EXTENDING THE FRONTIERS OF EXPROPRIATION IN HOST STATE

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Abstract

The 'national treatment' is one of the principle pillars of World Trade Organization (WTO) agreements and its standard is perhaps the single most important standard of treatment enshrined in international investment agreements (IIAs). At the same time, it is perhaps the most difficult standard to achieve as it touches upon economically (and politically) sensitive issues. In fact, no single country has so far seen itself in a position to grant national treatment without qualifications, especially when it comes to the establishment of an investment. National treatment can be defined as a principle whereby a host country extends to foreign investors treatment that is at least as favourable as the treatment that it accords to national investors in like circumstances. In this way the national treatment standard seeks to ensure a degree of competitive equality between national and foreign investors. The principle of national treatment has two facets to it. One of them has its origins in the Calvo doctrine under which aliens and their property are entitled only to the same treatment accorded to nationals of the host country under its national laws. The other has its basis in the doctrine of state responsibility for injuries to aliens and their property, under which customary international law is regarded to have established a minimum international standard of treatment to which aliens are entitled. This concept of international minimum standard would allow for treatment more favourable than that accorded to nationals where this falls below the international minimum standard. Historically, the idea based on the Calvo doctrine is favoured by the developing countries and developed countries favour the idea based on the principle of state responsibility. This article aims to provide an understanding of the international minimum standard of treatment and state responsibility in relation to the bilateral investment treaties (BITs) or free-trade agreements (FTAs). In doing so, this article will highlight some of the relevant cases where the international centre for settlement of investment disputes (ICSID) attempted to accord a narrow meaning to the term 'full protection and security', which set-up guidelines for later cases.

Keywords: International Minimum Standard, BITs, ICSID, FTAs, Foreign Investment

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INTRODUCTION

Many of the provisions of BITs and certain regional agreements such as North American free trade agreements (NAFTA) have gone beyond what customary international law provides in terms of protection of foreign investment; it is doubtful whether the BIT or NAFTA provisions are capable of modifying the rules of customary international law.[1]

Traditionally, the doctrine that underpins the law of foreign investment is, of course, the concept of the international minimum standard of treatment based on the rule of law in general and the traditional doctrine of state responsibility in particular. It is well established in international law that an internationally wrongful act of a state entails the responsibility of that state.[2]

Bilateral investment treaties (BITs)

However, it is less straightforward to establish whether a given act of a state is an internationally-wrongful act. Until the BITs and other regional economic agreements such as NAFTA or other FTAs were concluded it was less easy to establish whether a particular act of a state against a foreign investor was an internationally-wrongful act. But when there is a BIT or another agreement outlining a plethora of protections, privileges and concessions available to foreign investors, any infringement of such protections, concessions or privileges, however excessive they may be, would constitute an internationally-wrongful act giving rise to state responsibility. Thus, the doctrine of state responsibility which was used to argue for an international minimum standard during the early years of the law of foreign investment is now being used to argue for and defend the maximum international standard of treatment for foreign investors provided for either in the BITs or in other international treaties such as NAFTA or WTO agreements.

The attempts by certain ICSID tribunals to exploit this nexus between the provisions of BITs and the doctrine of state responsibility in order to provide the maximum protection possible – over and above what is accorded under customary international law to foreign investors – are seeking gradually to transform the rules of *lex specialis* character to *lex generalis* character, thereby changing the law of foreign investment in accordance with the factual realities of the changing world.

[1] See generally, Bean, V. 'Does an international 'Regulatory takings' doctrine make sense?', 11 NYU Env.L.J (2002), pp.49–63.

[2] See for the Draft Articles of the ILC on state Responsibility UN Doc.A/CN.4/L.602/Rev.1 of 26 July 2001.

For instance, although it is submitted that the primary obligation under the NAFTA provisions on foreign investment is to accord treatment to foreign investors in accordance with international law in general and the minimum standard of treatment in particular, the attempts on the part of the developed countries and the ICSID and the Iran–US claims tribunals have often been to stretch both the law and the meaning of the 'minimum standard' beyond reasonable limits in order to deliver the results desired by the investor countries. The ruling given in *Metalclad*[3] is a classic example. Decisions such as these could be regarded as attempts to make international law through the backdoor.

Calvo doctrine[4]

Those who were opposed to accepting the law of the investor countries in the name of the international minimum standard were of the view that no state should be required to offer more protection to foreign investors than that accorded to its own nationals. There had to be equality of treatment. If the state in question were not discriminating against foreign investors, it was not violating any rules of customary international law. The argument was that it would be difficult for some countries to accord a higher standard of treatment to foreign investors, such as those countries which:

- are newly independent;
- have not attained the level of economic development required;
- or have not acquired a developed legal system.

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

'It is certain that aliens who establish themselves in a country have the same right to protection as nationals, but they ought not to lay claim to a protection more extended. If they suffer any wrong, they ought to count on the government of the country prosecuting the delinquents, and not claim from the state to which the authors of the violence belong any pecuniary indemnity.

The rule that in more than one case it has been attempted to impose on American states is that foreigners merit more regard and privileges more marked and extended

[3] Metalclad Corporation v The United Mexican States, ICSID case no: ARB(AF)/97/1.

[4] Lipstein, K.'The place of the Calvo clause in international law' 24 BYIL (1945), p.130; Freeman, A.V. 'Recent aspects of the Calvo doctrine and the challenge to international law' 40 AJIL (1946), p.131.

than those accorded even to the nationals of the country where they reside.

The principle is intrinsically contrary to the law of equality of nations."[5]

The central element of the Calvo doctrine was to require that aliens submit disputes arising in a country to that country's courts. As deduced by Verwey and Schrijver, the Calvo doctrine basically stipulates that the principle of territorial sovereignty of the state entails:

- the principle of absolute equality before the law between nationals and foreigners;
- the exclusive subjection of foreigners and their property to the laws and juridical regimes of the state in which they reside or invest;
- strict abstention from interference by other governments, notably the governments of the states of which the foreigners are nationals, in disputes arising over the treatment of foreigners or their property (*i.e.* abstention from diplomatic protection).[6]

The essentials of the Calvo doctrine found their way into:

- numerous Latin American constitutions (*e.g.* those of Peru,[7] Venezuela and Mexico);
- treaties (*e.g.* the Pact of Bogota[8]);
- investment pacts (*e.g.* the Andean Foreign Investment Code[9]).

In simple terms, according to the Calvo doctrine land and other natural resources belong to the state by virtue of the doctrine of sovereignty and no foreign entity can permanently own land in the host states.

ICSID tribunals

Although some other ICSID tribunals have taken a more traditional approach in cases such as *S.D. Myers v Canada*[10] *and Pope & Talbot*[11], the momentum led by *Metalclad* is likely to continue. In *S.D. Myers* the tribunal

[5] Translated and quoted from Calvo's work in Spanish by Shea, D.R. The Calvo clause (1955), pp.17–19, as quoted in Lowenfeld, p.395.

[6] Verwey W.D. and Nico J. Schrijver, 'The taking of foreign property under international law: a new legal perspective?' XV Netherlands yearbook of international law (1984), pp.3–96, at 23.

[7] Article 17 of the 1939 Constitution of Peru provided that: 'Commercial companies, national or foreign, are subject, without restrictions, to the laws of the Republic. In every state contract with foreigners, or in the concessions which grant them in the foreigner's favour, it must be expressly stated that they will submit to the laws and courts of the Republic and renounce all diplomatic claims.'

[8] Article 7 of the American Treaty on Pacific Settlement (Pact of Bogota, 1948) reads: 'The High Contracting Parties bind themselves not to make diplomatic representations in order to protect their nationals, or to refer a controversy to a court of international jurisdiction for that purpose, when the said nationals have had available the means to place their case before competent domestic courts of the respective state.' 30 UNTS 55.

[9] Article 50 of the Andean Code of 1971 provided that 'Member countries shall not grant to foreign investors any treatment more favourable than that granted to national investors.' Text in XI ILM (1972), pp.126 et seq.

[10] Order, 2004 FC 38, (2004) 244 FTR 161, IIC 252 (2004), 13th January 2004, Canada; Federal Court [FC]

[11] IIC 192 (2000), 26th June 2000.

took the view that expropriation normally constitutes a taking of 'property' with a view towards transfer of ownership and no expropriation was found in this case. Although the tribunal held in *Pope & Talbot* that regulatory measures could constitute expropriation, it did not find that expropriation had taken place in this case either.

Relevant case-law

In the *SGV v Philippines*[12] case the tribunal did not regard non-payment of invoices by the Philippines as constituting expropriation. Nevertheless, in advancing the analysis made by the tribunal in this case, another ICSID tribunal in *Feldman v Mexico* found that by the application of certain tax laws by Mexico to the export of tobacco products by a company owned and controlled by an American citizen amounted to a violation of NAFTA Article 1102 and awarded a compensation to the company.[13]

Similarly, in *Enron v Argentina*[14] the tribunal upheld jurisdiction over Enron's claim that certain tax assessments imposed by certain Argentine provinces were tantamount to expropriation and thus in violation of the Argentina–US BIT, relying on the principles of fairness and equity of the treaty. In *Azurix v Argentina*[15] the Claimant had argued that by failing, inter alia, to provide transparency concerning the regulations, administrative practices and procedures, etc. that affected Azurix's investment, Argentina had breached the US–Argentina BIT. The claimant invoked the principles of fair and equitable treatment and full protection and security to argue that Argentina had failed to comply with the standards of treatment required by international law. In its turn, Argentina challenged the claim that the claimant's investment was covered by the BIT, arguing that the dispute was a contractual one related to the concession agreement. Nevertheless, the ICSID tribunal found that Azurix's investment made through its local subsidiary was covered by the BIT between the two countries.[16]

There have been other bold awards made by the ICSID tribunals. For instance, in the *Salini v Morocco*[17] case the tribunal regarded a construction contract as an investment within the meaning of the ICSID Convention and the applicable BIT.

In the *SGV v Pakistan*[18] case the tribunal decided to move forward with the proceedings despite a Pakistani Supreme

[12] ICSID Case No. ARB/02/6 of 29 January 2004.
[13] Marvin Feldman v Mexico, case no. ARB (AF)/99/1 of 16 December 2002: 42 ILM (2003), p.625.
[14] ICSID case no. ARB/01/3 of 14 January 2004.
[15] Azurix Corp. v. The Argentine Republic, ICSID Case No. ARB/01/12.
[16] *Ibid.*
[17] 42 ILM (2003). p.606.
[18] ICSID Case No. ARB/01/13.

Court decision restraining SGV from pursuing or participating in the ICSID arbitration while a Pakistani arbitrator was considering the case.[19]

The role of BITs in altering foreign investment law

Nevertheless, given the limited significance of the provisions of BITs and the decisions of the ICSID and Iran–US Claims tribunals, it is doubtful whether this new trend has already altered the central tenets of the traditional law of foreign investment. For instance, the Iran–US Claims Tribunal was required to consider cases of not only expropriation but also of 'other measures affecting property rights'. It is difficult to establish whether a particular award of the Tribunal was based on the application of the established or settled principles of international law of foreign investment or on its broader jurisdiction allowing it to consider cases involving 'other measures affecting property rights'.

The political background to the tribunal, its ad hoc character resembling a factual inquiry and the peculiar factual situation of the cases considered by the tribunal, do not allow its awards to command the same authority as do the judgements of other truly independent international courts and tribunals such as the ICJ.

UN Declaration 1962

Until it can be established that these central tenets have been modified by new state practice, the traditional customary international law, including the principles embodied in the so- called PSNR declaration of the UN General Assembly of 1962, remain valid. Of course, while customary international law is constantly evolving and new examples of state practice are liable to change the existing rules, such new practice should, nevertheless, meet other criteria, including consistency, generality and uniformity, before they can alter the existing rules. Although an arbitration tribunal held recently that so far as the application of customary international law rules to NAFTA disputes was concerned the term 'customary international law' 'refers to customary international law as it stood no earlier than the time at which NAFTA came into force',[20] what the tribunal was referring to was perhaps local, regional or special customary international law as opposed to general customary international law. The law developed by NAFTA is not *ipso facto* capable

[19] 42 ILM (2003), p.1285.

[20] Mondev International Ltd v United states. ICSID case no. ARB(AF)/99/2. NAFTA chapter 11 Arbitral Tribunal, 11 October 2002. 42 ILM 85 (2003), para 125.

of altering the meaning, nature and scope of general customary international law.

When the NAFTA treaty provisions and the decisions of the ICSID tribunals refer to customary international law, they should be understood to be referring to the law that was in existence until there was a division within the UN along the developing and developed country lines on these issues. The principles that were outlined in the 1962 declaration constituted the law at the time.

There has been no major development of truly universal significance since the adoption of this UN declaration that can safely be claimed to have altered the central character of the law of foreign investment. Yet the problem remains that the 1962 PSNR declaration covers only a limited aspect of the law of foreign investment. For guidance on the rest of the rules on the law of foreign investment reference should be made to other sources, including jurisprudence, state practice, and the writings of the publicists.

Because of the attempts to interpret the NAFTA and other BIT provisions in a manner too favourable to investors and too restrictive to sovereign states so as even to limit the so-called police powers of states, there has been a move in the recent past to counter the excesses of NAFTA or other ICSID tribunals by stating that when interpreting the NAFTA provisions the reliance must be laid on the customary international law of foreign investment; the protection that NAFTA provides is not over and above what customary international law provides.[21] Indeed, in some recent cases decided by ICSID there has been an attempt to accord a narrow meaning to the term 'full protection and security' rather than a broad one.

Relevant case-law

For instance, in the *Asian Agricultural Products*[22] case the ICSID tribunal held that: '(t)he state into which an alien has entered ... is not an insurer or a guarantor of his security ... It does not, and could hardly be asked to, accept an absolute responsibility for all injuries to foreigners.'[23] The ICJ too was reluctant in the ELSI case to accord a broad meaning to the term 'full protection and security'.[24]

[21] For instance, in a statement the Government of Canada described the limits of Article 1105 in the following terms: 'Article 1105, which provides for treatment in accordance with international law, is intended to assure a minimum standard of treatment of investments of NAFTA investors ... this article provides for a minimum absolute standard of treatment, based on long-standing principles of customary international law' Canada Gazette, Part I, January 1, 1994, at p.149.

[22] Asian Agricultural Products Ltd. v. Republic of Sri Lanka, ICSID Case No. ARB/87 /3.

[23] Asian agricultural products, Inc. v Sri Lanka, 4 ICSID reports 245.

[24] Case concerning Elettronica Sicula S.P.A. (ELSI) (United States v Italy), ICJ reports, 1989, 15; 28 ILM 1109 (1989).

These developments give an indication that international courts and tribunals are now perhaps willing to accept that states can exercise their regulatory powers or 'police powers' to impose certain reasonable restrictions on foreign investors.

Protecting foreign investment

This turnaround is partly due to the challenge mounted by foreign investors to the regulatory powers of those very investor countries, which had championed the unfettered rights for foreign investors. Indeed, The Third Restatement provides that:

'A state is not responsible for loss of property or other economic injury that is due to bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as a within the police power of states.'[25]

However, the developed countries supported the investors as long as they were initiating legal proceedings against the regulatory powers of developing countries, but when the investors began to challenge the regulatory powers of the developed countries themselves there was a shift in attitude in these countries. The following observations of Mr Sampliner with regard to the shift in attitude on the part of the US and Canada in relation to the rights of implications of the investment protection provisions of NAFTA are noteworthy:

'The right of foreign investors to proceed directly to arbitration against their host states under investment treaties for alleged expropriation has received increasing attention in recent years. Although the United States has entered into such treaties [*i.e.* BITs] for more than two decades, significant controversy about this right has only arisen since the first cases under the investment chapter of the North American Free Trade Agreement (NAFTA) were filed against the United States and Canada in the late 1990s. It was only at that point that the realization hit home in the United States and other developed countries that these investment treaties, thought necessary to address disputes with developing country governments, could be used by foreign investors in developed countries to challenge a wide variety of national and sub-national actions.'[26]

Indeed, the provisions of the US Trade Act of 2002 concerning the future directions with regard to the protection of foreign

[25] American Law Institute, Restatement (Third) of Foreign Relations Law of the United States (1987), s.712, comment (g).

[26] Sampliner, G.H. 'Arbitration of expropriation cases under US investment treaties - a threat to democracy or the dog that didn't bark?', 18 (1) ICSID Review: Foreign investment law journal (Spring 2003), pp.1–43 at 23.

investment within the US are noteworthy. Providing guidance as to the future course of action on the matter the Act goes on to read as follows:

'(3) Foreign investment - Recognising that United states law on the whole provides a high level of protection for investment, consistent with or greater than the level required by international law, the principal negotiating objectives of the United states regarding foreign investment are to reduce or eliminate artificial or trade- distorting barriers to foreign investment, while ensuring that foreign investors in the United states are not accorded greater substantive rights with respect to investment protections than United states investors in the United states, and to secure for investors important rights comparable to those that would be available under United states legal principles and practice, by:

a. reducing or eliminating exceptions to the principle of national treatment;
b. freeing the transfer of funds relating to investment;
c. reducing or eliminating performance requirements, forced technology transfer, and other unreasonable barriers to the establishment and operation of investments;
d. seeking to establish standards for expropriation and compensation for expropriation, consistent with United states legal principles and practice;
e. seeking to establish standards for fair and equitable treatment consistent with Untied states legal principles and practice, including the principle of due process;
f. providing meaningful procedures for resolving investment disputes;
g. seeking to improve mechanisms used to resolve disputes between an investor and a government through

(i) mechanism to eliminate frivolous claims and to deter the filing of frivolous claims;

(ii) procedures to ensure the efficient selection of arbitrators and the expeditious disposition of claims;

(iii) procedures to enhance opportunities for public input into the formulation of government positions; and

(iv) providing for an appellate body or similar mechanism to provide coherence to the interpretations of investment provisions in trade agreements; and

> (h) ensuring the fullest measure of transparency in the dispute settlement mechanism, to the extent consistent with the need to protect information that is classified or business confidential, by:
>
> (i) ensuring that all requests for dispute settlement are promptly made public;
>
> (ii) ensuring that:
>
> (aa) all proceedings, submissions, findings, and decisions are promptly made public; and
>
> (bb) establishing a mechanism for acceptance of amicus curiae submissions from businesses, unions, and non- governmental organisations.'[27]

This demonstrates that while the US would continue to seek for its investors abroad protection greater than the protection available to domestic investors in the host countries, it would not accord any protection to foreign investors in the US greater than that available to US investors in the US. In other words, the US is claiming some of its sovereignty or sovereign control back in its dealing with foreign investment. If other states were to emulate this US practice the world would in effect be witnessing the revival of the Calvo doctrine. What the US legislation is trying to do is to accord national treatment to foreign investors.

One of the central elements of the Calvo doctrine was designed to do precisely this: in other words, to accord national treatment to foreign investors. After challenging this doctrine for so long the US seems to be embracing the idea for different reasons. One of the reasons given was that there was a tendency on the part of certain NAFTA tribunals or at least on the part of certain claimants before these tribunals to interpret the term 'expropriation' too broadly so as to challenge many regulatory measures of the US.[28]

Consequently, some of the FTA agreements concluded by the US since the enactment of the Trade Act of 2002 have sought to limit the scope of the term 'expropriation' and protect the regulatory measures or the police powers of the US. Indeed, as stated by Mr Rubins, '(t)he realisation that international law is a two-way street has engendered sharp political pressure in Canada and the United states to scale back the power of NAFTA tribunals – a campaign that may lead to

[27] Trade Act of 2002, Pub.L.107-210 (107th Cong., 2d Sess.), s. 2102(b)(3).

[28] See a statement of the Senate Committee in S.Rep.107–139 (107th Cong., 2d Sess.) 13–15 (2002).

additional challenges of NAFTA awards.'[29] Furthermore, with a view to imposing a constraint on NAFTA or ICSID tribunals states, including the US, have introduced the idea of appeal against the awards of such tribunals.[30]

The proposed Model BIT of the US and the draft Central American Free Trade Agreement envisage an appellate system for investment disputes.[31] The US–Chile and US–Singapore FTAs also allow for this possibility. Although the WTO has an appeal mechanism against the recommendations of WTO panels, the idea of an appeal against the awards of arbitration tribunals on investment disputes would be quite a novelty in the law of foreign investment. What is also equally interesting is the absence of any investment dispute settlement mechanism in the US–Australia FTA.[32] This also represents an indirect revival of the Calvo doctrine under which investment disputes with foreign investors were supposed to be entertained by the domestic courts.[33]

Conclusion

Although the provisions of agreements, which discussed above would have a substantial impact on the development and interpretation of customary international law on foreign investment in the future. It is difficult at least at this stage to maintain that what the US has agreed with Chile and Singapore is the accurate reflection of the status of customary international law. As are the BITs, the FTAs are also *lex specialis* in character. Of course, examples of *lex specialis* may in due course transform themselves into *lex generalis*, yet there is no convincing evidence to suggest at this stage that this has already taken place.

[29] Rubins, N. 'Judicial review of investment arbitration awards', in Todd Weiler (ed.), NAFTA- investment law and arbitration: past issues, current practice and future prospec ts (2003), pp.359–390 at 362.

[30] See William H. Knull, III and Noah D. Rubins, 'Betting the farm on international arbitration: is it time to offer an appeal option?' 11 (4) The American review of international arbitration (2000), pp.531– 564.

[31] Outlining the US objectives for future negotiations on investment agreements a report of the Committee on Finance of the US Congress on the Bipartisan Trade Promotion Authority Act of 2002 states that the US negotiators 'should seek to establish a single appellate body to review decisions in investor-state disputes. As the United States enters into more investment agreements and the number of investor-state disputes grows, the need for consistency of interpretations of common terms – such as expropriation and fair and equitable treatment – will grow. Absent such consistency, key terms may be given different meanings depending on which arbitrators are appointed to interpret them. This will detract from the predictability of rights conferred under investment agreements. A single appellate mechanism to review the decisions of arbitral panels under various investment agreements should help to address this issue and minimize the risk of aberrant interpretation.' Calendar No.319, 107th Congress, 2d Session, Report 107–139 (2002).

[32] US–Australia Free Trade Agreement (FTA) concluded on 18 May 2004. See for text of the agreement: http:// www. ustr. gov / newfta /Australia /final /final.pdf

[33] Indeed, both Brazil and Argentina were reported to have stated that they would not agree to the investor-to-state arbitration dispute settlement mechanism in the future Free Trade Agreement of the Americas.