad.org/iiia). See too Article 60 of the 2004 FTA between Japan and Mexico and Article 10.4 of the 2003 US-Chile FTA available at [www.unctad.org/iiia](http://www.unctad.org/iiia).

<sup>52</sup> The following paragraph is adapted from Peter Muchlinski "Human Rights Social Responsibility and the Regulation of International Business: The Development of International Standards by Intergovernmental Organisations" 3 *Non-State Actors and International Law* 123 at p.128-30 (2003).

seen as evidence of emergent new standards of customary international law. For these purposes the origin of the legal principle in a “soft law” instrument, such as a voluntary code of conduct or a non-binding resolution of an international organisation, is of little consequence if a consensus develops that the principle in question should be viewed as an obligatory standard by reason of subsequent practice.<sup>53</sup> Given that many of the most important international expressions of welfare values tend to be in such form<sup>54</sup> the “hardening process” may be of especial importance here. On the other hand, it should not be forgotten that even in “hard law” agreements, provisions concerning controversial social issues have been put into very general, and probably meaningless, hortatory language, simply to show that something has been done, when there is little intent to give these provisions any real legal effect.<sup>55</sup> To dismiss voluntary sources of international standards as irrelevant seems to fail to appreciate how formal rules and principles of law emerge. The very fact that an increasing number of non-binding codes are being drafted and adopted in this area, suggests a growing interest among important groups and organisations – corporations, industry associations, NGOs, governments and IGOs - and is leading to the establishment of a rich set of sources from which new binding standards can emerge. No doubt this process can, and is being, criticised as one in which corporate interests are trying to capture the agenda through code making. It is fair to say that non-business NGOs are attempting the same with their codes. The real issue is when and how will all this “codification” turn into detailed legal standards that can act as fully binding benchmarks for the control of unacceptable lapses in corporate conduct at the international level. That is, as noted above, an issue of ideological contest, but one which seems to be veering slowly towards an acceptance of some kind of articulated set of minimum international standards for corporate social responsibility as a trade-off for greater corporate freedom in the market.

## (ii) Development of Substantive Standards

This section will consider some of the major policy issues surrounding the development of substantive standards in international investment law.<sup>56</sup> Four areas of concern will be highlighted: firstly, the “core issues”, concerning the protection of investors and their investments; secondly, the role of economic development related measures that involve explicit development policy implications; thirdly, corporate social responsibility issues; and finally, home country measures and obligations.

### “Core” Issues Concerning Investor/Investment Protection

Among the core issues in this area are scope and definition, admission and establishment, standards of treatment including fair and equitable treatment and non-discrimination, taking of property and transparency. Each issue will be considered in the light of the need to balance the protection of investors and their assets with the right of the host country to regulate investors and investments and to develop national economic policy. Development considerations are also highlighted as a significant negotiating issue in the international arena.

#### *Scope and Definition*

IAs usually commence with a provision that defines the “investments” of the contracting parties which are covered by the treaty.<sup>57</sup> More recent agreements tend to favour broad, asset-based, definitions that include not only physical assets, equity and choses in action but also intellectual property rights and contractual concessions.<sup>58</sup> The aim is to ensure sufficient flexibility to encompass not only equity but non-equity investments, and to allow for the evolution of new forms of investment between the parties. Furthermore, the

<sup>53</sup> See for example O.A. Elias and C.L.Lim *The Paradox of Consensualism in International Law* (The Hague, Kluwer Law International, 1998) at pp.230-2.

<sup>54</sup> *Ibid.*

<sup>55</sup> See for example the discussion of Article 19 of the Energy Charter Treaty (environmental aspects) by Thomas Waelde in “Sustainable Development and the 1994 Energy Charter Treaty: Between Pseudo-Action and the Management of Environmental Investment Risk” in F.Weiss, E.Denters and P. de Waart (Eds) *International Economic Law with a Human Face* (The Hague, Kluwer Law International, 1998) pp.223-70; and see T.Waelde “Non-conventional Views on “Effectiveness”: The Holy Grail of Modern International Lawyers: The New Paradigm? A Chimeria? Or a Brave New World in the Global Economy?” 4 *Austrian Review of International and European Law* 164 (1999).

<sup>56</sup> The most extensive treatment of these issues, in relation to the content of international investment agreements, can be found in the UNCTAD Series on Issues in International Investment Agreements, published between 1999 and 2004. All the papers have been brought together into UNCTAD *International Investment Agreements: Key Issues: Vols. I-III* (New York and Geneva, United Nations, 2004) on which this section relies significantly (Cited as UNCTAD: Key Issues below).

<sup>57</sup> This paragraph is based on Muchlinski *op.cit.* note 49 at p.620. See too Engela Schlemmer “Investment, Investor, Nationality, Shareholders and Foreign Investment Law” forthcoming at TDM *op.cit.* note 1.

<sup>58</sup> See, for example, ASEAN Agreement for the Promotion and Protection of Investments, Article 1(3) in UNCTAD *International Investment Agreements: A Compendium Vol II* (New York and Geneva, United Nations, 1996) at p.294.

notion of direct investment is not taken as the starting point. In place of such definitions, some agreements contain an enterprise-based definition focusing on “the business enterprise” or the “controlling interests in a business enterprise”,<sup>59</sup> while other agreements take a “transaction based” definition. For example the OECD Code of Liberalisation of Capital Movements does not define “investment” or “capital” as such but contains a list of covered transactions in Annex A, including direct investment.<sup>60</sup> The definition of “investment” may be limited. Thus some agreements exclude portfolio investment,<sup>61</sup> on the ground that it is less stable than direct investment and so should not be given equal protection, or limit protection to investments permitted under the law of the host country, a formulation common in Chinese and ASEAN agreements,<sup>62</sup> or investments of a certain size or in specific sectors.<sup>63</sup>

*Admission, the Right of Establishment and the Right to Control Entry*

The first point of contact between national FDI policy and foreign investment by MNEs and other investors arises at the border when such investors and their investments seek to enter the host country. Here there exists a policy choice regarding the degree of regulation or openness that the host country might adopt in relation to the admission, establishment and control of FDI. Under international law, a State has an absolute right to control the admission and establishment of aliens, including foreign investors, on its territory. This right can be qualified through the unilateral action of the host country and/or through international agreement with other countries.<sup>64</sup> Thus a State has a free choice as to the degree of open admission and the extent of rights of establishment it sees fit to offer to foreign investors.

Equally, a State is free to regulate the entry and establishment of FDI through forms of conditional entry. The economic rationale for granting open admission and rights of establishment is to allow for the efficient allocation of productive resources across countries, through the avoidance of market distorting policy controls that may serve to discriminate between foreign and domestic investors and/or investors from different home countries.<sup>65</sup> On the other hand, controls over entry and establishment, or conditional entry based on specific requirements that must be observed by the foreign investor, may be motivated by a need to preserve national economic policy goals, national security, public health and safety, public morals and other essential public policy goals such as environmental or consumer protection. Indeed, some developing countries may wish to retain a degree of control over the admission and establishment of FDI on their territory. This can be explained by a reluctance to open up their domestic markets to potentially damaging penetration on the part of economically dominant foreign firms by reason of an overbroad right of unconditional entry, or as a result of an excessively speedy process of admission that does not allow sufficient time to analyse the potential economic (and possibly social) advantages and disadvantages of the investment in question.<sup>66</sup> However, such motives may also be used to justify what are little more than measures designed to insulate inefficient or monopolistic national industries from competition at the cost of consumer welfare and productive efficiency. Thus national policy on FDI may be used for protectionist purposes that may not be in the long-term interests of national economic development.

The future role of provisions concerning admission, establishment and the right to control entry lies at the heart of development concerns as they arise in international investment negotiations. Indeed, this issue has already caused controversy among developed countries during the negotiations for the Multilateral Agreement on Investment (MAI). More recently, the issue was discussed in the WTO Working Group on Trade and Investment, where the possible use of a GATS type “positive list” approach to pre-establishment issues has focused attention on the precise architecture that any future investment rules pertaining to this area should

<sup>59</sup> See for example the Canada-US Free Trade Agreement 1988 cited in UNCTAD: Key Issues *op.cit.* note 56 at p.125

<sup>60</sup> UNCTAD: Key Issues at p.125.

<sup>61</sup> See for example the Denmark-Poland BIT Article 1(1)(b) where investment refers to “all investments in companies made for the purpose of establishing lasting economic relations between the investor and the company and giving the investor the possibility of exercising significant influence on the management of the company concerned” quoted in UNCTAD: Key Issues *op.cit.* note 56 at p.123.

<sup>62</sup> *Ibid.* at pp.122-3.

<sup>63</sup> *Ibid.* at p.125.

<sup>64</sup> Note that the US and Canadian BITs and Free Trade Agreements (FTAs) grant a right to admission by extending their national treatment and MFN provisions to “establishment”. See Articles 3 and 4 of the US-Uruguay BIT of 2004, and Articles 3 and 4 of the Canadian Model Agreement of 2004, *op.cit.* note 51

<sup>65</sup> See UNCTAD: Key Issues *op.cit.* note 56 at p.146.

<sup>66</sup> See further D. Conklin and D.Lecraw “Restrictions on Foreign Ownership During 1984-1994: Developments and Alternative Policies” 6 *Transnational Corporations* 1 (1997).

adopt.<sup>67</sup> Some developing and developed countries, including the EU, expressed their support for this approach while some developed countries suggested that a combined national and most-favoured treatment approach with “negative lists” of exceptions should be preferred. At Cancun, concern over this question was among the major reasons why developing countries decided to oppose the commencement of negotiations in this area as part of the Doha Round.<sup>68</sup>

Other significant questions in this area concern the scope, speed and nature of liberalising provisions. Thus, as suggested by the GATS approach, the range of sectors or industries to be liberalised can be addressed, the speed of liberalisation can be controlled by transitional provisions that offer specifically agreed lead times for the process to take full effect, and the binding or non-binding nature of commitments towards liberalisation of entry and establishment provisions can be considered, for example, by using a “best endeavours” clause that does not commit to a legally binding policy change but allows for a gradual change of attitude without the possibility of creating binding legal rights for investors. Finally, the scope of restrictions on entry and establishment rights may need to be considered further. A particular new issue here may arise in relation to environmental restrictions related to entry, such as, for example, a requirement for an environmental impact assessment of the proposed investment resulting in environmental performance requirements being imposed as a condition of entry.

### *Standards of Treatment*

#### *Non-Discrimination*

The principle of non-discrimination is a core standard of protection for investors and their investments in IIAs. It consists of two main elements: the Most-Favoured-Nation (MFN) standard, which ensures that investors and investments from one country are treated in the same, or no less favourable, manner than like investors/investments from other countries<sup>69</sup>, and the national treatment standard, which ensures that investors and investments from outside the host country are treated in the same, or no less favourable, manner than like investors/investments from inside the host country<sup>70</sup>. Thus the non-discrimination standard aims to ensure that all foreign investors and investments are guaranteed at least equality of competitive conditions with other foreign investors/investments and domestic investors/investments in like situations. In addition, where national FDI policy uses the “no less favourable” standard in the case of national treatment, it is possible to ensure better competitive conditions for foreign as compared to domestic investors. As regards the MFN standard this formulation may permit more favourable treatment for investors/investments from certain countries, though this is usually achieved by special preferences that have been introduced as an exception to MFN. The principle of non-discrimination may also be enhanced as an aspect of the general standard of fair and equitable treatment, which can be distinguished from MFN and national treatment on the basis that it is an unconditional standard, while the latter are conditional on the existence of other investors/investments, whether foreign or domestic, that are in a like situation to the investor/investment that is protected by the relevant standard<sup>71</sup>. It should be noted that many BITs contain separate provisions against arbitrary and/or discriminatory treatment.<sup>72</sup>

<sup>67</sup> See further WTO *Modalities for Pre-Establishment Commitments Based on a GATS-Type Positive List Approach Note by the Secretariat* WT/WGTI/120 19 June 2002.

<sup>68</sup> See further *Communication of 2 September 2003 from the Permanent Mission of India to the Ministerial Conference Fifth Session Cancun 10-14 September 2003* (WT/MIN(03)/W/4 4 September 2003) at p.3 para.2.

<sup>69</sup> See further UNCTAD *Most-Favoured-Nation Treatment Series* on issues in international investment agreements (New York and Geneva, United Nations, 1999) or UNCTAD: Key Issues *op.cit.* note 56 ch.6; OECD *International Investment Law: A Changing Landscape* (Paris, OECD, 2005) ch.4. and the draft paper by Pia Acconci “Most Favoured Nation Treatment and the International Law on Foreign Investment” available on the TDM website *op.cit.* note 1. Note too the recent controversy surrounding the effect of the MFN standard, inspired by the procedural decision in the case of *Maffezini v Spain* (ICSID Case No.ARB/97/7 decision on objections to jurisdiction 25 January 2000: 16 ICSID Rev-FILJ 212 (2001)) as a technique for extending substantive and procedural protection from one investment agreement to another containing less favourable protection standards. See further Jurgen Kurtz “The MFN Standard and Foreign Investment: An Uneasy Fit?” 6 JWIT 861 (2004); Rudolph Dolzer and Terry Myers “After *Teched* Most-Favoured-Nation Clauses in International Investment Protection Agreements” 19 ICSID Rev-FILJ 49 (2004); Dan H. Freyer and David Herlihy “Most-Favoured-Nation Treatment and Dispute Settlement in Investment Arbitration: Just how ‘Favoured’ is ‘Most-Favoured’?” 20 ICSID Rev-FILJ 58 (2005); Locknie Hsu “MFN and Dispute Settlement – When the Twain Meet” 7 JWIT 25 (2006). This issue will be fully discussed in the final report of the Committee.

<sup>70</sup> See further UNCTAD *National Treatment Series* on issues in international investment agreements (New York and Geneva, United Nations, 1999) or UNCTAD: Key Issues *op.cit.* note 56 ch.5.

<sup>71</sup> See further UNCTAD *Fair and Equitable Treatment Series* on issues in international investment agreements (New York and Geneva, United Nations, 1999) or UNCTAD: Key Issues *op.cit.* note 56 ch.7; OECD *op.cit.* note 69 ch.3.

<sup>72</sup> See UNCTAD *Bilateral Investment Treaties in the Mid-1990s* (New York and Geneva, United Nations, 1998) at pp.55-6.

From a development perspective, the issue of non-discrimination is highly contentious, especially in relation to differential treatment between domestic and foreign investors, given that developing host countries may seek to protect the development of indigenous industrial production and service provision in the face of potentially negative competitive pressure from powerful foreign investors. In relation to the development implications of the non-discrimination standard, it is important to distinguish the kinds of measures that might be applied to MFN as opposed to national treatment, as they tend to create different degrees of policy sensitivity, especially as regards the scope, nature and extent of exceptions to the standard concerned. Thus MFN is less likely to be the subject of exceptions than national treatment, reflecting the fact that host countries generally find it more difficult to treat foreign and domestic investors/investments equally than to provide for equal treatment among investors from different home countries.<sup>73</sup> The most frequent exceptions to the MFN standard relate to international networks of obligations, such as those arising from bilateral tax treaties or membership of regional economic integration groupings, where a degree of preferential treatment for the investors and investments of the other contracting parties is usual. By contrast, national treatment may elicit more exceptions than MFN. These will include certain general exceptions based on national security or public health or morals (which may also apply to MFN treatment), subject specific exceptions relating to certain fields that require reciprocity of treatment from home countries of investors, such as taxation or intellectual property, or which are excluded for reasons of national policy, such as incentives or public procurement, and industry specific exceptions which exclude or limit the participation of foreign investors in certain types of activities of industries on the basis of national economic and social policy.<sup>74</sup>

The MFN and national treatment standards are essentially treaty-based standards. They are covered in most IIAs, principally in relation to the post-entry stage of investment, though the practice in North American bilateral and regional agreements extends these standards to the pre-entry stage as well. There, the approach is to provide for the protection of MFN and national treatment subject to general and country specific exceptions as described earlier. Similarly, the GATS Agreement protects MFN on this “opt-out” basis. On the other hand, in relation to national treatment, it provides for an “opt-in” by way of an express commitment to extend national treatment to those sectors that a contracting party chooses to open up to full market access.<sup>75</sup> As regards exceptions, virtually all regional and inter-regional IIAs contain general national security and public health/morals exceptions to the non-discrimination standard though BITs generally do not.<sup>76</sup>

The core, development oriented, issue in this area concerns the extension of non-discrimination to the pre-entry stage of investment. As such it is intimately related to the issue of admission and the right of establishment. Other important, development oriented issues for the future concern the range and extent of exceptions. Traditionally, in order to retain the maximum effective discretion for regulatory purposes, it has been considered that certain exceptions and qualifications are necessary to the non-discrimination standard. On the other hand, changes in the nature and structure of national markets, and in particular, their increasing integration into global chains of production and distribution puts into question whether high levels of discriminatory regulation are in fact desirable. Hence a balance needs to be sought out between necessary exceptions, based on overriding regulatory requirements, and overbroad ones that may serve to undermine the positive integrating effects of economic openness and may, indeed, be little more than protectionist devices for inefficient national industries and firms.

#### *Fair and Equitable Treatment*

Moving to other important standards of treatment, currently the most important standard, from the perspective of investor protection, is the fair and equitable treatment standard. To date, arbitral case law has concentrated on the responsibilities of the host country in its conduct towards the investor. As a result, certain elements of an emergent standard of review of administrative action appear to be taking shape. This standard of review reflects contemporary approaches to good governance. Thus, Tribunals have noted that the original customary

<sup>73</sup> UNCTAD *Most-Favoured-Nation Treatment* op.cit. note 69 at p.31.

<sup>74</sup> See UNCTAD *National Treatment* op.cit. note 70 at pp.43-6. A good example of a national law that uses a range of such exceptions is the Mexican Foreign Investment Act 1993: 33 ILM 207 (1994) discussed in Muchlinski op.cit. note 49 at p.195-6. These exceptions are, in turn, reserved from the operation of the non-discrimination provisions of NAFTA in Mexico's schedule of exceptions to that agreement, as are the corresponding exceptions of the United States and Canada.

<sup>75</sup> UNCTAD *National Treatment* op.cit. note 70 at pp.23-25; UNCTAD *Admission and Establishment* Series on issues in international investment agreements (New York and Geneva, United Nations, 1999) at pp.20-21

<sup>76</sup> UNCTAD op.cit. note 72 at p.86.

international law standard, with its emphasis on outrageous mistreatment of the alien, is no longer sufficient.<sup>77</sup> Instead, the correct question is,

“whether, at an international level and having regard to generally accepted standards of administration of justice, a tribunal can conclude in the light of all the available facts that the impugned decision was clearly improper and discreditable, with the result that the investment has been subjected to unfair and inequitable treatment.”<sup>78</sup>

In the light of this contemporary perspective, it is now reasonably well settled that the standard requires a particular approach to governance, on the part of the host country, that is encapsulated in the obligations to act in a consistent manner, free from ambiguity and in total transparency, without arbitrariness and in accordance with the principle of good faith.<sup>79</sup> In addition, investors can expect due process in the handling of their claims<sup>80</sup> and to have the host authorities act in a manner that is non-discriminatory and proportionate to the policy aims involved.<sup>81</sup> These will include the need to observe the goal of creating favourable investment conditions and the observance of the legitimate commercial expectations of the investor.<sup>82</sup> On the other hand, the standard is case specific and requires a flexible approach given that it offers a general point of departure in formulating an argument that the foreign investor has not been well treated by reason of discriminatory or other unfair measures that have been taken against its interests.<sup>83</sup> Such case specific flexibility may require an examination not only of governmental but also of investor conduct in a given case.

Such a consideration may be justified by reference to the issue of investment risk. Given the international character of foreign investment it may be said to carry a higher degree of risk than purely domestic investment. Indeed, foreign investment may be characterised as a prime example of high risk-high return investment. Even large multinational enterprises can experience a high level of risk in a host country that is unfamiliar to the firm. Such risk is exacerbated where the country in question is noted for political instability, corruption, and an inefficient system of administration. In these cases it may be especially important for the investor to be able to rely on international standards of treatment, and international systems of dispute settlement, to ensure the full security of its investment. On the other hand, in a market economy, a degree of independent judgment as to the scope of an investment risk will be expected of the investor. Not all investment risks can, or should, be protected against. This may prove inimical to the efficient functioning of a market economy, where the freedom of economic actors to make informed business judgments lies at the heart of the market mechanism. It is up to the firm to determine the risks and to develop an appropriate strategy to deal with them.<sup>84</sup> Any assessment of regulatory fairness will need to be made in the light of this factor. Investor conduct should be considered not only because it may break the chain of causation between the governmental act and the loss to the investor, but as a matter of principle and duty, so as to balance out the emergent duties of the host country to act with proper regard to good regulatory practice.<sup>85</sup>

#### *Full Protection and Security*

Most BITs and other IIAs contain clauses providing for the compensation of the investor for losses due to armed conflict or internal disorder. These do not establish an absolute right to compensation. Rather, they lay down that the investor shall be treated in accordance with the national treatment and/or MFN standard in the matter of compensation. The scope of the host country’s responsibility for such losses should be determined by reference to a

<sup>77</sup> For example in *USA (L.F. Neer) v Mexico (Neer Claim)* (1927 AJIL 555 at 556 such treatment was defined as treatment amounting to an “outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency”.

<sup>78</sup> *Mondev International Ltd v United States* ICSID Case No. ARB (AF)/99/2 award of 11 October 2002: 42 ILM 85 (2003) at para.127.

<sup>79</sup> See *Teched v Mexico* ICSID Case No.ARB(AF)/00/2 award of 29 May 2003 available at [www.worldbank.org/icsid/cases](http://www.worldbank.org/icsid/cases) or 43 ILM 133 (2004) at para.154-5.

<sup>80</sup> See for example *Loewen v United States* ICSID Case No.ARB(AF)/98/3 award of 26 June 2003: 42 ILM 811 (2003).

<sup>81</sup> See *Loewen v United States* *ibid*; *Waste Management Inc v Mexico* ICSID Case No. ARB (AF)/00/3 award of 30 April 2004: 43 ILM 967 (2004) at para.98; *MTD Equity v Chile* ICSID Case No.ARB/01/7 award of 25 May 2004: 44 ILM 91 (2005) at para.109.

<sup>82</sup> *TECMED v Mexico* *op.cit.* note 79 at para.156-7.

<sup>83</sup> *Mondev International Ltd v United States* *op.cit.* note 78 at para.118 and *Waste Management* *op.cit.* note 81 at para.99.

<sup>84</sup> See further Christopher A. Bartlett, Sumantra Ghoshal and Julian Birkinshaw *Transnational Management: Text Cases and Readings in Cross-Border Management* (Boston, McGraw Hill Irwin, 4<sup>th</sup> Ed, 2004) Ch.3.

<sup>85</sup> See further Peter Muchlinski “ ‘Caveat Investor’? The Relevance of the Conduct of the Investor Under the Fair and Equitable Treatment Standard” forthcoming, ICLQ.

"due diligence" standard.<sup>86</sup> As noted by the ICSID Tribunal in *AMT v Zaire*<sup>87</sup> the host country is bound to observe an obligation of vigilance in protecting the property of the investor.<sup>88</sup> This requires the host country to take measures to ensure the protection and security of the investments in question. An omission to do so can amount to a case of *res ipsa loquitur*. The fact that the host country may have also failed to protect the investments of investors from third States is irrelevant.<sup>89</sup> As to the question of compensation, an interference with full protection and security is not a case of expropriation, but one of loss and damage to property. Thus the method of assessing compensation cannot be assimilated to that used in cases of expropriation. Accordingly, the actual loss, based on the actual market value of the damaged and lost property, taking into account the realities of the political and economic risks faced by the investor in the host country, is the proper approach.<sup>90</sup>

### *Taking of Property*

The power of a government to take foreign owned private property, either into State ownership through nationalisation, or into new, usually local, private ownership through expropriation has a long history. Indeed, major takings of foreign owned property in the course of the twentieth century, particularly by socialist States, led to the development of certain rules of customary international law that aimed to control the conditions under which such a taking could be lawfully effected.<sup>91</sup> These rules are not without controversy. In the past, certain countries have denied the legal validity of international rules in this area, asserting that only national law could determine the legality of a governmental taking of foreign owned property. Nonetheless, in more recent years certain basic principles have been universally accepted and many countries will refer to these as the legal basis of their national laws and practices.<sup>92</sup> They are as follows: the taking should be for a public purpose, it should be non-discriminatory, it should comply with rules of basic due process and compensation should be payable in the event of a taking. On this last point there is no hard and fast agreement among States as to the appropriate level and method of calculating the compensation payable. Some countries favour a high level of State discretion in this matter, referring to principles of "appropriate" or "just" compensation and using a book value method of valuation, while others, mainly the major capital exporting countries, favour a standard of "prompt, adequate and effective" compensation based on actual market values of the property taken<sup>93</sup>. Thus the principal regulatory issue in this area is whether, and how far, a national regime for the taking of foreign owned property, whether located in general compulsory purchase laws, or in specific acts relating to particular firms or industries, conforms to basic international legal standards.

In recent years outright nationalisations and mass expropriations of foreign owned property have not been a significant national economic policy, whether in developed or developing countries, though their renewed use cannot be ruled out completely<sup>94</sup>. Rather, the dominant trend has been towards privatisation and deregulation of State-owned assets with foreign investors often being encouraged to buy those assets. On the other hand, increasing attention has been paid to the possibility of so-called "indirect expropriation" whereby the property in question is subjected to governmental action that results in an, "effective loss of management, use or control, or a significant depreciation of the value of the assets of a foreign investor."<sup>95</sup> In other words the value of the investment is undermined to such an extent by the governmental action as to deprive the investor of the reasonably expected benefits of the investment. This may be as a result of "creeping expropriation", where the

<sup>86</sup> *Asian Agricultural Products Ltd v Republic of Sri Lanka* ICSID Case No.ARB/87/3 award of 27 June 1990: 30 ILM 577 (1991). See too *Wena Hotels v Egypt* ICSID Case No.ARB/98/4 award of 8 December 2000 available at [www.worldbank.org/icsid/cases](http://www.worldbank.org/icsid/cases) or 41 ILM896 (2002) at para.84.

<sup>87</sup> ICSID Case No.ARB/93/1 award of 21 February 1997 available at [www.worldbank.org/icsid/cases](http://www.worldbank.org/icsid/cases) or 36 ILM 1531 (1997). See too *Wena Hotels v Egypt* *ibid.* where the seizure of the Claimant's two hotels, by the Egyptian partner in the investment, was seen to violate the full protection and security standard as Egypt had failed to discharge its duty of vigilance and due diligence in protecting the hotels, despite knowledge of the intention to seize them, and by subsequently failing to restore them to their owners with suitable reparations: see paras.85-95.

<sup>88</sup> *Ibid.* at para.6.05.

<sup>89</sup> *Ibid.* at para.6.09-6.10.

<sup>90</sup> *Ibid.* at paras.7.13 and 7.16-7.17.

<sup>91</sup> UNCTAD *Taking of Property* Series on issues in international investment agreements (New York and Geneva, United Nations, 2000) at p.5 or UNCTAD: Key Issues *op.cit.* note 56 ch.8. See too OECD *op.cit.* note 69 ch.2.

<sup>92</sup> See for example the French nationalisation policy of the early 1980s: Muchlinski *op.cit.* note 49 at p.503.

<sup>93</sup> UNCTAD *Taking of Property op.cit.* note 91 at p.13-14

<sup>94</sup> *Ibid.* at p.5-6; E. Penrose, G. Joffe and P. Stevens "Nationalisation of Foreign Owned Property for a Public Purpose: An Economic Perspective of Appropriate Compensation" 55 MLR 351 (1992).

<sup>95</sup> UNCTAD *Taking of Property op.cit.* note 91 at p.2. See further the draft paper by August Reinisch "Expropriation" at the TDM website *op.cit.* note 1.

economic value of the investment is gradually neutralised by incremental regulatory interference in the investment that falls short of divesting the investor of its legal title in the investment, and of “regulatory takings” which arise out of the exercise of policing powers of the State or from other measures such as those regulating the environment, health, morals, culture or economy of the host country.<sup>96</sup> Here the major problem is to distinguish between a legitimate exercise of governmental discretion that interferes with the enjoyment, or leads to the expropriation, of foreign owned property and an illegitimate act of unlawful taking.

Recent US and Canadian Model BITs explain that non-discriminatory regulatory actions that are designed and applied to effectuate legitimate public welfare objectives, such as public health, safety and the environment, do not constitute expropriations except in rare circumstances.<sup>97</sup> The Canadian model adds that such rare circumstances will exist where, “a measure or series of measures are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good faith...”<sup>98</sup> Both Models add that, in determining whether a regulatory act has an effect equivalent to expropriation, the economic impact of the act (though the mere loss of economic value in itself does not show that the act is an indirect expropriation), the extent of interference with legitimate investment backed expectations and the character of the act are all of significance.

In addition, the issue of compensation is key to determining the legality or otherwise of a regulatory taking. It is well settled that any taking of property that is not accompanied by compensation will be unlawful, even if pursued under the general police power of the State (unless it is a taking authorised under lawful sanctions of confiscation). The compensation offered must reflect the actual loss to the investor. Therefore, it may be said that the State’s power to expropriate will be preserved, upon the payment of adequate and effective compensation, in cases where the deprivation of the use and enjoyment of the investor’s property is undertaken for a public purpose, under the authority of law and in a non-discriminatory manner. The measure of compensation will normally be based on the legitimate economic expectations of the investor, as determined in all the circumstances of the case, including the question whether the investment was in fact a profitable venture that had a real prospect of making the returns hoped for by the investor.

Provisions dealing with the taking of property can be expected to continue in future IIAs. Indeed, given the need to determine the proper balance between legitimate regulation and improper interference with private property rights through regulatory acts such provisions appear to gain importance. They will be central to a fuller understanding, and legal expression, of the “right to regulate” in the context of the development priorities of host countries. The attempt, in the US and Canadian BITs, to define what is meant by a regulatory taking testifies to this. In addition, the possibility that a taking might be justified by reason of necessity has been accepted in principle in the recent arbitral award of *CMS Gas Transmission Co v Argentina*.<sup>99</sup> Another significant future issue is whether, and how far, IIAs should permit international review of takings by host country authorities: should these be subject to a prior requirement to exhaust domestic remedies or should international review be available as a matter of right? This matter is further discussed in relation to dispute settlement.

### *Transparency*

The question of transparency is a relatively recent element to appear in international investment treaties. Indeed, most BITs do not refer to the issue at all. However more recent agreements have made reference to it.<sup>100</sup> Given

<sup>96</sup> UNCTAD *Taking of Property* at pp.11-12. This has given rise to significant recent international arbitral activity under ICSID and NAFTA. See further J.C.Thomas “Reflections on Article 1105 of NAFTA: History, State Practice and the Influence of Commentators” 17 *ICSID Review-Foreign Investment Law Journal* p.21 (2002); P.G. Foy and J. Deane “Foreign Investment Under Investment Treaties: Recent Developments Under Chapter 11 of the North American Free Trade Agreement” 16 *ICSID Review-Foreign Investment Law Journal* p.299 (2001).

<sup>97</sup> US-Uruguay BIT 2004 Annex B; Canada Model Agreement Annex B 13.1 *op.cit.* note 51.

<sup>98</sup> *Ibid.*

<sup>99</sup> ICSID Case No.ARB/01/8 award of 12 May 2005 available at <http://www.cmsenergy.com/invest/> or 44 ILM 1205 (2005). See further the draft paper by Andrea K. Bjorklund “Emergency Exceptions to International Obligations in the Realm of Foreign Investment: The State of Necessity as a Circumstance Precluding Wrongfulness” forthcoming TDM website *op.cit.* note 1.

<sup>100</sup> UNCTAD *Transparency* (New York and Geneva, United Nations, 2004) UNCTAD Series on issues in international investment agreements p.13. See too OECD *International Investment Perspectives* (Paris, OECD, 2003) ch.4. See for example the US-Uruguay BIT 2004 Articles 10 and 11, Canada Model Agreement Article 19 *op.cit.* note 51. See further Akira Kotera “Transparency in Investment Agreements” forthcoming TDM website *op.cit.* note 1.

this recent pedigree, the precise content of transparency provisions is not yet completely settled. On the other hand certain key issue areas have emerged. These may be said to encompass: the identification of the addressees of the transparency obligation, the scope of the obligation and, in particular, the extent of its “intrusiveness”, that is, the degree to which the obligation demands publicity and disclosure of the relevant information, the mechanisms of implementation, the timing of the required disclosure and, finally, issues of safeguards and exceptions.<sup>101</sup>

As to the issue of addressees, the traditional focus of IIAs upon host country obligations may be said to be under challenge. In particular, there may be good grounds for expecting not only the host country to offer clear and transparent information about matters relevant to the investment process and the protection of investors, but also to expect investors themselves, to comply fully with obligations of corporate accountability and disclosure as the *quid pro quo* of doing business in the host country. In other words, the transparency obligation may extend not only to questions of good governance on the part of the State but also to questions of corporate governance and responsibility on the part of investors. More difficult is the question of how far an IIA could impose transparency obligations upon the home country.<sup>102</sup> According to UNCTAD, it is arguable that transparency provisions of a general character, that refer to “the Contracting Parties” or “both Contracting Parties” to the agreement, cover home country parties as well. Thus the latter may be bound to make available information on laws and regulations that pertain to investment and/or upon investment opportunities and incentives, where the terms of the agreement so state.<sup>103</sup> This may be of some importance in ensuring that the investment promotion policies and rules of the home country are made fully transparent, thereby enhancing their effectiveness as vehicles for transferring capital technology and skills to developing countries in particular, through the means of FDI.

As to the content of the transparency obligation, countries parties to IIAs will have considerable discretion as to the extent of the disclosure requirement and its level of intrusiveness. Thus general commitments to publish investment policy information will be rather unintrusive, while an obligation to publish the details of individual administrative decisions would be highly intrusive, as it involves detailed information on individual cases. In the case of corporate disclosure, much will depend on whether the information required is of a kind usually required for the purposes of ensuring the correct application of national company fiscal and prudential regulation laws, or whether a wider agenda of issues encompassing what may be termed “social disclosure” is required.<sup>104</sup>

Turning to modalities of implementation and timing issues, there is a close correlation between the type of disclosure mechanism adopted and the degree of intrusiveness that results. Thus consultation over what information to disclose would entail a weaker obligation upon contracting parties than a unilateral obligation to do so. Equally disclosure could be voluntary or subject to a strict mandatory code. In addition, the timing of the disclosure may affect the scope of the obligation, in that the shorter the period between the governmental act that needs to be disclosed and the date of such disclosure, the greater the extent of the obligation.<sup>105</sup>

Finally, transparency obligations will need to be balanced by safeguards and exceptions. These will tend to cover the following matters: national security and defence, the requirements of law enforcement and judicial procedure, the need to ensure the freedom to determine policy through confidential deliberations, the protection of discretion in the making of investment decisions through a protection of their confidential nature until the final decision is made, and the requirements of commercial confidentiality.<sup>106</sup> In arbitral practice concerning the application of the fair and equitable treatment standard, transparency plays a very important role together with predictability and the protection of the investor's legitimate expectations.<sup>107</sup>

---

<sup>101</sup> UNCTAD *Ibid.* at pp.7-12.

<sup>102</sup> Indeed, some IIA provisions apply exclusively to the host country by referring to the obligation of each party to make publicly available its laws, regulations and procedures that may affect investment within their national territory, a qualification that can only arise in relation to a host country. See for example, Article 15 of the Finland Model BIT.

<sup>103</sup> UNCTAD *op.cit.* note 100 at pp.14-16.

<sup>104</sup> *Ibid.* at p.9. See further Muchlinski *op.cit.* note 49 ch.10.

<sup>105</sup> *Ibid.* at p.11.

<sup>106</sup> *Ibid.* at p.11-12.

<sup>107</sup> See for example, *Tecmed v Mexico op.cit.* note 79 at paras. 154-64. See further C.Schreuer “Fair and Equitable Treatment in Arbitral Practice” 6 *JWIT* 357 (2005) at pp.374-80.

### *The Development Dimension*

The development dimension of international investment issues formed a central feature of the Doha work programme. It has already been seen that the “core” investor/investment protection issues raise development related questions. In this section some further issues will be discussed which all have, as a common theme, the regulation of national economic policy through development oriented instruments that may impact upon those “core” rights.

#### *Performance Requirements*

Performance requirements are one class of measures that comes within the generic category of host country operational measures. They are stipulations, imposed on investors by the host government, requiring them to meet certain specified goals with respect to their operations in the host country. These may act as conditions for the entry and establishment of the investor in the host country, they may cover many types of measures,<sup>108</sup> they are specifically designed to affect FDI and they usually apply to the post-entry phase of the investment<sup>109</sup>. As such they represent an act of State intervention in the investor’s economic choice of how to structure the organisation and arrange the operation of their investment. They are usually justified on the basis of the host country’s need to minimise the possible disadvantages, and maximise the potential benefits, of the investment in line with its economic and developmental policies. They are often criticised as an unwarranted interference, through governmental action, in the process of economic decision making on the part of investors and that they will result in a distortion of that process with detrimental results to productive efficiency.<sup>110</sup> This approach has gained some ascendancy with the adoption of the WTO Agreement on Trade Related Investment Measures (TRIMS) which seeks to prohibit certain classes of performance requirements that are seen as being inconsistent with the national treatment obligation and the prohibition against quantitative restrictions in the GATT.<sup>111</sup>

Performance requirements have been extensively used, by both developing and developed countries, to further their industrial and investment policy goals.<sup>112</sup> Such measures have, in particular, been employed by developing countries to secure the types of investment needed for their development priorities, to protect balance-of-payments against distortions caused by profit remittances or payments for goods and services and to control possible restrictive business practices on the part of foreign firms related to their market power and ownership of technology.<sup>113</sup> By contrast, while developed countries have used performance requirements for similar purposes, these countries tend to rely more on incentives, or regulation or restrictive business practices, to achieve such ends. Developing countries may not have sufficient capital reserves or fiscal revenues to be able to offer extensive incentives. Nor do they necessarily have controls over restrictive business practices. Thus they have tended to prefer the use of performance requirements as tools of economic and investment policy.

Most IIAs do not cover performance requirements. However, North American bilateral and regional agreements have introduced restrictions and prohibitions on the use of certain types of performance requirements. At the multilateral level, as noted above, the TRIMS Agreement prohibits certain types of trade distorting performance requirements. In such agreements, performance requirements are dealt with either by way of an outright multilateral prohibition, as in the TRIMS Agreement, or a prohibition at the bilateral or regional level but not at the multilateral level, as in the abovementioned North American practice. There then remains a category of performance requirements, such as, for example, a requirement to transfer environmentally sound technology, that are generally not contested in IIAs.<sup>114</sup>

The major question from a development perspective is whether the current prohibitions in the TRIMS Agreement ought to be maintained or reduced so that developing countries can attain greater freedom and flexibility in the conduct of their FDI policy and, in particular, their approach to conditional entry and establishment of foreign investments, or whether they should be increased so as to ensure the least possible

<sup>108</sup> For example: local content rules, employment requirements, capital requirements, export requirements. For a fuller illustrative list see UNCTAD *Host Country Operational Measures Series* on issues in international investment agreements (New York and Geneva, United Nations, 2001) at pp.8-9 or UNCTAD: *Key Issues op.cit.* note 56 ch.14.

<sup>109</sup> *Ibid.* at p.10-11.

<sup>110</sup> see Muchlinski *op.cit.* note 49 at pp.257-60.

<sup>111</sup> See further UNCTAD, *Host Country Operational Measures op.cit.* note 108 at pp.17-26.

<sup>112</sup> Muchlinski *op.cit.* note 49 at pp.257-9

<sup>113</sup> See C. Raghavan, *Recolonisation: GATT, the Uruguay Round and the Third World* (London, Zed Books, 1990) at pp.147-8, UNCTAD *Host Country Operational Measures op.cit.* note 108 at pp.5-6

<sup>114</sup> See for a full discussion UNCTAD *Ibid.* at pp.2-3, 13-14, 17-54.

freedom for countries to intervene in the economic processes through which FDI is conducted. Other possible issues concern the availability of special and differential treatment for developing country parties to IIAs with, for example, longer phase out periods for prohibited performance requirements, or possible development exceptions allowing developing country parties to maintain certain performance requirements indefinitely where their vital national economic interests so require.<sup>115</sup>

Equally the question of whether controls over performance requirements should be linked to controls over the use of investment incentives should be considered, especially given the existing regulatory imbalance in IIAs between provisions that address performance requirements, used principally by developing countries, while at the same time omitting any provisions that would introduce disciplines in the operation of incentives that would predominantly affect developed host countries.

### *Incentives*

Incentives are used by governments to attract investment, to steer investment into favoured industries or regions, or to influence the character of an investment, for example, when technology-intensive investment is being sought.<sup>116</sup> They can take two major forms, fiscal incentives, based on tax advantages to investors, and financial incentives based on the provision of funds directly to investors to finance new investments, or certain operations, or to defray capital or operational costs. Other types of incentives may not be easy to discern but they can have a positive effect on the overall profitability of an investment. These may include general infrastructure development by the host country, market preferences or preferential treatment on foreign exchange.<sup>117</sup> The major issues that incentive policies raise in the context of development concern the practical value of using such techniques as a means of attracting FDI. Where a tax advantage is offered this will entail the foregoing of revenue by the host country. Where a financial incentive is offered this will entail a positive application of public funds to the investment in question, thereby preventing the opportunity of those funds being applied to other public purposes. In either case the host country government reduces the amount of public finance available to it for its activities. Consequently, the host country must be sure that the offering of tax or financial incentives is actually warranted in economic terms. A further issue concerns competition between countries for FDI through the use of incentives. This may lead to “incentive races” to attract internationally mobile investments. This can be particularly problematic for developing countries that may have limited public finances to be able to compete with sufficiently attractive incentive packages.

The use and operation of incentives is generally not covered in IIAs, whether at the bilateral or multilateral levels. The only related policy devices that have received some attention, mainly in North American bilateral and regional treaty practice, are performance requirements. On the other hand, at the regional level the need to curtail the abuse of national incentive policies has been recognised as an important aspect of creating a truly integrated regional economy. The leading example is the EC, which operates controls over market-distorting, anti-competitive State aids to investment under the Treaty of Rome. Only such aids as are listed in Article 87 as being compatible with the creation of a common market are permitted. These relate to: aid having a social character; aid to make good the effects of natural disasters; aid to promote economic development in areas where the standard of living is abnormally low, or where there is serious underemployment; aid to promote an important European interest or to remedy a serious disturbance in the economy of a Member State; aid to facilitate economic activities in certain economic areas, provided that such aid does not adversely affect trading conditions and aid to promote culture and heritage conservation where this does not adversely affect trading conditions and competition. Clearly there is much in this list that could be of relevance to developing countries, in that many of the permissible criteria for the award of state aid in the EC are development related criteria, or emergency criteria that may well apply to the economic and social realities of the least developed countries.

The major advantage of new multilateral disciplines in this area would be to create a degree of general agreement as to the permissible limits of State aid policy in the investment field. It would thus set some basic ground rules for the operation of incentive regimes that would be as economically efficient as possible, through examining whether a given policy was market distorting, but offering certain public interest exceptions where a degree of such distortion would be tolerated for socio-economic reasons. Clearly, this would be a significant issue for developing countries as it might help reduce the incidence of market-distorting incentive races, which

<sup>115</sup> UNCTAD *Ibid.* at pp.62-71.

<sup>116</sup> UNCTAD *Incentives and Foreign Direct Investment* (New York and Geneva, United Nations, 1996) at p.1. See too UNCTAD *Incentives Series* on issues in international investment agreements (New York and Geneva, United Nations, 2004) or UNCTAD: *Key Issues op.cit.* note 56 ch.15.

<sup>117</sup> UNCTAD *Incentives and Foreign Direct Investment* at p.5 UNCTAD *Incentives* at pp.5-7.

many developing countries would probably never win, while at the same time permitting such countries to offer development oriented incentives, where these are seen as absolutely essential for the increase of development friendly FDI into the developing host country concerned. Short of a multilateral arrangement in this field, bilateral arrangements such as clauses in BITs covering incentives might be of use, especially if they elicited agreement as to the limitation of levels of incentives and a simplification of types of incentives on offer.<sup>118</sup>

### *Transfer of Technology*

The transfer of technology continues to be a central concern of developing country economic policy. Access to technology is a foundation of economic growth. However, the presence of adequate and appropriate technology in a national economy is not always possible, given the nature of international markets for technology, which tend to favour developed economies with high levels of corporate research and development.<sup>119</sup> In this process less developed countries will have relatively limited access to technology. They are unlikely to meet all their technological needs from domestic sources, which may not even exist in the least developed economies, and they are therefore more dependent on outside sources of technology than more developed countries. Indeed, in the absence of alternative sources, a majority of developing country technological needs are met by FDI undertaken by MNEs, the leading creators and owners of proprietary technology in global markets.<sup>120</sup> This raises the issue of how the technology that is indispensable to economic development can be supplied to such a country. This, in turn raises at least four sets of related issues: how best to treat proprietary technology; how to encourage technology transfer; how to deal with the competition related issues that the existence of market power on the part of technology owners creates; whether special host country technology related measures such as, for example, performance requirements are needed to deal with certain development priorities related to the transfer and dissemination of technology.

IAs have traditionally remained silent on questions of technology transfer. This means that the range of responsibilities owed by the host country to the investor in relation to their technology is limited to the observance of the standards of protection specified in the agreement, on the basis that the technology comes within the definition of assets that are within the protected subject matter of the agreement. On the other hand this approach does not include in the agreement any internationally agreed commitments for MNEs, or their home governments, to cooperate in the promotion of the generation, transfer or diffusion of technology to the host country or to the control of undesirable terms and conditions in technology transfer agreements.<sup>121</sup> In the TRIPS Agreement, certain development-oriented provisions have been included. For example, this Agreement contains, in Articles 66 and 67, a duty on the part of home countries to promote the transfer of technology to the least developed county members and to engage in positive programmes of cooperation with the developing and least developed countries in order to implement the substantive terms of the TRIPS Agreement. In addition the TRIPS Agreement offers transitional provisions allowing developing countries an extended period in which to ensure compliance with the disciplines introduced by the Agreement.<sup>122</sup>

The introduction of technology transfer issues into future IAs may be necessary as a means of remedying the continuing imbalances of the international market for technology. Hence it may be desirable further to develop special and differential treatment provisions, for which the TRIPS Agreement offers an initial model, that can address this issue in favour of the interests of developing countries in acquiring effective, appropriate and affordable technology. At present the TRIPS Agreement offers only rather limited commitments. It may well be that such commitments may need to be extended into full technology transfer policies based on a legally binding commitment to ensure adequate access to technology.<sup>123</sup> In this regard the continuing debate over pharmaceutical patent protection and access to essential life saving medicines in developing countries offers an important case-study.<sup>124</sup> In addition, in order to further environmental protection policies it may be necessary to

<sup>118</sup> UNCTAD *Incentives and Foreign Direct Investment op.cit.* note 116 at pp.79-80

<sup>119</sup> UNCTAD, *Transfer of Technology* (New York and Geneva, United Nations, 2001) at pp.89-94 or UNCTAD: Key Issues *op.cit.* note 56 ch.23.

<sup>120</sup> *Ibid* at pp.11-16

<sup>121</sup> *Ibid.* at p.95.

<sup>122</sup> On which see further UNCTAD-ICTSD *Resource Book on TRIPS and Development* (Cambridge, Cambridge University Press, 2005) Ch.34.

<sup>123</sup> See Keith E. Maskus *Intellectual Property Rights in the Global Economy* (Washington DC, Institute for International Economics, 2000) at pp.239-40.

<sup>124</sup> See further WTO *Declaration on the TRIPS Agreement and Public Health* WT/MIN (01)/DEC/2 20 November 2001.

develop further requirements on foreign investors to transfer environmentally sound technology to ensure that developing countries in particular can meet such policy challenges.<sup>125</sup>

### *Special and Differential Treatment for Developing Countries*

The foregoing discussion on technology transfer highlights just one area where claims may be made for special and differential treatment for developing countries in future multilateral investment rules. More generally, development concerns, if taken seriously, will influence the entire process of drafting multilateral investment rules as such. Thus development considerations can be expressed not only through special and differential treatment provisions, but also through the objectives provisions of the IIA, as where the Preamble commits the parties to consider development issues as an essential policy goal behind the entire agreement, a commitment that will be reflected in the use of policy goals stated in the Preamble as an aid to the interpretation of specific obligations in the rest of the agreement. Equally, development considerations can be expressed through the manner in which exceptions to substantive commitments for investor/investment protection are drafted (which explains in part the preference expressed by some developing countries for a GATS type “opt-in” approach to market access commitments in future multilateral investment rules<sup>126</sup>). Finally, the modes of application of such rules can promote development concerns as where, for example, a commitment to technical assistance for developing country members is given the full force of binding legal obligation rather than being expressed through a non-binding “best efforts” provision.

### *Corporate Social Responsibility*

A third area of concern to the future development of substantive standards in international investment law relates to the perception that new multilateral disciplines in the field of FDI, which are in the main oriented towards greater investor and investment protection, may require an element of reciprocal regulation of corporate responsibility as the *quid pro quo* for such improved legal treatment. This raises two basic issues: what are the main kinds of provisions that could fall under this general heading and the modalities through which these provisions might be expressed.<sup>127</sup>

As to the first issue, three areas stand out as being central to corporate responsibility: labour rights, human rights, environmental issues and development as exemplified in the UN Global Compact<sup>128</sup> and other relevant international instruments.<sup>129</sup> However, the range of possible issues covered by the idea of corporate social responsibility is vast, ranging from corporate governance as such to fair competition, anti-corruption obligations, consumer protection and ethical business standards, to name but a few.<sup>130</sup> If extensive provisions were to be included on all of these issues, multilateral regional or bilateral investment rules would probably be impossible to adopt, let alone apply, given the extensive subject matter. There would also be the problem of institutional overlap, given that many of these matters are already being dealt with by specialised intergovernmental organisations or other specialist bodies. Thus the drafters of IIAs will have to think very carefully as to how corporate responsibility provisions should appear.

<sup>125</sup> See United Nations Conference on Environment and Development *Rio Declaration, Agenda 21* (New York and Geneva, United Nations, 1993) Ch.34. See further UNCTAD *Environment Series* on issues in international investment agreements (New York and Geneva, United Nations, 2001) especially pp.41-50 or UNCTAD:Key Issues *op.cit.* note 56 ch.16.

<sup>126</sup> See, for example, Republic of Korea: *Communication from Korea: Non-Discrimination and GATS-Type Approach for Investment* WT/WGTI/W/123 28 June 2002.

<sup>127</sup> For a detailed discussion of substantive provisions in IIAs that come under this concept see: Peter Muchlinski “The Social Dimension of International Investment Agreements” in J.Faundez, M.E.Footer, J.J.Norton (Eds) *Governance Development and Globalisation* (London, Blackstone Press, 2000) p.373, UNCTAD *Social Responsibility Series* on issues in international investment agreements (New York and Geneva, United Nations, 2001). See too UNCTAD *World Investment Report 2003 op.cit.* note 25 Ch VI.

<sup>128</sup> See further [www.unglobalcompact.org](http://www.unglobalcompact.org)

<sup>129</sup> See further UNCTAD *Social Responsibility*; on employment and environment: UNCTAD *Employment Series* on issues in international investment agreements (New York and Geneva, United Nations, 2000), UNCTAD *Environment* (New York and Geneva, United Nations, 2001); on human rights see International Council on Human Rights Policy *Beyond Voluntarism: Human Rights and the Developing International Legal Obligations of Companies* (Versoix, International Council on Human Rights Policy, 2002). Peter Muchlinski “Human Rights and Multinationals – Is there a Problem?” 77 *International Affairs* p.31 (2001), UN Sub-Commission on Human Rights *op.cit.* note 18, D. Kinley and J.Tadaki “From Talk to Walk: The Emergence of Human Rights Responsibilities for Corporations at International Law” 44 *Va.J.Int'l.L.* 931 (2004).

<sup>130</sup> These additional issues are raised in UNCTAD *Social Responsibility op.cit.* note 127.

Given the abovementioned problems, it is likely that corporate responsibility issues will be dealt with by means that do not seek to offer detailed provisions but, rather, provide for overall commitments to certain standards. This may be achieved in a number of ways. First a general commitment on the part of the signatory States to further the observance by MNEs of corporate responsibility standards could be included in the Preamble and/or in a specific substantive provision. Equally, where an issue is not yet fully developed, it can be expected that hortatory, best efforts provisions may be used. Secondly, international instruments and agreements that already contain a more extensive treatment of specific social responsibility issues could be incorporated as part of the new investment rules, in the manner that existing international minimum standards of treatment for intellectual property, contained in the Paris and Berne Conventions were incorporated by reference into the TRIPS Agreement.<sup>131</sup> A third possibility would be to follow the practice under NAFTA and use “side-agreements” on specific social issues or to follow the precedent of the negotiations over the ill-fated MAI, where some delegations favoured appending the OECD Guidelines on Multinational Enterprises to the text of that agreement in a non-binding appendix.

Whether corporate social responsibility standards will be included in future investment agreements cannot be predicted at this stage. On the other hand, given the extensive concern expressed by civil society groups over the lack of social responsibility provisions in the MAI, it is highly likely that some reference to corporate responsibility will be needed in future international investment arrangements to ensure a balance between corporate rights, as expressed in the investor/investment protection provisions of such instruments, and corporate responsibilities, as expressed in specialised international instruments and national legal standards. The absence of such a balance might endanger the political acceptability of those rules.

### ***Home Country Measures***

As noted above, a further new area for international rule making may arise in relation to the obligations of home countries in the field of foreign investment.<sup>132</sup> Such measures could assist in the provision of beneficial FDI for developing countries in particular. This may be achieved through both “soft” and “hard” commitments. In the former category, for example, home countries could provide information related to investment opportunities, training and skills transfer, encouraging technology transfer and assisted outreach to home-country business groups.<sup>133</sup> In the latter category they may offer financial assistance to outward investors through investment and technology transfer incentives, investment insurance and other legally binding obligations to promote outward investment. Whether such obligations should be embodied in future international investment rules depends on the willingness of the major home countries to shift what are at present national policies, based on full national policy discretion, to the international level where they would be enshrined in treaty provisions. It can be expected that such measures will often be contained in “best efforts” clauses, but even such soft obligations may pave the way for a legal hardening where required. Given the lack of home country obligations in IIAs to date such a process would appear to be unlikely at the time of writing.

### **(iii) Enforcement and Dispute Settlement**

The enforcement of international investment law involves at least two main areas of policy concern. First, how are the norms of such international law to be given effect before national legal systems and second, how are international dispute settlement mechanisms to be applied?

#### ***International Investment Law and National Law***

From the foregoing discussion of sources of international investment law at least two main sets of questions arise: what is the effect, in national law, first, of IIA provisions and, second, of the increasing number of non-binding instruments that help to develop standards in this field? The effect of an IIA provision within the legal systems of the contracting states depends on the applicable rules of national law concerning the domestic effect of treaties.<sup>134</sup> Some States, like the United Kingdom, adopt a dualist approach whereby a treaty can only become a part of English law if an enabling Act of Parliament has been passed. Therefore, an IIA can create no directly effective legal rights within the English legal system without such transforming legislation. To date no such legislation has

<sup>131</sup> See Article 2 TRIPS Agreement.

<sup>132</sup> See UNCTAD *Home Country Measures* Series on issues in international investment agreements (New York and Geneva, United Nations, 2001) or UNCTAD: Key Issues *op.cit.* note 56 ch.22 UNCTAD *World Investment Report 2003 op.cit.* note 25 at pp.155-163.

<sup>133</sup> *World Investment Report 2003* at p.161.

<sup>134</sup> See Muchlinski *op.cit.* note 49 at pp.634-7 on which this paragraph draws.

been passed and IIAs remain purely international obligations.<sup>135</sup> Unlike the United Kingdom, a number of countries adhere to the principle that treaties made in accordance with the constitution bind the courts without any specific act of incorporation. Thus, for example, by Art.157 of the Sri Lankan Constitution BITs are given the force of law in Sri Lanka, and no executive or administrative action can be taken in contravention of the treaty, save in the interests of national security.<sup>136</sup> However, each system must be carefully examined to see whether it imposes additional conditions before the treaty can be invoked as a source of rights under municipal law.

Turning to non-binding codes of conduct, such instruments can acquire legal force in private law.<sup>137</sup> Private law suits can be brought against the firm or organisation adopting a voluntary code by other firms or organisations, consumers or other members of the community. Such claims may allege that a failure to comply with the code is evidence that the sponsoring firm or organisation is not meeting industry standards of conduct and is, therefore, not exercising reasonable care or due diligence. Furthermore, failure to follow the terms of a voluntary code could be evidence of a breach of contract, where such adherence is an express or implied term of the agreement, or of an actionable misrepresentation, as where a firm alleges that its adherence to a code of conduct entitles it to be regarded as qualifying for a governmental standard setting marque of approval, but where in fact it fails to meet such standards. In such cases, consumers can bring an action if they claim to have been attracted to purchasing the firm's products or services in the light of such assertions of good conduct. Also the relevant government agency might bring an action for abuse of its certification scheme.<sup>138</sup>

### *Dispute Settlement*<sup>139</sup>

The settlement of disputes between investors and host countries is an issue that is central to national FDI policy, and more broadly to national developmental concerns, in that the availability of effective dispute settlement acts to reinforce the rights of investors and adds to the reduction of investment risk, thereby making the host country more attractive to investors. Accordingly, the host country needs to ensure that such disputes can be effectively resolved. Usually a host country will provide dispute settlement procedures and remedies as a part of the general law of the land. However, investors may, perceive host country laws and procedures not to be sufficient as a means for the resolution of disputes with the host country. They may prefer an internationalised approach to dispute settlement. This allows the investor the freedom to choose between national and international dispute settlement mechanisms. The latter usually takes the form of international arbitration between the investor and the host country. This may be *ad hoc* arbitration, based on an arbitral panel and procedure that is agreed between the investor and the host country. In the alternative, there may be an institutional system of international arbitration that can apply to the dispute in question.

The United Nations Commission on International Trade Law (“UNCITRAL”) Arbitration Rules, adopted by the United Nations General Assembly in 1976, are possibly the most commonly-selected *ad hoc* arbitral system, whereby arbitration procedures are conducted without supervision by any administrative institution. A particular advantage of UNCITRAL arbitration is that it may be cheaper than institutional arbitration since there are no administrative fees to compensate for an institution’s services. Other systems are the Permanent Court of Arbitration (PCA) Optional Rules for Arbitrating Disputes between Two Parties of Which Only One Is a State, the International Chamber of Commerce (ICC) Arbitration Rules and the Stockholm Chamber of Commerce (SCC) Arbitration Rules.

The most important arbitral institution in the field of investment disputes is the International Centre for Settlement of Investment Disputes (ICSID) set up under the auspices of the World Bank. Specific procedural requirements for the use of this system of arbitration are contained in the ICSID Convention. Rules of procedure for arbitration proceedings are also contained in ICSID Rules which are tailored for arbitration with the participation of a government party. Oversight by the ICSID Secretariat and the availability of the institution’s

<sup>135</sup> But see *Occidental Exploration and Production Company v Republic of Ecuador* [2005] EWCA Civ 116, 45 ILM 249 (2006) where the Court of Appeal accepted the right of a party to an arbitration brought under a BIT to challenge the jurisdiction of the arbitral tribunal under the UK Arbitration Act 1996 even though the treaty was not incorporated into English law.

<sup>136</sup> See *Asian Agricultural Products Ltd v Republic of Sri Lanka* ICSID Case No.ARB/87/3 award of 27 June 1990 30 ILM 577 (1991).

<sup>137</sup> This paragraph draws on Muchlinski *op.cit.* note 52 at p.129.

<sup>138</sup> See Government of Canada *Voluntary Codes: A Guide for their Development and Use* (Ottawa, March 1998) at p.27 also available on <http://strategis.ic.gc.ca/volcodes>; Kernaghan Webb “Voluntary Initiatives and the Law” in R.Gibson (ed) *Voluntary Initiatives: The New Politics of Corporate Greening* (Peterborough Ont, Broadview Press, 1999) pp.32-50.

<sup>139</sup> The following sections draws upon the *World Investment Report 2003 op.cit* note 25 at p.114.

resources and experienced personnel clearly represents a major asset in investment arbitrations, which tend to be complex and involve voluminous submissions and documentation.<sup>140</sup>

National policies on investor/host country dispute settlement will vary from those that require the exclusive use of national procedures and remedies<sup>141</sup> and those that offer free choice between national and international dispute settlement to the investor.<sup>142</sup> National investment laws will often expressly permit such internationalisation of investment disputes by enshrining investor choice in a specialised dispute settlement provision in the relevant FDI legislation.<sup>143</sup> On the other hand many FDI laws are silent on this issue<sup>144</sup> and the investor is thus required to use the internal legal remedies available to them under host country law. The same is true of countries that have no specialised FDI laws as such. In these two latter cases international remedies may, however, be available on the basis of the international treaty obligations undertaken by the host country in IIAs to which it is a party. Thus a dispute settlement clause in a BIT that allows the investor choice between national and international procedures will bind the host country as a matter of international legal obligation. Equally such an international obligation can be made enforceable before national tribunals where the investment contract between the investor and host country includes a dispute settlement clause that incorporates the latter's international treaty obligations to allow the use of internationalised systems of dispute settlement. In this way, dispute settlement clauses in IIAs side-step the local remedies requirement and create a presumption that it is inapplicable in the absence of an express provision to the contrary.

The issue of remedies (including monetary compensation) has recently emerged as a possible source of concern. The emergence of arbitration-enforceable novel regulatory disciplines such as national treatment, legitimate expectations, denial of justice – has not yet led to a concise and easily manageable body of rules on remedies and compensation. It may thus be useful to develop an approach that takes into consideration the following points: (a) making use of the vast comparative experience of judicial review of domestic administrative action (b) sequencing conduct-related remedies before final financial remedies and (c) favouring individualised ways to determine compensation rather than on the bases of standardised methods.<sup>145</sup>

A major issue for future development is the extent to which investor freedom and choice in this field may be allowed to inform the content of dispute settlement clauses, or whether a degree of increased host country control over investment dispute settlement methods is desirable, especially in the light of concerns over the scope of the “right to regulate”, and also in the light of the possibility that national legal systems can evolve increasingly effective local dispute settlement mechanisms. It would appear that the trend, at least in the case of Western Hemisphere IIAs, is to make international dispute settlement more central and to offer detailed rules on how investor-State disputes should be conducted.<sup>146</sup>

Another development oriented issue that could be more fully addressed concerns the role to be played by the recently established regional dispute settlement centres in certain developing countries. The possibility of including recourse to these centres could be considered in future negotiations, thereby giving a strong injection of support for these initiatives.<sup>147</sup> A further new area concerns the extension of dispute settlement mechanisms to third parties who may have a stake in the outcome of an investor-State dispute. This is likely to impact on

---

<sup>140</sup> See further C.Schreuer *The ICSID Convention: A Commentary* (Cambridge, Cambridge University Press, 2001); Christopher F. Dugan Don Wallace, Jr. Noah D. Rubins, *Investor-State Arbitration: The Practice of Investment-Related Dispute Resolution under International Treaties* (Oceania Publications, Inc, 2005)

<sup>141</sup> This approach was favoured by Latin American countries and was encapsulated in the so-called “Calvo doctrine”. More recently, they have departed from this doctrine in their BITs as well as in the context of Mercosur. See further *Maffezini v Spain op.cit.* note 69.

<sup>142</sup> See C.Schreuer “Consent to Arbitration” draft paper available on the TDM website *op.cit.* note 1.

See further UNCTAD *Dispute Settlement Investor-State Series* on issues in international investment agreements (New York and Geneva, United Nations, 2003) pp.26-44 or UNCTAD: Key Issues *op.cit.* note 56 ch.12.

<sup>143</sup> See for example the *Nigerian Investment Promotion Commission Law 1995* section 26.

<sup>144</sup> See for example the *Federal Law on Foreign Investment in the Russian Federation* (July 9 1999): 39 ILM 894 (2000).

<sup>145</sup> See the draft paper by Thomas Waelde on “Remedies and Compensation in International Investment Law” available on the TDM website *op.cit.* note 1.

<sup>146</sup> See for example the US-Uruguay BIT 25 October 2004, Section B; Canada Model Foreign Investment Protection Agreement 2004 Section C. *op.cit.* note 51.

<sup>147</sup> See further A. Asouzu *International Commercial Arbitration and African States* (Cambridge, Cambridge University Press, 2001).

development concerns where such third parties may be the very individuals or groups that are most directly affected by the development implications of a given investment. For example, where an investor and a host country are in dispute over the application of environmental regulations to the investment in question, local communities affected by the environmental performance of that investment might wish to participate as interested third parties. This can be accommodated through rights of audience before national tribunals in countries where there is a strong tradition of access to justice by interested third party individuals or groups. However, where the investor exercises a treaty-based right to international arbitration, interested third parties may have no standing before such a body and will be denied the possibility of a hearing. On the other hand the most recent US Model BIT allows for the tribunal to accept third party *amicus curiae* submissions, though this is not general practice outside Western Hemisphere BITs<sup>148</sup> as well as the proposed changes to ICSID Rules.<sup>149</sup> Other issues of importance relate to the need for greater openness and transparency in the international dispute settlement process, the composition and selection of arbitrators and the need for an appellate mechanism in investment arbitrations.<sup>150</sup>

### Concluding Remarks

The preceding discussion has highlighted the actors, ideologies and major technical questions that may be said to contribute to the development of policy in the field of international foreign investment law. The range of actors has become wider than merely the investor and the host country. Thus the home country may have to take on active obligations in relation to the investor and the investment, corporate investors are being subjected to increasing demands for compliance with good corporate citizenship and governance standards, in return for the benefit of investment protection, while civil society groups and NGOs are increasingly active as monitors of corporate behaviour and as lobbyists for more balanced IIAs that cover obligations for all the main sets of actors. These developments are a direct outcome of increasing global economic integration through the instrumentality of the MNE. As such they represent a challenge for a new reflexive international law that is capable of acting as a wider underpinning not only for pro-corporate liberalisation and reaffirmation of private property rights, but also for the regulation of national policy space and rights of regulation as well as the balancing of commercial and non-commercial values that lie at the heart of a healthy democratic and participatory society.

<sup>148</sup> See for example the US-Uruguay BIT 25 October 2004 Article 28 (3) and Canadian Model Agreement *op.cit.* note 51 Article 39 which is more detailed than the US provision.

<sup>149</sup> Paragraph (2) of ICSID Arbitration Rule 37 would provide as follows: "After consulting both parties as far as possible, the Tribunal may allow a person or a State that is not a party to the dispute (hereafter called the 'non-disputing party') to file a written submission with the Tribunal. In determining whether to allow such a filing, the Tribunal shall consider, among others things, the extent to which: (a) the non-disputing party submission would assist the Tribunal in the determination of a factual or legal issue related to the proceeding by bringing a perspective, particular knowledge or insight that is different from that of the disputing parties; (b) the non-disputing party submission would address a matter within the scope of the dispute; (c) the non-disputing party has a significant interest in the proceeding."

<sup>150</sup> See generally ICSID Secretariat *Possible Improvements of the Framework for ICSID Arbitration* (ICSID Secretariat, Discussion Paper, October 22, 2004). See further, with respect to the composition of arbitral tribunals, the draft paper by Loretta Malintoppi "Independence, Impartiality and the Duty of Disclosure in Investment Arbitration" available on the TDM website *op.cit.* note 1, and, on the issue of an appeal process, see US-Uruguay BIT 2004 *op.cit.* note 51 Annex E where the Parties will consider the setting up of an appellate body or similar mechanism to review awards made under the dispute settlement provisions of the treaty.