REGULATION OF FOREIGN INVESTMENT UNDER BILATERAL AND REGIONAL INVESTMENT TREATIES

Mohammad Belayet Hossain*

Abstract

'Globacolisation' is a concept that derives from 'globalisation' and 'colonisation'. There was a time when the developed countries colonised the developing and least-developed countries in the world through land but since the independence of these countries during 1940-50s, the developed states invented a new idea to colonise them that is through economy. 'Globacolisation' is a newly invented word that reflects the reality of the economic colonisation of the developing and least-developed states in the past, present and future. This article aims to analyse the institution of a bilateral investment treaty (BIT) and regional investment treaties and their contribution to the development of the law of foreign investment. It will also cover: an analysis of the investment protection provisions of the main regional trade and investment treaties; and the recent free trade agreements. The objective is to provide a sophisticated understanding of the standard of treatment of foreign investors under these treaties as opposed to customary international law.

Keywords: Foreign Investment, Regulation, Bilateral Investment Treaties, Regional Investment Treaties, Customary International Law

PREFERRED CITATION

- Mohammad Belayet Hossain, Regulation of foreign investment under bilateral and regional investment treaties, *The Lex-Warrier: Online Law Journal* (2019) 1, pp. 1 - 25, ISSN (O): 2319-8338

* Lecturer, School of Law, Chittagong Independent University of Bangladesh

Introduction

After the Second World War, by Bretton Woods Conference in 1944, the developed countries established gradually the World Bank, International Monetary Fund and General Agreement on Tariffs And Trade (GATT) (replaced by World Trade Organization) to ensure their supremacy over the undeveloped states by pretending to help them economically (providing financial aid and loan).[1] Due to the protest from few developing countries in 1970s, the developed countries invented another idea in 1990s, called 'globalisation'. Through globalization *i.e.* 'free-trade without any barrier' helped the developed countries to enter into the sovereign territory of the host states and take control over almost every activities.[2] The developing and least developed (LDCs) countries have consumed the idea of 'globalisation' so well that they started to compete with each other to liberate their trade barrier to attract more foreign investments with the expense of sovereignty, national interest and security or even human rights of citizens.[3] These countries find themselves into an economic trap, if any of them try to come out of it; they are seriously hit with economically and politically by the developed states. For examples, Argentina, Zimbabwe, Brazil, Iran and recently Turkey has experienced the other side of globalization.[4]

The supporters of 'neoclassical theory' propounds that FDI has contributed positively to the economic development of the host country.[5] The argument continues: (a) foreign investors usually bring capital into the host state, thus increases total savings and revenue via tax of the country, reduces balance of payment constraints and makes domestic capital available for other uses and so on;[6] (b) FDI through multinational enterprises (MNEs) plays the role of a 'tutor' in the host state by replacing the inferior production function with a superior one from the advanced industrialized countries through transferring technology, managerial and marketing skills, market information, organizational experience, innovation in products and production techniques, training of workers and so on;[7] (c) FDI increases competition in an industry with a likely improvement in productivity, which can led to reallocation of resources to more productive activity across the economy,

[1] B. Hettne, *Development Theory and the Three Worlds* (New York: Wiley, 1990), 82.
[2] *Ibid.*
[3] Sherif H. Seid, *Global regulation of foreign direct investment* (Routledge, 2018), 17.
[4] Surya P. Subedi, *International Investment Law: Reconciling Policy and Practice* (Hart Publishing, 2008), 8-15.
[5] C.F. Bergten *et al*, *American Multinationals and American Interests* (Washington: Brookings Institution, 1978), 36.
[6] Bureau of Industry Economics, *Foreign Direct Investment in APEC: A Survey of the Issue. Report 95/21* (Canberra: Australian Government Publishing Service, 1995).
[7] K. Kojima, *Direct Foreign Investment: a Japanese model of multinational business operations* (London: Croom Helm, 1978).

reduction of overmanning, efficient utilization of capital, removal of poor management practices and linking local producers with the world markets;[8] (d) FDI generates employment, influences favourably the distribution of income and power, development of infrastructures, reduction of poverty and illiteracy and so on[9]. Example includes, in Indonesia people living in absolute poverty dropped from 58% in 1960 to 10.12% in 2017, in Malaysia from 37% in 1960 to 0.2% in 2016, in China from 88% in 1981 to 6.2% in 2012[10].

States have traditionally welcomed foreign investment for a variety of reasons. Foreign investment has been regarded as:

- an engine of economic growth;
- a source of foreign currency income;
- a stimulator of the local economy;
- a source of foreign skills, information and know-how, among other features.

Foreign investment takes place in different forms, including:

- through committing capital resources abroad either directly or through portfolio investment;
- by licensing the use of technology, etc.

Because of the form such investment takes it requires special protection under the law of the country concerned. This is because foreigners who purchase land and other immovable property or enter into joint ventures to create a new company cannot leave the host country as and when they want. Their commitment to the host country is long-term, hence the need for long-term protection under special laws. Traditionally, such protection has been sought under international law and lately under bilateral investment treaties (BITs).

The origins of BITs

Unlike local laws on foreign investment, which can also offer adequate protection and incentives to foreign investors but are liable to change with a change of government, no state can unilaterally change international law or the provisions of BITs.[11]

---

[8] *Ibid, 153.*

[9] G.L. Reuber *et al*, *Private Foreign Investment in Development* (Oxford, 1973).

[10] "Overview", Worldbank, accessed 28 December 2017, http:// www. worldbank. org/en/country.html.

[11] See a background paper on BITs produced by the British Foreign and Commonwealth Office, Press Release on Investment Promotion and Protection Agreements, Press Release No. 174 (1230) of 21 October 1991).

Such treaties are of long duration, usually 10 years, with continuing cover for 20 years after termination on investments made while they are in force. The formal safeguards and guarantees that BITs provide on non-commercial risks have acted as an incentive to potential investors and as a useful reassurance to those with existing investments in the signatory states.

Therefore, when it comes to promoting foreign investment states have sought additional safeguards and guarantees under international law and BITs designed to set standards of protection. Although any protection provided for foreign investment is always under the law of the host country, this law has to conform to the commitments undertaken by the state concerned:

- either under BITs, FTAs; or
- other principles of international law.

A bilateral investment treaty is a relatively recent phenomenon and a German invention perfected over the years by the US and the UK. Initially BITs were seen as a challenge to international efforts by developing countries to regulate foreign investment through an international instrument adopted under the auspices of the UN. The Federal Republic of Germany was the first country to conclude BITs with certain developing countries in the 1960s in order to protect German investment in these countries.

As pointed out by Gunawardana, the German investors, 'having lost their foreign assets in the two world wars, were particularly concerned about investment protection.'[12]

Both the US and the UK were relative newcomers to this sphere; the first BIT concluded by the UK was with Egypt in 1975; it was soon followed by the US.

The ancestor of the BIT is the first generation of Friendship, Commerce and Navigation treaties (FCN) concluded by the US with various European powers, including:

- France;
- Spain;
- the former Prussia;
- the Netherlands;
- the UK.

The second generation of FCN treaties was concluded by the US with newly independent Latin American states in the early nineteenth century, followed by the third during the inter-war period and the fourth after the Second World War.

[12] Gunawardana, A. de Z. 'The inception and growth of bilateral investment promotion and protection treaties', Proceeding of the ASIL 86th annual meeting, 1992, pp.544–550, at 545.

Although the early FCN treaties were concluded primarily to establish trading relations, they did include provisions concerning the protection of alien property, including a clause prohibiting the expropriation of property of aliens without compensation.[13]

The fourth generation of treaties were the ones concluded in the aftermath of WWII following the failure of the Havana Charter to include foreign investment provisions favoured by the US. The main purpose of the fourth generation of FCN treaties concluded between 1946 and 1966 was to protect American investment abroad. For instance, Article IV(2) of the Treaty of Amity between the US and Iran provided as follows:

'Property of nationals and companies of either High contracting party, including interests in property, shall receive the most constant protection and security within the territories of the other High Contracting party, in no case less than that required by international law. Such property shall not be taken except for a public purpose, nor shall it be taken without the prompt payment of just compensation. Such compensation shall be in an effectively realizable form and shall represent the full equivalent of the property taken; and adequate provision shall have been made at or prior to the time of taking for the determination and payment thereof.'[14]

The US launched its BIT programme in 1977. This is because:

- the US was having difficulty in concluding any new FCN treaties with newly-independent states of Asia and Africa after 1966;
- the political situation was turning against the US interests within the UN, where the developing countries were launching their campaign for an NIEO.

Explaining the US motive for concluding the BITs, Vandevelde, who was on the US negotiating team for BITs while in the legal adviser's office at the Department of State, states that:

'(T)he legal consideration was to build a network of treaties adopting the principle that the expropriation of foreign investment was unlawful unless accompanied by prompt, adequate and effective compensation. A strong case can be made that this was the single most important goal of the BIT program.

[13] Vandevelde, K.J. 'The BIT program: a fifteen-year appraisal', Proceeding of the ASIL 86th annual meeting, 1992, pp.532– 540, at 533.

[14] 284 UNTS 93.

Consider the context in which the decision to begin the program was launched. The 1960s and early 1970s had witnessed scores of expropriatory acts by foreign governments against US investors, beginning in 1959 with the seizure of an IT&T subsidiary in Brazil and Castro's massive expropriations in Cuba. In 1974, the UN General Assembly's adoption of the Charter of Economic Rights and Duties seemed to suggest that the world community, at least in political fora, was willing to endorse expropriations unaccompanied by payment of full compensation.

The general hostility to property rights evident in the world community during this period from 1959 to the mid-1970s was deeply troubling to American policy makers. It is no accident that these years coincided with the enactment of the Hickenlooper Amendment, the Gonzalez Amendment, and similar provisions in the Trade Act of 1974 and the Caribbean Basin Initiative, all of which imposed sanctions on foreign states that expropriated US property without payment of full compensation.

In the midst of these expropriations and the passage of the Charter of Economic Rights and Duties, American policy makers looked for a way to bolster the traditional American position that customary international law required payment of prompt, adequate and effective compensation for expropriation of foreign-owned property. They believed that a network of treaties embracing this principle would be one highly visible way of building state practice in support of that traditional position.'[15]

Indeed, according to the US, 'under international law,' it had 'a right to expect: that any taking of American private property will be non-discriminatory; that it will be for a public purpose; and that its citizens will receive prompt, adequate and effective compensation from the expropriating country.'[16]

The fifth generation of the BITs are those concluded in the 1990s with Asian, Eastern European and Latin American states, following:

- the triumph of Western liberal economic philosophy over socialist philosophy;
- the collapse of the concept of the NIEO led by the developing countries.[17]

Under this generation of treaties Asian, Eastern European and Latin American states came around to accepting the Western concept of the international minimum standard not only in its traditional form, but

[15] Vandevelde, op.cit note 75, p.534.
[16] US Dept of state, statement on Foreign Investment and Nationalisation, 30 September 1975, XV ILM (1976), p.186.

[17] See Vanderdevelde, K. 'The political economy of a bilateral investment treaty', 92 (4) AJIL (October 1998), pp.621–641.

also its new form, which encompasses the due process of law, fair and equitable treatment, and full protection and security.

For instance, Argentina, a country which was holding out for the Calvo doctrine for a long time, made a *volte face* and concluded a BIT with the US in 1991.[18] The US regarded this as a major achievement and breakthrough in its economic relations with the South American countries. As outlined in a Presidential communication to Congress, the main US objectives in the conclusion this BIT were as follows:

'Investment of nationals and companies of one Party in the territory of the other Party (investments) receive the better of the treatment accorded to domestic investments in like circumstances (national treatment), or the treatment accorded to third country investments in like circumstances (most-favored-nation (MFN) treatment), both on establishment and thereafter, subject to certain specified exceptions;

- Investments are guaranteed freedom from performance requirements, such as obligations to use local products or export goods;
- Companies which are investments may hire top managers of their choice, regardless of nationality;
- Expropriation can occur only in accordance with international law standards: in a non-discriminatory manner; for a public purpose; and upon payment of prompt, adequate, and effective compensation;
- Investment-related funds are guaranteed unrestricted transfer in a freely usable currency; and
- Nationals and companies of either Party, or their investments, have access to binding international arbitration in investment disputes with the host government, without first resorting to domestic courts.'[19]

After concluding a number of BITs designed to achieve the above-mentioned objectives with other South American states and others in Asia and Africa, the US has moved to the next generation of bilateral trade and investment treaties. At the time of writing, the US seems to be busy concluding the sixth generation of BITs in the form of FTAs designed to ensure not only favourable treatment of foreign investment once it is in the host countries, but also to secure free and unrestricted investment access to different areas of economic activity in such countries.

The content of BITs

Regardless of the negotiating position taken by various states at the international platforms, when it came to negotiating

[18] 1991 UST. LEXIS 176.

[19] US Treaty Doc. 103-2, Focus – 32 of 48 Documents, 1991 UST. LEXIS 176.

bilateral investment treaties the host states have, by and large, accepted the Hull formula and agreed to the provisions favoured by the home or investor countries. Most of the BITs concluded since the 1960s reflect the Hull formula and incorporate the concerns of the investor countries because most developed countries hold views similar to those of the US.

For instance, protesting the Libyan nationalisation of the property, rights and assets under an oil concession contract of British Petroleum in 1971 the British Government stated that:

'An act of nationalisation is not legitimate in international law unless it satisfies the following requirements:

- it must be for a public purpose related to the internal needs of the taking state; and
- it must be followed by the payment of prompt, adequate and effective compensation.

Nationalisation measures which are arbitrary or discriminatory or which are motivated by considerations of a political nature unrelated to the internal well being of the taking state are, by a reference to those principles, illegal and invalid.'[20]

Regulating foreign investment through BITs

When the debate was taking place within the UN about the codification and progressive development of the law of foreign investment, the business of regulating foreign investment through bilateral investment treaties gathered pace outside of the UN. Those developed countries who wanted to protect investment by their nationals in foreign countries also wanted to conclude BITs of *sui generis* or *lex specialis* character rather than wait for international legislation under the auspices of the UN. Most of these treaties incorporated provisions more akin to the traditional position taken by the developed countries such as the Hull formula rather than the ideas behind the UN initiatives such as the NIEO or the CERD. When new regional trading blocs such as NAFTA were created to promote the free flow of capital, goods and services among the countries of the region they, too, followed the pattern of bilateral investment treaties.

The practice of conforming to the Hull formula and offering as many incentives as possible to foreign investors through a BIT was confined to the treaties concluded not only between one developed country and

[20] As cited in 53 ILR 317 (1974).

another, but also between the developed and developing countries.[21]

Therefore, the law on foreign investment has been understood in many quarters to be the law as incorporated in the modern bilateral and regional investment treaties and not as included in the resolutions of recommendatory character of the UN General Assembly or other international 'soft law' instruments.

When the international efforts to conclude an internationally-acceptable treaty or a mandatory code of conduct within the UN remained unsuccessful, increasing numbers of states (including those leading developing countries which had championed the international regulation of foreign investment) also started concluding bilateral investment treaties along the pattern favoured by the developed countries. This is one reason why greater weight has been accorded to the content of such treaties in determining what the law is on foreign investment.

Thus, the 1992 Guidelines prepared under the auspices of the World Bank and the IMF, the Draft MAI or the Guidelines of the OECD itself drew heavily on such bilateral investment treaties.

'Investment'

When the developing countries themselves started competing with each other for foreign direct investment that was flowing from developed countries to developing countries, they were in competition to offer greater incentives to foreign investors. Thus, they agreed to provisions designed to strengthen the position of foreign investors. The term 'investment' itself was defined as broadly as possible so as to accord protection to all conceivable forms of investment under the treaties, including asset-based investments (*e.g.* portfolio investment). Of course, there are some BITs, which exclude portfolio investment from the definition of the term 'investment', but the general trend seems to be to include it.

Jordan–US Treaty 1994

For instance, a bilateral investment treaty concluded between Jordan and the US in July 1997 defines the term 'investment' as comprehensively as possible in Article I(d) in the following terms:

"investment" of a national or company means every kind of investment owned or controlled directly or indirectly by that

[21] See generally, Akinsanya, A. 'International protection of direct foreign investment in the third world', 36 ICLQ (1987), pp.58–75.

national or company, and includes investment consisting or taking the form of:

a. a company;
b. shares, stock, and other forms of equity participation, and bonds, debentures, and other forms of debt interests, in a company;
c. contractual rights, such as under turnkey, construction or management contracts, production of revenue-sharing contracts, concessions, or other similar contracts;
d. tangible property, including real property; and intangible property, including rights, such as leases, mortgages, liens, and pledges;
e. intellectual property rights, including copyrights and related rights, industrial property rights, patents, rights in plant varieties, utility models, industrial designs or models, rights in semiconductor layout design, indications of origin, trade secrets, including know-how, confidential business information, trade and service marks, and trade names; and rights conferred pursuant to law, such as licenses and permits.'

With regard to the treatment and protection of investment, the Jordan–US treaty is illustrative of the practice of states. The provisions included in Article II of the treaty are typical of the trend of the 1990s:

'Treatment and protection of investment –

1. With respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of covered investments, each contracting party shall accord treatment no less favourable than that it accords, in like situations, to investments in its territory of its own nationals or companies (hereinafter "national treatment") or investments in its territory or nationals or companies of a third country (hereinafter "most favoured nation treatment"), whichever is most favourable (hereinafter "national and most favoured nation treatment"). Each contracting party shall ensure that its state enterprises, in the provision of their goods or services, accord national and most favoured nation treatment to covered investments.

   a. Each contracting party shall at all times accord to covered investments fair and equitable treatment and full protection and security, and shall in no case accord treatment less favourable

than that required by international law.

b. Neither contracting party shall in any way impair by unreasonable and discriminatory measures the management, conduct, operation, and sale or other disposition of covered investments.

2. Each contracting party shall provide effective means of asserting claims and enforcing rights with respect to covered investments.
3. Each contracting party shall ensure that its laws, regulations, administrative practices and procedures of general application, and adjudicatory decisions, that pertain to or affect covered investments are promptly published or otherwise made publicly available.'

Articles III and IV of the treaty deal with the question of expropriation and compensation. The provisions included in the treaty are designed to provide as strong a protection as possible against any potential expropriation and provide for the best form of prompt, adequate and effective compensation:

'Article III –

1. Neither contracting party shall expropriate or nationalize a covered investment either directly or indirectly through measures tantamount to expropriation or nationalisation ("expropriation") except for a public purpose; in a non-discriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with due process of law and the general principles of treatment provided for in Article II(3).[22]
2. Compensation shall be paid without delay; be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken ("the date of expropriation"); and be fully realisable and freely transferable. The fair market value shall not reflect any change in value occurring because the expropriatory action had become known before the date of expropriation.
3. If the fair market value is denominated in a freely usable currency, the compensation paid shall be no less than the fair market value on the date of expropriation, plus interest at a commercially reasonable rate for that currency, accrued from the date of expropriation until the date of payment.

[22] 36 ILM 1498 (1997).

4. If the fair market value is denominated in a currency that is not freely usable, the compensation paid – converted into the currency of payment at the market rate of exchange prevailing on the date of payment – shall be no less than:

    a. the fair market value on the date of expropriation, converted into a freely usable currency at the market rate of exchange prevailing on that date, plus (b) interest, at a commercially reasonable rate for that freely usable currency, accrued from that date of expropriation until the date of payment.

Article IV

Each contracting party shall accord national and most favoured nation treatment to covered investments as regards any measures relating to losses that investments suffer in its territory owing to war or other armed conflict, revolution, state of national emergency, insurrection, civil disturbance, or similar events.

Each contracting party shall accord restitution, or pay compensation in accordance with paragraphs 2 through 4 of Article III, in the event that covered investments suffer losses in its territory, owing to war or other armed conflict, revolution, state of national emergency, insurrection, civil disturbance, or similar events, that result from:

a. requisitioning of all or part of such investments by the contracting party's forces or authorities, or
b. destruction of all or part of such investments by the contracting party's forces or authorities that was not required by the necessity of the situation.'

Similar provisions relating to the treatment and protection of foreign investment can be found in many bilateral investment treaties concluded by the US with other states, including the Russian Federation.[23]

Under Article II(1) of the treaty each state 'shall permit and treat investment, and activities associated therewith, on a non-discriminatory basis'. Article 2(a) is also of interest: 'Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security, and shall in no case be accorded treatment inconsistent with the norms and principles of international law.' The treaty concluded between Japan and Bangladesh in 1998 is illustrative of a tight regime of protection

[23] 31 ILM 794 (1992).

accorded to foreign investors. Article 5(1) and (2) read as follows:

1. Investments and returns of investors of either contracting party shall receive the most constant protection and security within the territory of the other contracting party.
2. Investments and returns of investors of either contracting party shall not be subjected to expropriation, nationalisation or any other measure the effect of which would be tantamount to expropriation or nationalisation, within the territory of the other contracting party unless such measures are taken for a public purpose and under due process of law, are not discriminatory, and are taken against prompt, adequate and effective compensation.'[24]

This provision provides protection for foreign investment in excess of that which is accorded by traditional customary international law. It incorporates not only the Hull formula, but also additional qualifications such as:

- 'due process of law';
- settlement of investment disputes under ICSID;
- retroactive protection of foreign investment.

Indo–UK Treaty 1994

However, a bilateral investment treaty concluded in 1994 between India, a leading developing country, and the UK, a leading capitalist country, varies slightly from other BITs. The Indo–UK Treaty does not subscribe to the Hull formula in respect of every type of expropriation or nationalisation. Rather, it speaks of 'fair and equitable compensation' as opposed to 'prompt, adequate and effective' compensation with regard to most forms of foreign investment and 'prompt, adequate and effective' compensation only with regard to compensation for foreign shareholders in an expropriated company. The provision concerning the nationalisation and expropriation of foreign investment admits the possibility of expropriation and nationalisation not simply for 'a public purpose', but for 'a public purpose related to the internal requirements for regulating economic activity'; it accords a wider meaning to this qualification:

'Article 5: Expropriation –

Investments of investors of either contracting party shall not be nationalised,

[24] Reproduced in the Japanese journal of international law, vol.43 (2000), pp.229– 236.

expropriated or subjected to measures having effect equivalent to nationalisation or expropriation (hereinafter referred to as "expropriation") in the territory of the other contracting party except for a public purpose related to the internal requirements for regulating economic activity on a non-discriminatory basis and against fair and equitable compensation. Such compensation shall amount to the genuine value of the investment expropriated immediately before the expropriation or before the impending expropriation became public knowledge, whichever is the earlier, shall include interest at a fair and equitable rate until the date of payment, shall be made without unreasonable delay, be effectively realizable and be freely transferable.

The investor affected shall have a right, under the law of the contracting party making the expropriation, to review, by a judicial or other independent authority of that party, of his or its case and of the valuation of his or its investment in accordance with the principles set out in this paragraph. The contracting party making the expropriation shall make every endeavour to ensure that such review is carried out promptly.

Where a contracting party expropriates the assets of a company which is incorporated or constituted under the law in force in any part of its own territory, and in which investors of the other contracting party own shares, it shall ensure that the provisions of paragraph (1) of this Article are applied to the extent necessary to guarantee prompt, adequate and effective compensation in respect of their investment to such investors of the other contracting party who are owners of those shares.'[25]

A further feature of significance in the Indo–British treaty is the confirmation, in Article 11(1), that 'all investments shall be governed by the laws in force in the territory of the contracting party in which such investments are made.' These provisions demonstrate that not all BITs were conforming fully to the Hull formula nor were they completely abandoning the Calvo Doctrine. However, most of the other BITs concluded by the US with developing countries conformed to the Hull formula.[26]

Argentine Treaty 1991

For instance, when the US concluded in 1991 its first ever BIT more or less on its terms with a leading Latin American state, Argentina, which had been a staunch

[25] 34 ILM 935 (1995).

[26] An example is the 1998 Agreement between Japan and Bangladesh concerning the Promotion and Protection of Investment. See 43 Japanese annual of international law (2000), p.229 ff.

supporter of the Calvo Doctrine, it conveyed the message that the Calvo Doctrine was going to be consigned to history. As pointed out by Propp:

'The Argentina BIT is quite important. Its most notable achievement is the first-ever unqualified right to investor-state arbitration agreed to by a Latin American country in the BIT context. This overcomes the legacy of the Calvo doctrine that foreign investors should have the same recourse as local nationals, that is, local courts.'[27]

The protection accorded to foreign investors under the US– Argentine Treaty of 1991 was perhaps the most comprehensive and most favourable to foreign investors at the time. The provision in Article IV of this treaty is illustrative:

'Article IV –

1. Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization ("expropriation") except for a public purpose; in a non-discriminatory manner; upon payment of prompt, adequate, and effective compensation; and in accordance with due process of law and general principles of treatment provided for in Article II(2).[28] Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became known, whichever is earlier; be paid without delay; include interest at a commercially reasonable rate from the date of expropriation; be fully realizable; and be freely transferable at the prevailing market rate of exchange on the date of expropriation.
2. A national or company of either party that asserts that all or part of its investment has been expropriated shall have a right to prompt review by the appropriate judicial or administrative authorities of the other Party to determine whether any such expropriation has occurred and, if so, whether such expropriation, and any compensation thereof, conforms to the

[27] Propp, K.R. 'Bilateral investment treaties: the US experience in eastern Europe', in Proceeding of the ASIL 86th annual meeting, 1992, pp.540–544, at 544.

[28] Article II (2) reads as follows: '(a) Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law. (b) Neither Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments. For the purposes of dispute resolution under Articles VII and VIII, a measure may be arbitrary or discriminatory notwithstanding the opportunity to review such measure in the courts or administrative tribunals of a party. (c) Each party shall observe any obligation it may have entered into with regard to investments.' 1991 UST. LEXIS 176.

provisions of this Treaty and the principles of international law.

3. Nationals or companies of either party whose investments suffer losses in the territory of the other party owing to war or other armed conflict, revolution, state of national emergency, insurrection, civil disturbance or other similar events shall be accorded treatment by such other party no less favourable than that accorded to its own nationals or companies or to nationals or companies of any third country, whichever is the more favourable treatment, as regards measures it adopts in relations to such losses.'[29]

Thus, the provisions just cited seek to provide as tight a protection as possible to foreign investors.

The Iranian Revolution 1979

The US seems to have tried to incorporate all the eventualities that its nationals or companies have had to deal with in Iran in the run up to and in the immediate aftermath of the Islamic revolution in Iran in 1979. This treaty seems to provide a detailed prescription for any future dispute settlement body in deciding investment cases involving US nationals or companies. Most of the principles developed by the Iran–US Claims Tribunal in favour of American nationals or companies seem to have been incorporated into this BIT itself, leaving little room for manoeuvre for future tribunals. No wonder that the arbitration panels established in the 1990s to consider investment disputes followed closely the content of what the US had dictated through its BITs.

For instance, the addition of the words expropriation 'indirectly through measures tantamount to expropriation or nationalisation' have been inspired by the jurisprudence developed by the Tribunal. The dispute settlement mechanism provided for in Article VII is as elaborate as possible and as all-encompassing as possible. Not only has the definition of the term 'dispute' been defined as broadly as possible, but the range of choice of methods of settling disputes available to the foreign investor is also very wide. Foreign investors are not required to exhaust local remedies before resorting to international mechanisms. One by one many Latin American states concluded similar BITs with the US signalling their *volte face* to deal with the changed reality of the world. This process was further strengthened when Mexico agreed to the NAFTA, which contained provisions similar to those included in the BITs in respect of the

[29] 1991 UST. LEXIS 176.

protection of foreign investment and the settlement of investment disputes.

Free trade agreements (FTAs)

The newest generation of trade and investment treaties concluded by the US with other states are the so-called free trade agreements. Those concluded with Chile and Singapore are some of the most ambitious and comprehensive bilateral treaties ever concluded in the history of international economic relations. For instance, the massive 800-page treaty concluded with Chile in June 2003 and the even longer 1,400-page treaty with Singapore in May 2003 contain detailed provisions on foreign investment, spelling out many of the key terms and phrases whose definition has dogged the debate on the law of foreign investment for so long. For instance, the treaty with Chile defines not only the terms such as 'national treatment' and 'most-favoured-nation treatment', but also more controversial and challenging terms such as 'fair and equitable treatment' and 'full protection and security'.[30]

Similarly, Article 15.1(13) of the US-Singapore FTA defines the term 'investment' as comprehensively as possible in the following words:

'investment means every asset owned or controlled, directly or indirectly, by an investor, that has the characteristics of an investment. Forms that an investment may take include:

a. an enterprise;
b. shares, stock, and other forms of equity participation in an enterprise;
c. bonds, debentures, other debt instruments, and loans;
d. futures, options, and other derivatives;
e. turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts;
f. intellectual property rights;
g. licenses, authorisations, permits, and similar rights conferred pursuant to applicable domestic law;
h. other tangible and intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges.'[31]

Even so, the list is not exhaustive. Article 15.5 of the treaty outlines the minimum standard of treatment to be accorded to foreign investors in the following words:

'Article 15.5: Minimum standard of treatment –

[30] Article 10.4 (2) (a), (b) of the US-Chile Agreement. See text of the Treaty in http://www.ustr.gov/new/fta/chile.htm.

[31] http://www.ustr.gov/new/fta/singapore.htm

Each party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.

For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights.

The obligation in paragraph 1 to provide "fair and equitable treatment" includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world; and

The obligation in paragraph 1 to provide "full protection and security" requires each party to provide the level of police protection required under customary international law.'

Although these treaties seem to be aiming to codify certain key principles of the law on foreign investment, various provisions keep referring to customary international standards. This more or less takes the debate back to square one. Hence, the relevance of customary international law has not been diminished, even with the conclusion of such comprehensive trade and investment treaties. It is noteworthy that the provisions such as these are somewhat more cautious and narrowly defined than the provisions of many other previous BITs in terms of the protection accorded to foreign investors. This may have been due to the ICSID panel decisions, such as those in *Metalclad* where the panel sought to stretch the meaning of various terms beyond the reasonable meaning accorded to them under customary international law.

The significance of BITs

In the view of many international tribunals and publicists, the law on foreign investment at this juncture seems to be the law supported, albeit not created, by the provisions of the BITs and regional treaties such as NAFTA. Indeed, although the individual BITs could be regarded as *lex specialis*,[32] it is difficult to deny that the practice of states in concluding such treaties is capable of strengthening the alleged rules of customary international law on the

[32] See Sornarajah, M. 'State responsibility and bilateral investment treaties', Journal of world trade law (1986), pp.79–98, at 82.

subject-matter. These treaties have been regarded by international tribunals in various cases as a source of law.

Of course, doubts have been expressed in the *Aminoil case*[33] and the *Sedco case* (Second Interlocutory Award)[34] on the value of such treaties in creating rules of customary international law on expropriation and compensation. In the *Sedco case* the Iran–US Claims Tribunal stated that:

'Assessment of the present state of customary law on the subject on the basis of the conduct of states in actual practice is difficult, inter alia, because of the questionable evidentiary value for customary international law of much of the practice available ... [these] types of agreements can be so greatly inspired by non-judicial considerations – *e.g.* resumption of diplomatic or trading relations – that it is extremely difficult to draw from them conclusions as to *opinio juris i.e.* the determination that the content of such settlements was thought by the states involved to be required by international law ... The bilateral investment treaty practice of states, which much more often than not reflects the traditional international law standard of compensation for expropriation, more nearly constitutes an accurate measure of the high contracting parties' views as to customary international law, but also carries with it some of the same evidentiary limitations as lump sum agreements. Both kinds of agreements involve in some degree bargaining in a context to which "*opinio juris*" seems a stranger.'

Indeed, the manner in which the US has concluded its BITs with developing countries[35] testifies to the observations made by the tribunal. The following observation made by Alvarez, who was on the US BIT negotiating team while he was in the legal adviser's office of the US Department of State, is noteworthy:

'BIT partners turn to the US BIT with the equivalent of an IMF gun pointed at their heads; others may feel that, in the absence of a rival superpower, economic relations with one that remains are inevitable. For many, a BIT relationship is hardly a voluntary, uncoerced transaction. They feel that they must enter into the arrangement, or that they would be foolish not to, since they have already made the internal adjustments required for BIT participation in order to comply with demands made by, for example, the IMF. A BIT negotiation is not a discussion between sovereign equals. It is more like an intensive training seminar

---

[33] 21 ILM 976.

[34] 10 Iran–US C.T.R. 180 at pp.184–185 (1986).

[35] See on the Chinese BITs, Kong Qingjiang, 'Bilateral investment treaties: the Chinese approach and practice', 8 Asian yearbook of international law (2003), pp.105–136.

conducted by the United States, on US terms, on what it would take to comply with the US draft.'[36]

In the *Barcelona Traction case* the ICJ was not prepared to take any guidance from the BITs or the so-called 'lump sum' settlement agreements because they were *sui generis* in character.[37]

However, more recent cases, especially those decided by the ICSID, accord considerable weight to the content of BITs in determining the rules of customary international law on the subject-matter. According to these tribunals, these treaties could be taken to confirm and thus enlarge the traditional rules of international law of foreign investment,[38] including the Hull Formula, favoured by the developed investor countries rather than those preferred and championed for a long time by the developing countries within the UN.

The depoliticisation of disputes

The BITs concluded since the introduction of ICSID in the mid-1969s made investor-to-state dispute resolution possible for the first time. Under a typical BIT, an investor was entitled to take a host state to a binding, third-party arbitration, typically under the rules of the ICSID, to settle any disputes involving the interpretation of the application of the BIT. Should the host state refuse to participate, the BIT made provision for an appointing authority to appoint arbitrators on behalf of the host state to enable the arbitration to proceed even without the co-operation of the host state. This constituted an innovation in the history of dispute settlement at the international level.

By allowing binding, third-party arbitration for state-to-state as well as investor-to-state disputes, the BITs bade farewell to the hard-core element of the Calvo doctrine. What is more, BITs do not, unlike many other international dispute settlement mechanisms, require the exhaustion of local remedies before resorting to binding, third-party arbitration. In fact, as pointed out by Vandevelde,[39] under many BITs the investor forfeits the right to binding, third-party arbitration if it invokes local remedies.

---

[36] Jose E. Alvarez's remarks made as Chairman of a panel at the ASIL annual meeting in 1992: Proceeding of the ASIL 86th annual meeting, 1992, pp.550–555, at 552 and 553.

[37] ICJ Rep. 1970, p.3 at 40.

[38] See Mann, F.A. 'British treaties for the promotion and protection of investment', 52 BYIL (1982), p.241.

[39] Vandevelde, K.J. 'The BIT program: a fifteen-year appraisal', Proceeding of the ASIL 86th annual meeting, 1992, pp.532– 540, at 538.

Although it could be said that by making it possible to depoliticise investment disputes the BITs were endorsing the very ideas that lay behind the Calvo doctrine, the BITs do so in a manner which is just the opposite of that envisaged under the Calvo doctrine. In other words, while the Calvo doctrine sought to depoliticise investment disputes by preventing foreign state interference either in the form of diplomatic protection or 'gunboat diplomacy' by requiring the settlement of such disputes under the local laws of the host states, the BITs seek to depoliticise investment disputes by providing for binding, third-party arbitration for both state-to-state and investor- to-state disputes.

Thus, the BITs allow the home or investor countries to extricate themselves from involvement in private investment disputes without diminishing the effectiveness of the remedies available to investors. This is because prior to the BIT era, investors from a country had to look to the government of their own country for assistance when their investment was expropriated or unlawfully impaired by a foreign government. Since there were no binding, third-party dispute settlement mechanisms available for foreign investors and host states could invoke sovereign immunity and the act of state doctrine before any municipal courts, diplomatic protection was the only avenue open to such investors. When the state machinery decides to espouse a claim and pursue a remedy on behalf of its private investors through diplomatic channels or international arbitration or impose economic sanctions on the alleged wrongdoer, the dispute acquires a political character.

When an effective dispute settlement mechanism such as the ICSID is available to private foreign investors there is no need for government intervention and the politicisation of investment disputes. Thus, one of the major positive contributions made by the BITs is, to borrow the word from Vandevelde,[40] the 'depoliticisation' of investment disputes. BITs do not also require the exhaustion of local remedies before the host state could be sued by foreign investors before an international tribunal such as the ICSID.

Regional treaties: NAFTA and the Energy Charter Treaty:

North American Free Trade Agreement (NAFTA):

In the absence of a global treaty on foreign investment, both BITs and regional treaties have sought to fill the vacuum and lead the

[40] *Ibid.*

way. This is especially the case with the North American Free Trade Agreement (NAFTA).

At the time of adoption, the provisions of this regional treaty provided far more protection to foreign investors than accorded hitherto in customary international law. Appleton rightly states that: '(p)lurilateral treaties such as the NAFTA go even further than customary international law.'[41]

Thus, the NAFTA set the trend for much greater protection of foreign investment throughout the 1990s, whether it be through the BITs, the TRIMS agreement of the WTO or other regional treaties. Jackson, Davey and Sykes rightly observe that:

'If global progress on investment issues has been slow, more dramatic developments are visible at the regional level. NAFTA incorporates broad rules on investment within the region, including general obligations to afford MFN and national treatment to NAFTA investors. The "investor rights" provisions of NAFTA are particularly remarkable in that they create private rights of action to enforce their terms (unlike most of the provisions of NAFTA, which can only be enforced by member nations), including a private right of action for damages in the event of "expropriation," a concept that has proved elusive.'[42]

By far, the NAFTA provisions on the treatment of foreign investors are the most favourable ones for foreign investors. They offer greater protection to foreign investment than does the TRIMS agreement. The main NAFTA provision on foreign investment protection reads, in Article 1110(1), as follows:

'No party may directly or indirectly nationalise or expropriate an investment of an investor of another party in its territory or take a measure tantamount to nationalisation or expropriation of such investment ("expropriation") except:

a. for a public purpose;
b. on a non-discriminatory basis; in accordance with due process of law and Article 1105(1);
c. on payment of compensation in accordance with paragraphs 2 through 6.'

Article 1105(1) provides for additional protection for foreign investors: 'Each party shall accord to investments of investors of another party treatment in accordance with

[41] See the remarks of Barry Appleton under the title 'Investment Disputes and NAFTA chapter 11' in the ASIL proceedings, 2001, footnote 6, p.197.

[42] Jackson, J.H., William J. Davey and Alan O. Sykes, Jr, Legal problems of international economic relations: cases, materials and text (St.Paul, Minn.: West Group, 2002), fourth edition p.1137.

international law, including fair and equitable treatment and full protection and security.'

Thus, this provision implies that the protection of foreign investment under customary international law is as broad as that provided in NAFTA, as if the NAFTA provisions were mere codification of customary international law. It is doubtful whether the protection afforded to foreign investors under customary international law goes as far as that afforded under NAFTA. This provision of NAFTA represents an attempt to broaden the scope of customary international law and expand its reach beyond the limits generally accepted in international law.

Indeed, Articles 1110(1) and 1105(1) add the following three new concepts to the regime of protection available to foreign investors:

- the due process of law;
- fair and equitable treatment;
- full protection and security.

Of course, there can be little doubt that these three new elements derive from customary international law on the subject-matter.

The problem, however, lies in the interpretation of the meaning, nature and scope of these concepts, as there have been tendencies on the part of various NAFTA tribunals to stretch the meaning of these concepts beyond the limits generally understood in customary international law. It is doubtful whether the idea of the minimum international standard of treatment of foreign investment accepted in traditional international law encompasses all of the new elements embodied in the NAFTA regime under the heading 'minimum standard of treatment'.

Traditionally, BITs were designed to extend the national, non- discriminatory and most-favoured-nation (MFN) treatment to foreign investors and to protect their property against acts of expropriation. Thus, the BITs sought to accord greater protection to foreign investors than that provided under customary international law.

However, the NAFTA provisions imply that the protections enjoyed by foreign investors under BITs are also available under customary international law, which is not, perhaps, the case. What is more, neither customary international law nor BITs have ever provided free and unhindered opportunities for investment in any given host country. There have always been some restrictions on foreign investment, either in terms of the areas of economic activity or geographical regions of the country concerned.

Unlike other investment treaties NAFTA includes provisions relating to the method according to which compensation has to be

paid against expropriation. It provides for the award of monetary damages with interest. It also requires that compensation must be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place. The treaty goes on to outline the valuation criteria of the assets expropriated: 'the valuation criteria shall include going concern value, asset value including the declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.'[43]

The Energy Charter Treaty

The Energy Charter Treaty of 1994 includes equally greater protection for foreign investment than that accorded under customary international law. Article 10(1) on Promotion, Protection and Treatment of Investments provides that:

'Each contracting party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable and favourable and transparent conditions for investors of other Contracting Parties to make investments in its area. Such conditions shall include a commitment to accord at all times to investments of investors of other Contracting Parties fair and equitable treatment. Such investments shall also enjoy the most constant protection and security and no contracting party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal. In no case shall such investments be accorded treatment less favourable than that required by international law, including treaty obligations. Each contracting party shall observe any obligations it has entered into with an investor or an investment of an investor of any contracting party.'[44]

Conceived initially as the European Energy Charter, the 1994 Treaty has been ratified not only by the Western and Eastern European states (including Russia) but also by the other members of the CIS, as well as by Japan, Mongolia and Australia.[45] The protections accorded to foreign investors are enforceable by international arbitration. The protection accorded to foreign investors under the principles of national treatment and most-favoured-nation treatment are also extended to the 'related activities including

[43] Article 1135 (1) (a) of NAFTA.

[44] United Nations Conference on Trade and Development (UNCTAD), International investment instruments: a compendium, Vols. I, II and III (New York and Geneva: United Nations), UN Publications, Sales Nos. E.96.II.A.9, 10 and 11, p.555.

[45] See Thomas W. Walde (ed.), The Energy Charter Treaty: An East-West gateway for investment and trade (The Hague: Kluwer Law International, 1996); Maniruzzaman, A.F.M. 'Towards Regional Energy Co- operation in the Asia-Pacific: Some lessons from the Energy Charter Treaty', 3 (6) The journal of world investment (December 2002), pp.1061–1122.

management, maintenance, use, enjoyment or disposal.'[46]

Conclusion

In the absence of a global treaty, bilateral investment treaties have been the main instruments regulating foreign investment. They have been used successfully by investor countries constantly to expand the protection accorded to foreign investors by host states. There is some evidence to suggest that BITs have increased foreign investment and they certainly have instilled a sense of security in foreign investors. These treaties have provided the assurance to foreign investors that should something go wrong within the host states due to governmental interference then they have an international legal remedy. BITs have made a significant contribution to the development of international law of foreign investment.

[46] Article 10(1) of the Energy Charter Treaty.