Introduction

Few areas of international law excite as much controversy as the law relating to foreign investment.¹ A spate of arbitration awards resulting from investment treaties has added much to the debates in recent times. These have been followed by massive literature analysing the law resulting from the treaties and the arbitration awards. Since the awards often conflict, the confusion has been exacerbated. Though the conflict in the awards is often attributed to the inconsistencies in the language in the treaties each tribunal had to interpret, the more probable explanation is that there are philosophical, economic and political attitudes that underlie the conflict which in turn reflect the underlying causes for the controversies that have existed in the area for a long time.

The law on the area has been steeped in controversy from its inception. Much controversy has resulted from the law on the subject being the focus of conflict between several forces released at the conclusion of the Second World War. The cyclical nature of the ebbs and flows of the controversy is evident. The ending of colonialism released forces of nationalism. Once freed from the shackles of colonialism, the newly independent states agitated not only for the ending of the economic dominance of the former colonial powers within their states but also for a world order which would permit them more scope for the ordering of their own economies and access to world markets. The Cold War between the then superpowers made the law a battleground for ideological conflicts. The non-aligned movement, which arose in response to this rivalry, exerted pressure to ensure that each newly independent state had complete control over its economy. One avenue for the exertion of such pressure by the non-aligned movement was the formulation of new doctrines through the use of the numerical strength of its members in the General Assembly of the United Nations. Several resolutions were enacted asserting the doctrine of permanent sovereignty over natural resources and calling for the establishment of a New International Economic Order, the aim of which was to ensure fairness in trade to developing countries as well as control over the process of foreign investment. The oil crisis in the 1970s illustrated both the power as well as the weakness of the states which possessed natural resources. It brought

¹ Compare Harlan J in United States v. Sabbatino, 374 US 398 (1964), who said, regarding one aspect of this branch of the law: ‘There are few if any issues in international law today on which opinion seems to be so divided as the limitation of the state’s power to expropriate the alien’s property.’ The statement seems equally applicable to other areas of the international law on foreign investment.
about industry-wide shifts through collective action organised by the oil-producing states. The producers of other mineral resources were not able to achieve the same success.

The ability of the developing states to exert their collective influence on shaping the law shifted dramatically towards the end of the twentieth century. Sovereign defalcations associated with the lending of petrodollars dried up private lending by banks. Aid had already dried up due to recession in the developed states. The rise of free market economics associated with President Reagan of the United States and Prime Minister Thatcher of the United Kingdom gave a vigorous thrust to moves to liberalise foreign investment regimes. The acceptance of an ‘open door’ policy by China and the success of the small Asian states like Hong Kong and Singapore, which had developed through liberal attitudes to foreign investment, made other developing states choose a similar path. The dissolution of the Soviet Union led to the emergence of new states committed to free market economics. Developing states began to compete with each other for the foreign investment that was virtually the only capital available to fuel their development. Third World cohesion, which drove the ideas behind the New International Economic Order, was on the verge of collapse, though it had by then evolved competing norms challenging the previously existing ones. The vigorous espousal of free market economics by the International Monetary Fund and the World Bank also led to pressures being exerted on developing countries to liberalise their regimes on foreign investment. Neo-liberal economic theories became prominent. The view that the market will allocate resources fairly came to be adopted in the domestic economic sphere. Liberalisation of assets in the international economy became the favoured policy. In the context of this swing in the pendulum, the developing states entered into bilateral treaties containing rules on investment protection and liberalised the laws on foreign investment entry. They also participated in regional treaties like the North American Free Trade Agreement (NAFTA) and sectoral treaties like the Energy Charter Treaty. The World Trade Organization (WTO) came into existence with the avowed objective of liberalising not only international trade but also aspects of investment which affected such trade. The link between international trade and international investment was said to justify the competence of the WTO in this area. The Singapore Ministerial Conference of the WTO decided to study the possibility of an instrument on investment. New factors had entered the area of the international law on foreign investment. Many of the new instruments of the WTO dealt directly with areas of foreign investment. But, the WTO was unable to bring about a comprehensive instrument on investment.

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2 Though initially it was thought that these states achieved prosperity by the adoption of liberalisation measures, this view has since been queried, with many holding the view that astute interventionist measures by the state combined with selective liberalisation measures and regulation of foreign investment were the reason for the growth.

3 The move to create an instrument on investment within the WTO failed as a result of concerted opposition from developing states.

4 Intellectual property was covered by the Trade-Related Aspects of Intellectual Property Rights (TRIPS) instrument. The General Agreement on Trade in Services (GATS) deals with the services sector and covers the provision of services through a commercial presence in another country, which is foreign investment in the services sector. The Trade-Related Investment Measures (TRIMS) instrument deals with performance requirements associated with foreign investment. The Singapore and Doha Ministerial Meetings of the WTO agreed to consider an instrument on investment and an instrument on competition which would directly impact foreign investment. But, these efforts failed, signalling disenchantment with the free market model of development.
Economic liberalism was generally triumphant at the end of the last millennium. The impact of its triumph was felt on the international law on foreign investment. The incredible proliferation of bilateral investment treaties was evidence of this triumph. United Nations Commission on Trade and Development (UNCTAD) reports indicate that the 1990s began with some 900 treaties and ended with over 2,900 treaties. The treaties created jurisdiction in arbitral tribunals at the unilateral instance of the foreign investor. After *AAPL v. Sri Lanka*,\(^5\) where such unilateral recourse to arbitration on the basis of appropriately worded dispute-settlement provisions in treaties was first upheld, the number of arbitral awards based on standards of treaty protection of foreign investment increased substantially. This in turn led to the articulation by these tribunals of principles which confirmed and extended notions that favoured movement of foreign investment and their treatment in accordance with external standards. It also restricted governmental interference with such investment significantly by considerably expanding the notion of compensable taking to include regulatory takings.\(^6\)

There is evidence of yet another swing taking place at the beginning of the new millennium. Successive economic crises in Asia and Latin America attributed to the sudden withdrawal of foreign funds have led to the re-evaluation of whether the flow of foreign funds and investments is the panacea for development as originally thought. The Organization of Economic Co-operation and Development (OECD) attempted to draft a Multilateral Agreement on Investment (MAI) in 1995 thinking that the time was ripe for such an effort, given the seeming willingness of developing countries to liberalise their economies and enter into bilateral economic treaties. But, during the discussions, the members of the OECD, all developed states, found that they could not agree among themselves on the principles of the rules on foreign investment protection. The attempt also spawned a protest coalition of environmentalists and human rights activists who complained that the draft of the MAI emphasised the protection of investment without adverting to the need to protect the environment and human rights from abuse by multinational corporations. An important idea had been articulated during this protest that the multinational corporation may be an agent of progress and deserves protection but that it could also be an agent of deleterious conduct, harmful to economic development. In this case, it requires not protection but censure through the withdrawal of such protection and, even, the imposition of liability. As a result, there have been various efforts made to formulate standards of conduct for multinational corporations.

The collective protests against the MAI were a prelude to the protests against globalisation that were to mar the meetings of economic organisations like the WTO, the IMF and the World Bank at Seattle, Prague, Montreal and other capitals of the Western world. These protests have continued. The protests signified the emergence of lobbies within the developed world which required the rethinking of issues relating to foreign investment. The protests signified that the dissent was not the concern solely of developing states but that sections within the developed

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\(^6\) Thus, for example, in *Santa Elena v. Costa Rica* (2000) 39 *ILM* 317; (2002) 5 *ICSID Reports* 153, an environmental measure was held to be expropriatory. Later awards, which recognised that such regulatory takings may be non-compensable, cast doubt on these trends.
states were concerned with the fact that the law was being used in a manner that gave protection to the interests of foreign investment to the detriment of the interests of the eradication of poverty, the protection of the environment and the promotion of human rights.

New forces that could reshape the law had been released. There were dramatic disclosures of massive corporate frauds resulting in disenchantment with once admired corporations, resulting in stringent corporate disclosure laws. These events have been accentuated by the global economic crisis resulting from the massive unsecured loans given by banks in Europe and North America. There has emerged a disillusionment with neo-liberal policies that had been adopted in the previous decade. The law, particularly the international law on foreign investment, was an instrument of effecting neo-liberal policy, and the issue has to be faced whether some of the changes made in the past need to be changed in light of new circumstances. The instrumental role that the law played may have to go into reversal.

A new phenomenon that has emerged in the area is the role of non-governmental organisations (NGOs) committed to the furtherance of environmental interests and human rights and the eradication of poverty. These NGOs operate within developed states and espouse, to a large extent, what they believe to be the interests of the people of the developing world and the world as a whole. In addition, there are the protest movements against globalisation which also seek to espouse causes that favour developing-world interests, ranging from economic development, the writing-off of Third World debt and foreign investment. It has been suggested that, with the increase in the gap between rich and poor within developed states brought about by globalisation, there is a Third World within developed states ready to protest against excessive reliance on free market ideas.

More dramatic has been the fact that there has been a change in the patterns of foreign investment. Newly industrialising countries such as China, India and Brazil have become exporters of capital. Sovereign wealth funds of many small countries are playing leading roles in acquiring established businesses in developed countries. As a result, developed states in North America and Europe are becoming massive recipients of foreign capital. These changes will result in the assertion of sovereign control of such investments by the developed states and a selective relinquishing of the inflexible rules on investment protection that these states had built up.

This trend is already evident as leading companies of the United States and Europe are taken over by foreign investors from Asia and elsewhere. The rules the developed states crafted to protect the foreign investment of their nationals will soon come to haunt them. As a result, they may be bent on backtracking on these rules and creating, as developing countries did in the past, significant sovereignty-based defences to liability and redrawing the boundaries of investment protection. These sovereignty-based defences are often the

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9 This is already evident in the introduction of exceptions relating to regulatory takings, defences based on the environment, the devising of an exceptional regime for taxation, self-defined national security exceptions and broad necessity defences which can be found in the US and Canadian model investment treaties. The changes resulting in the recognition of defences to liability justify a new chapter in this edition.
refuge of the developed states in response to the neo-liberal expansions that were made. That
this reaction took place over such a short period attests to the responsiveness of the law to the
changes that are effected by circumstances as well as by the expansive attempts at the
interpretation of instruments in the field by decision-makers in the area, principally, arbitrators.  

But, still, there will be considerable restraint in dismantling the existing system. As the
power of multinational corporations increases, developed states will continue to espouse
their interests not only because of the enormous power that these corporations achieve
through lobbying but also because it is in their interests to do so. The expansion of trade and
investment increases the economic power of developed states. They have traditionally seen
the need to ensure the protection of the multinational corporations responsible for such trade
and investment as coincidental with their own interests.

The multinational corporations themselves must be seen as distinct bases of power
capable of asserting their interests through the law. Their individual economic resources
far exceed those of many sovereign states. Their collective power to manipulate legal
outcomes must be conceded. It is a fascinating fact that, through the employment of private
techniques of dispute resolution, they are able to create principles of law that are generally
favourable to them. That they can bring about such outcomes through pressure on their
states is obvious. It is notable that textbooks on international law do not contemplate the
legal personality of these corporations when they wield so much power in international
relations. The role of these actors in the international legal system is seldom studied due to
the dominance in the field of positivist views which stress that states are the only relevant
actors in international relations. They provide a convenient cloak for hiding the absence of
corporate liability. Positivism also enables law-creation by an entity often held to lack legal
personality. By employing low-order sources of international law such as decisions of
arbitrators and the writings of ‘highly qualified publicists’, it is possible to employ vast
private resources to ensure that a body of law favourable to multinational corporations is
created. This, again, is a phenomenon that international lawyers have been reluctant to
explore lest it shakes the hoary foundations on which their discipline is built.

There will be entirely new types of multinational corporations entering the scene. The
state-owned oil corporations of China and India are aggressively entering the field and
seeking mergers with existing multinational corporations. The investment funds of many
rich, smaller states like those in Singapore and Dubai as well as those newly industrialising

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10 C. Duggan, D. Wallace, N. Rubins and B. Sabahi, *Investor–State Arbitration* (2008), suggest that the United States, which had
opposed the Calvo doctrine that international law has no relevance to foreign investment and only national laws have
competence, may now be adopting that doctrine. They observe, at p. 488: ‘It is indeed ironic that the United States – long the
leading opponent of the Calvo Doctrine – may now be considered its proponent, at least in regard to national treatment and
indirect expropriation.’

11 It has been pointed out that multinational corporations exist in developing states as well. But, they are nowhere near as large as
US and European multinational corporations and cannot wield the same degree of influence.

12 Writers on international relations, however, concede the power of these corporations to affect the course of international
relations. Their behaviour, as a consequence, is extensively studied in that field. It is unfortunate that there are no parallel
studies in international law. There are, however, efforts being made to grapple with the problem in international law. Jennifer

states which have excess capital will enter the scene as actors who will shape the rules of the

game. The very states which wanted strong rules in the area may baulk at the prospect of

these rules being used in a manner favourable to these new actors.14

The rapid changes in this subject area call for an understanding not only of the role of

states and multinational corporations but also of the role of NGOs. In addition, since much

of the exploitation of natural resources takes place on the land of minorities and tribal and

aboriginal groups, the interests of these groups also have to be taken into account in the
development of the law. It is an area in which international law is clearly moving away from
the old positivist notion that international law is shaped entirely by the activities of states.

Even as techniques to protect foreign investment are coming to be explored more fully
through the creation of standing for multinational corporations, so, at the same time, by
contrast, there is pressure to ensure that the subject reflects the concerns of human rights and
environmental interests through the imposition of liability on these corporations. These
emphasise, not the protection of the investments of multinational corporations, but their
social and corporate responsibility to the host communities in which they operate. These
concerns are reflected in the increasing volume of literature that is devoted to the new
directions that foreign investment law has taken.15

The interplay of various economic, political and historical factors shaped, and con-
tinues to shape, the development of the international law on foreign investment. If
international law is generated by the eventual resolution of conflicting national, business
and social interests, the international law of foreign investment provides an illustration of
these processes of intense conflicts and their resolution at work. It is an area in which the
interests of the capital-exporting states have clashed with the interests of capital-
importing states. The resultant resolution of the conflict, if any resolution is indeed
achieved, indicates how international law is made and how open-ended the formulation
of its principles are in the face of intense conflicts of views among states as to the law.
These conflicts become accentuated when other actors in the field are divided in their
views and support the contesting norms that each camp espouses. Positivist studies of
the subject which emphasise the rules in treaties and arbitral awards fail to capture the
rich policy implications behind the shaping of these rules through a constant clash of
interests.

As a result of such clashes, the field provides for the study of international law as an
interdisciplinary subject in which ideas in the sphere of economics, political science and
related areas have helped to shape the arguments. Yet, for all its richness, the field has

14 An instructive situation is the effort of the Chinese state oil company, Sinopec, seeking to buy into the American oil company,
Unocal. The matter created considerable concern and the offer fell through. In the United States, national security and other
concerns were cited as reasons for opposing the merger.

15 There is a concentration in the new literature on foreign investment arbitration. For the literature, see C. McLachlan, L. Shore and
M. Weiniger, International Investment Arbitration: Substantive Principles (2007); C. Duggan, D. Wallace, N. Rubin and
B. Sabahi, Investor–State Arbitration (2008). These works are a result of increasing practitioner interest in the area. There is
Law and Practice of Investment Treaties (2009) is an excellent book developing the law on the basis of investment treaties. There are
works which deal with the impact of external forces on the law. See, for example, J. Zerk, Multinational Corporations and
Corporate Social Responsibility (2006); J. Dine, Companies, International Trade and Human Rights (2005); D. Kinley, Human
seldom been looked at as a whole, until recently. It is necessary to carve out a niche for the subject within international law so that the manner in which the norms of international law are affected by the seemingly irreconcilable interests that operate in this area could be studied more intensively.

Interest in the area also arises from the fact that the trends in this field cannot be explained on the basis of any existing theory of international law. Most theories of international law are rooted in positivism and are aimed at explaining law as an existing, static phenomenon, unaffected by political and other trends. These theories are incapable of being applied to a situation where the existing principles of law, formulated at a time when they were kept in place by hegemonic control and dominance, are under attack. Other theories are idealistic, seeking to achieve objectives based on morality and conscience. These theories are also inadequate to explain a situation in which different value systems of somewhat equal moral validity are in collision. Where existing rules supported by the established group of nations are subject to attack by relatively new members of the international community, they become feeble and, until they are replaced, a situation of chaos or normlessness will exist.

The task of decision-makers and scholars will be to examine the conflicts in norms in the area and ensure that adjustments are made to bring about some acceptable norms so that the situation of normlessness may be ended. This book is a contribution to this process in an area of abundant normative conflicts. The identification of the conflicts in norms will itself facilitate the process of a future settlement of the conflicts and bring about a clearer set of rules on the international law of foreign investment.


17 The creation of new subjects within international law must be addressed with caution, as the charge is made that these are studied without any foundation in the major discipline of international law. This is a legitimate criticism. An unfortunate facet of this area of the law is that many arbitrators who have made awards in the area have no grounding in international law and approach issues from an entirely commercial perspective, without regard to the public law elements in the disputes or to the public international law doctrines that may apply. Specialisation, within international law, helps to enhance the law. Also, often in modern times, the law has to be explained to persons who may not have the inclination to study the whole area of international law. The fact is that the areas of international law are burgeoning so rapidly that they cannot be addressed by a generalist with sufficient depth. There is a need for specialist works, well grounded in basic principles of international law. As indicated in the previous footnote, there are studies on more specialised aspects of this area of international law.

18 The European origins of international law have been extensively commented on. One view is that new nations are born into the world of existing law and are bound by it. See D. P. O’Connell, ‘Independence and State Succession’, in W. V. Brian (ed.), *New States in International Law and Diplomacy* (1965). The opposing view is that they may seek revision of existing principles of international law, as they are not bound by these rules. This dispute takes an acute form in many areas of international law. For general descriptions of the disputes, see R. P. Anand, *The Afro-Asian States and International Law* (1978). The attack on Eurocentric international law is more evident in this field, as the conflict is between the erstwhile colonial powers which are now the principal exporters of capital and the newly independent nations which are the recipients of such capital.
The normative conflicts are accentuated by the fact that parties interested in this area of the law have become diverse. NGOs engaged in the promotion of single issues such as the protection of the environment from the hazardous activities of multinational corporations or the protection of human rights from violation by elites of states in association with multinational corporations have entered the fray. Large law firms see the area as a lucrative field of practice. They may seek to promote rules that cater to their interests in maintaining volatility in the area, ensuring wide bases of liability and a continuation of arbitration as the means of settlement of investment disputes. Arbitrators have agendas in that the field is one that provides scope for the lucrative pursuit of their profession. These interests often collide, increasing the fragility of the law.

1. The definition of foreign investment

Foreign investment involves the transfer of tangible or intangible assets from one country to another for the purpose of their use in that country to generate wealth under the total or partial control of the owner of the assets. There can be no doubt that the transfer of physical property such as equipment, or physical property that is bought or constructed such as plantations or manufacturing plants, constitute foreign direct investment. Such investment may be contrasted with portfolio investment. Portfolio investment is normally represented by a movement of money for the purpose of buying shares in a company formed or functioning in another country. It could also include other security instruments through which capital is raised for ventures. The distinguishing element is that, in portfolio investment, there is a separation between, on the one hand, management and control of the company and, on the other, the share of ownership in it. Investment treaties also define the nature of the foreign investment that is protected through their provisions. As a result, definitions differ according to the purpose for which they are used. It is emphasised that this work is not confined solely to the law created by treaties.

1.1 The distinction between portfolio investment and foreign direct investment

In the case of portfolio investment, it is generally accepted that the investor takes upon himself the risks involved in the making of such investments. He cannot sue the domestic

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19 Compare the definition of foreign investment in the Encyclopaedia of Public International Law (vol. 8, p. 246), where foreign investment is defined as ‘a transfer of funds or materials from one country (called capital-exporting country) to another country (called host country) in return for a direct or indirect participation in the earnings of that enterprise’. The difficulty with this definition is that it is broad enough to include portfolio investment. The IMF, Balance of Payments Manual (1980), para. 408, used a narrower definition which excluded portfolio investment. It defined foreign investment as ‘investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of an investor, the investor’s purpose being to have an effective choice in the management of the enterprise’. A definition that includes portfolio investment should demonstrate that its inclusion for the purposes of the international law on foreign investment is justified.

20 Such a distinction is drawn in the texts on economics, and is also a sound basis for distinguishing direct and portfolio investment in the law. Thus, control is stressed in the following definition in E. Graham and P. Krugman, Foreign Direct Investment in the United States (1991) p. 7: ‘Foreign direct investment is formally defined as ownership of assets by foreign residents for purposes of controlling the use of those assets.’

21 Because of the extensive practitioner-oriented interest in treaty-based investment arbitration, there is an over-concentration on the law under investment treaties in the literature, despite the fact that contract-based arbitration continues and the roots of the law are also in other sources, such as customary practice on diplomatic responsibility.
stock exchange or the public entity which runs it if he were to suffer loss. Likewise, if he were to suffer loss by buying foreign shares, bonds or other instruments, there would be no basis on which he could seek a remedy. Portfolio investment was not protected by customary international law. Such investment was attended by ordinary commercial risks which the investor ought to have been aware of. But, customary international law protected the physical property of the foreign investor and other assets directly invested through principles of diplomatic protection and state responsibility.

One view maintains that there should be no distinction between portfolio investments and foreign direct investments as to the protection given to either by international law. This view is based on the assumption that there is no distinction between the risks taken by either type of investor, both being voluntarily assumed. But, this view is not accepted generally in international law, where it is clear that foreign direct investment alone is subject to the protection of customary international law. Several reasons are given for this difference in treatment. The foreign investor takes out of his home state resources which could otherwise have been used to advance the economy of the home state. The home state is said to be justified in ensuring that these resources are protected. Portfolio investments, on the other hand, can be made on stock exchanges virtually anywhere in the world. Since the host state cannot know to whom linkages are created through the sale of shares on these stock exchanges, there can be no concrete relationship creating a responsibility. This is not so in the case of foreign direct investment where the foreigner enters the host state with the express consent of the host state. Nevertheless, the trend of the law in the area may be to create responsibility towards those who hold portfolio investments through treaties. This is a trend associated with the liberalisation of the movement of assets. Opinions are found in some publications that portfolio investments are now to be included in foreign direct investments. To a large extent, such opinions are influenced by the fact that treaties defining investments include shares in the definition of foreign investment. But, as will be demonstrated, shares in this context mean the shares of a joint venture company in which the foreigner present in the host state has invested, and is not meant to include shares held by a non-resident and purchased entirely outside the host state. There will be continued uncertainty attached to the question whether portfolio investment is protected in the same manner as foreign direct investment in international law. The better view is that portfolio investment is not protected unless specifically included in the definition of foreign investment in the

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22 Unless, as Fedax v. Venezuela (1998) 37 ILM 1378, would have it, an investment treaty could be interpreted as extending to portfolio investments.


24 This is not much of a reason, as portfolio investment also constitutes resources within the state which could have been used within the state if not committed to a company overseas. But, sums of money that are used in portfolio investments are often small, shares being bought by individuals on stock exchanges.

25 But, again, the reason breaks down. The home state itself takes a risk in allowing these resources to leave the state. The question is why should it not have to bear the consequences of its own risk if the resources were to be harmed. Obviously, there is no answer to this logical issue, other than the pragmatic one that powerful states have conferred protection on the person and the property of its citizens who work or invest abroad.
relevant treaty.26 The issue is considered later in this volume when dealing with investment treaties and their extension to cover portfolio investments.

1.2 Definition of foreign investment in investment treaties

The tendency of many treaties in the area of foreign investment, particularly the model treaties drafted by the United States and other capital-exporting states, has been to broaden the scope of the definition of foreign investment.27 The objective behind this is to ensure that treaty protection could be given to a wide variety of activities associated with foreign direct investment. This objective has to a large extent been facilitated by the attitudes taken by arbitral tribunals and writers in the area. It is important for those who negotiate treaties to understand the purpose behind the making of these extensions.28

Several arbitration awards have been concerned with the issue as to whether the transactions that gave rise to the disputes could be characterised as investments. They are dealt with in the chapter on investment treaties. All of them contain definitions of foreign investment. But, these definitions apply only in the context of the protection given by the treaties. The notion of foreign investment may be wider than that contained in the treaty definitions, though these definitions also seek to capture a complete range of the types of foreign investments. But, for the moment, it is sufficient to indicate that one technique has been to identify foreign direct investment as having distinct criteria such as commitment of assets into a project with the object of profit and permanence and with a view to the risks arising from legal, political and economic changes. Controversy has centred on whether economic development is a criterion that marks foreign investment protected by international law. Certainly, one policy justification for the protection of foreign investment through the mechanism of international law has been the argument that it promotes economic development. It is interesting to note that, in early arbitrations in the field, a distinction was made between, on the one hand, foreign investments in developed countries which were subject to the host state’s domestic law and, on the other, investments in developing countries which were subject to a supranational or international legal system on the basis that the agreements in the developing countries involved high risk but were made to promote economic development. Indeed, the contracts made in developing countries were designated ‘economic development agreements’ so as to reflect this distinction.29 The controversy has continued under investment treaties which, their preambles suggest, are made in order to promote economic development through the flows of foreign investment. This controversy is dealt with in greater detail in Chapter 5 below.

26 There are treaties, such as the ASEAN Framework Agreement on Investment, which specifically exclude portfolio investments from the scope of the treaty.
28 Sometimes, a distinction is made between an asset-based definition, which simply lists the types of property which amount to protected investments, and a corporation-based definition, which lists the assets which are owned by the corporation which makes the investment. No material difference flows from this distinction.
1.3 The evolution of the meaning of the term ‘investment’

It is clear that, from early times, the meaning of investment in international law was confined to foreign direct investment. The evolution of the international law was towards the idea that the responsibility of the state would arise if it did not treat the alien in accordance with a minimum standard of treatment. This standard of treatment was extended to his physical property. Physical presence in the host state and injury suffered at the hands of the host state or its agencies was the basis of the development of the law. The early discussion of the law on state responsibility for injuries to aliens took place in the context of either physical abuse or the violation of the rights of the alien to physical property held by him in the host state. The genesis of the international law on foreign investment was in the obligation created by the law to protect the alien and his physical property and state responsibility arising from the failure to perform that obligation. In terms of customary international law, the obligation was created largely through the practice of the United States which asserted the existence of such an obligation in its relations with its Latin American neighbours. As foreign investments grew, the law was extended to protect the tangible assets of the foreigner from governmental interference by way of the taking of such property. The early cases dealt with the destruction of property or the taking of land belonging to the foreigner. The concept of taking was also narrow, for only tangible assets could be taken by the state. This original feature of an economic asset in the form of physical property protected by a legal right under the law of the host state has always remained the starting-point of the definition of an ‘investment’ for the purposes of this area of the law. This still remains the paradigm case upon which extensions later came to be made. The failure to have regard to this factor has led to many errors by those who have sought to extend the scope of the protection of the law beyond parameters that were drawn by its essential principles.

Progressively, consistent with this essential feature, the term ‘investment’ was extended to include intangible assets. Initially, these consisted of contractual rights in pursuance of which the foreign investor took his assets, such as machinery and equipment, into the host state. The rights associated with the holding of property such as leases, mortgages and liens came to be included. There are cases that indicate that loans also fell into this category. There was difficulty in the case of shares in companies. In the Barcelona Traction Case, the International Court of Justice held that a shareholder’s rights in a company that was the vehicle of the foreign investor could not be protected through the diplomatic intervention of the home state of the shareholder. The much criticised view taken by the Court was that only the state in which the company was incorporated could intercede on behalf of the company and that the shareholders of the company had no independent interests that were protected by international law. It indicated a problem as to the protection of the rights of the shareholder which continues to befuddle international law. The situation becomes more difficult.

30 [1970] ICJ Reports 1. The position was affirmed in the more recent ICJ decision, Diallo Case, ICJ (Judgment, 24 May 2007).

31 This is particularly seen in the case law under the International Convention on the Settlement of Investment Disputes. In the ICSID Convention, shareholder rights are to be protected only where the host state gives its consent to treat the corporate vehicle for the investment as a foreign corporation for the purpose of ICSID arbitration. Complex litigation has resulted on the issue of corporate nationality. See further on this, M. Sornarajah, The Settlement of Foreign Investment Disputes (2000), pp. 194–207.
where the foreign investor operates his investment through a company that is incorporated under the laws of the host state or is a minority shareholder in such a company. The International Convention on the Settlement of Investment Disputes (ICSID) seeks to overcome this through the requirement that the host state specifically agrees to regard the company as a foreign company despite its incorporation as a local company, if, for purposes of dispute settlement, the locally incorporated company was to be regarded as a foreign company.

In response to the Barcelona Traction Case, the issue of shareholder protection was addressed directly in bilateral investment treaties by including shares in companies within the meaning of the term ‘investment’. The shares that are referred to in such treaties are shares in a company that is to serve as a vehicle for the investment that is contemplated and presumably not portfolio investments.\(^{32}\) It is unfortunate that this reference to shares has been read by some as meaning that portfolio investment is protected by these investment treaties. Such an interpretation is made without regard to the reason for the inclusion of shares in the definition of investments.

There were further developments which took place in the area since the Barcelona Traction Case and the inclusion of shares in corporations established by the foreign investor within the meaning of foreign investment. There are now statements in publications which state that shares are investments that are protected by investment treaties, without having regard to the specific history that led to the inclusion of shares in investment treaties. These statements give the impression that portfolio investments are protected by international investment law the same way foreign direct investments are. This view, which is expansive, does not accord with the context in which the law was developed. Some treaties expressly counter the possibility of such a view being adopted by excluding portfolio investments from the definition of protected investments. The fact that some treaties contain express protection for portfolio investment while giving protection to shares in companies also supports the view taken here.

The next phase of the extension made through treaties was the inclusion of intellectual property rights within the meaning of foreign investment. Widespread copying of inventions made in developed states was the reason for the extension of protection to intellectual property rights. Many of these rights were associated with the making of foreign investments. When a new invention was to be manufactured in the developing state or when new technology was to be transferred by a foreign investor to a local partner within a joint venture, it would be necessary to provide for the protection of the intellectual property rights associated with the venture. When such a need for the recognition of intellectual property rights arose, the treaties extended the meaning of foreign investment to include intangible

\(^{32}\) But, it is evident that, whatever change is made by the treaties, this will not affect the manner of the protection that could be given to companies under the ICSID Convention. This nicely proves the point that the definition of investment in the ICSID Convention remains unaffected by the changes to the meaning of the term ‘investment’ that are later made through treaties and other means of developing international law. The different approaches to shareholder protection under the ICSID Convention and the bilateral investment treaty show that the meanings of the term ‘investment’ in the different treaty instruments do not coincide. If this view is correct, then the use of the term ‘investment’ has a temporal meaning varying from treaty to treaty depending on the period in which it was drafted.
rights associated with intellectual property, thus increasing the scope of the meaning of foreign investment which had hitherto been confined to the physical assets of the foreign investor. Analytically too, the situation was different, for the intellectual property was created by the local law through the recognition of the right by an act of the host state. So, technically, it was property that was created by the host state in the foreigner that was being protected. The types of intellectual property that are to be recognised are often elaborately spelt out in the treaties to include patents and copyright which are rights technically granted to the foreign investor by the host state laws, as well as lesser rights such as know-how. The policy justification for the protection of intellectual property rights through investment treaties is that there will be more technology transferred to developing countries if such intellectual property is protected through investment treaties. When a state interferes with these intellectual property rights, it is interfering with property it had itself created in the foreign investor. The treaty internationalised the rights once they had been created and required them to be protected in accordance with the standards of the treaty. The argument that the state can control the property it had created can no longer apply as a result of the operation of the treaty. This process of the internationalisation of the property that was created under the local law is the basis of the protection of intellectual property which is adopted in the field of both foreign investment and international trade. It is clear that, in the area of international trade, the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreed under the auspices of the World Trade Organization operates on the basis of the same technique.33 TRIPS, however, does not give a remedy directly to the foreign investor, as investment treaties do. As a result of this internationalisation, any state interference with intellectual property thereafter becomes a breach of treaty which amounts to an expropriation and has to be compensated.34 Wide interpretations are sometimes given to the concept of the taking of property in treaties. As a result, there is a danger that the compulsory licensing of patents and parallel imports by the state can amount to taking and involve the state in liability for breach of the treaty standards. This danger arises in areas such as pharmaceuticals. The parallel import of an AIDS drug manufactured cheaply in another state stands in danger of being regarded as a violation of treaty standards as a result of this widening of the meaning and scope of the term ‘foreign investment’ and of the notion of ‘taking’.35

The protection of intellectual property under bilateral and multilateral investment treaties, the WTO regime and the earlier regimes will mean that there will be an absence of

33 There is burgeoning literature on TRIPS. The rationale behind the instrument has provoked much controversy. See S. Sell, Private Power, Public Law: Globalisation of Intellectual Property Rights (2003); C. Arup, World Trade Organization Knowledge Agreements (2008).

34 Modern treaties, however, provide an exception in the situations where compulsory licensing of the technology is permitted under domestic patent law. Such compulsory licensing is not expropriation. There are also treaties which are devoted entirely to the protection of intellectual property. The TRIPS regime on intellectual property is augmented by both the investment treaties and the intellectual property treaties. TRIPS may well serve as the floor, whereas higher levels of protection could be created by bilateral or regional treaties. The argument would be that such a parallel import interferes with the expectations of profit of the patent holder and therefore amounts to a taking. Under TRIPS, the parallel import of drugs imported for epidemics became an issue which has been resolved. But, the issue remains unresolved under the investment and intellectual property treaties. The question as to what amounts to a taking is discussed in Chapter 10 below.
coordination as to how the law in the area will be developed. The remedies provided and the mechanisms employed are different. The investor may have a unilateral remedy under an investment treaty whereas only a state could invoke the dispute-settlement mechanism of the WTO for violation of the TRIPS standards. The substantive law on protection may also be differently stated. No real claims have yet arisen in which the law has been considered.

Once the idea that the concept of foreign investment need not be confined to tangible assets took hold, there were further inclusions of intangible rights in the list of matters which are to be included in the definition of the term foreign investment in the treaty. One such inclusion is the contractual rights which the foreign investor acquires as a result of its relationship with the state and its agencies. It is generally conceded that a breach of a contract which the state has made with a foreign investor does not by itself give rise to an international remedy.36 There are obvious reasons for this. There may be good reasons for the breach by the state, for example defective performance by the foreign investor. There is also the possibility of settling the claims that arise through domestic litigation. There is a view that distinguishes between the violation of a contract through a commercial act by the state and a violation through the use of its sovereign powers. On this view, the conclusion is drawn that a violation through the use of sovereign power would amount to a breach of international norms. Even if the distinction can be drawn, the issue as to whether a contractual violation *per se* gives rise to responsibility in the state remains a moot point. There is authority for the view that a contractual violation made through the exercise of sovereign power incurs responsibility in the state.37 The other view is that there must be an exhaustion of local remedies and a clear denial of justice for such a result to follow. This view accords with the customary law on the subject.

The conflict may be resolved by treaty. The treaty inclusion of contractual rights in the definition of the term ‘foreign investment’ would mean that, upon the breach of a contract by a state, an international obligation arises on the state that caused the breach of contract. As a result, a right arises in the foreign investor to seek remedies under the treaty. Again, the contract which is ordinarily subject to the laws of the host state becomes effectively internationalised as a result of this technique being adopted in the treaty. This internationalisation enables the foreign investor to have recourse to the remedies that are provided for him in the event of a violation of his rights under the treaty.38 This results from the inclusion of contractual rights within the definition of foreign investment and not from the so-called umbrella clause,39 the effect of which is contentious.40 So, crucial to the strategy of protection is defining foreign investment to include the contractual rights of the foreign investor in the definition of foreign investment.

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36 See further Chapter 10 below.
38 Awards have established that the claims arise not from breach of the contract but from the consequent breach, if any, of the treaty rights of the foreign investor. The manner of the breach may indicate such breach of treaty rights.
39 An umbrella clause is a catch-all provision which seeks to protect all assurances and commitments made to the foreign investor. Properly speaking, where the contractual rights are already included in the definition of the foreign investment, the umbrella clause must logically refer to extra-contractual interests, the protection of which seems logically difficult as they do not create legal rights or interests of the required specificity.
40 The effect of the umbrella clause is discussed in Chapter 5 below.
A further extension of foreign investment is to include the administrative rights that the foreign investor acquires in the host state. Why is the extension to include administrative rights so important? In the 1970s, influenced to a large extent by the views of the United Nations Committee on Transnational Corporations that foreign investment could be beneficial to the host economy if the foreign investment is harnessed to the economic development of the host economy, developing states began to enact legislation that was designed to screen foreign investment having regard to the effects such investment would have on the domestic economy. Much of the screening was done through administrative agencies. Such administrative agencies have over time undergone transformation in line with the prevailing and changing philosophies relating to foreign investment in that country. Obviously, when economic liberalism takes hold, there will be a more permissive approach. The dismantling of these screening procedures and the recognition of a right to entry is one of the aims of treaties based on economic liberalism. But, there will be greater control when there are more restrained attitudes to foreign investment, especially if some crisis, such as a financial crisis, results which is attributed to foreign investment. The tide of economic liberalism did not result in the dismantling of screening legislation in many states. They continue to be maintained. In Canada, for example, the Foreign Investment Review Act, introduced in response to the Gray Report which commented on the intrusion of large US multinationals into Canada, has not been dismantled. This was despite the later conclusion of the North American Free Trade Agreement which liberalised the flow of foreign investment and trade in the region including the United States, Canada and Mexico.

The functions of these administrative agencies change from time to time. Their basic functions are to take administrative measures both to facilitate as well as to control foreign investment. Such roles are carried out in almost all states to varying degrees. Even where it is not carried out at the entry stage, there would be various administrative procedures involved such as environmental licences and planning permissions, which the foreign investor has to secure before he can commence his investment project. Such licences are administrative rights which the foreign investor acquires at either the entry or the post-entry stage. The treaties define all these administrative rights as constituting foreign investment. The justification for this is easy to understand. If the government were to withdraw any of these administrative rights, the foreign investor will not be able to operate his foreign investment. His plant and machinery will remain his, and, to that extent, there has been no interference with his physical assets but they will be of no use to him for he cannot operate them without having the necessary administrative licences. Hence, from the point of view of the capital-exporting states, it is only logical that protection be given to these administrative rights which are indispensable to the purpose for which the foreign investor entered the host state. But, the inclusion of these administrative law rights within the definition of investments greatly restricts the right of the state to exercise regulatory control over the foreign investment.

41 NAFTA recognised a right of entry and establishment. The draft Multilateral Agreement on Investment of the OECD also sought to recognise such a right.

42 Administrative lawyers refer to such rights created through licences as ‘new property’. The licences are indispensable to the conduct of the regulated activity.
investment. It also enhances the possibility of interferences with the licences for regulatory reasons being regarded as taking of property. An issue that will arise is whether the withdrawal of a license for violation of the conditions attached to it is a regulatory measure which does not violate treaty or other norms. This issue will be dealt with when considering expropriation.

So far, the discussion has shown that, in defining the foreign investment which is to be given protection, the capital-exporting state adopts the obvious strategy of defining the foreign investment protected by the treaty to include three principal concerns. These are, first, to protect the physical property of the foreign investor; second, to extend protection to the intangible rights which are themselves to be regarded as property and to be protected as such; and, third, to include within foreign investment the administrative rights that are necessary for the operation of the investment project. The latter rights are granted by the state, as are intangible rights relating to most intellectual property. Technically, the state which gives can take back what it gives. But, the treaty has the effect of lifting out of the realm of domestic law the right that is given to the foreign investor and subjecting it to treaty protection so that the right cannot be withdrawn without engaging the responsibility of the state. But, where the right that is given by the domestic law is subject to conditions created in that law, there cannot possibly be treaty violations where the right is withdrawn for violations of the conditions.

There has been a tendency to extend the meaning of investment in treaties. A variety of attempts have been made to test the limits to which the meaning could be extended. Arguments have been made that the costs associated with preparations for the making of the investment should be included in the definition of investment. In *Mihaly v. Sri Lanka*, the strategy of litigation was based on the notion that the costs involved in tendering for a project and negotiating it should be considered as investment if the negotiations fail for improper reasons after an expectation as to their success has been created. There have also been efforts to argue that the legitimate expectations of the foreign investor constitute rights which can be protected through expansive interpretations of treaty provisions. If new rights are effectively created by treaties for foreign investors, the meaning of investments for the purpose of those treaties will be correspondingly enlarged. This meaning, however, will not be received into general law. In the *Ceskoslovenska Case (1997)*, the ICSID tribunal considered the question whether the failure to repay a loan, which the Slovak government had guaranteed, could be regarded as a foreign investment within the meaning of the ICSID Convention. The tribunal said that there was ‘support for a liberal interpretation of the question whether a particular transaction constitutes a foreign investment’. It took the view that the language in the Preamble to the ICSID Convention permits ‘an inference that an international transaction which contributes to cooperation designed to promote the economic development of a contracting state may be deemed to be an investment as that term is understood in the Convention’. This purposive view that any activity

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43 That treaties can do so is well recognised. In the areas of minority rights, treaties have often done this. Rights in immigration law can also be subjected to treaties.


that is considered to promote economic development should be considered an investment is again too expansive to receive acceptance. A loan may benefit economic development but it lacks the other essential criteria of foreign investment such as the entry of personnel into the state and the direct generation of profits as a result. Such expansive views are the product of the dominance of economic liberalism and must be regarded as passing fashions that do not accord with legal prescriptions. Indeed, the schisms which have developed within investment arbitration flow from the divisions between arbitrators who adopt neo-liberal views and those who show a fidelity to the principle that undue expansion of the base on which parties submitted to arbitration is not warranted. Financial transactions are commercial transactions and are settled through mechanisms provided by domestic law. It was not in the contemplation of states that the treaties on foreign investment should affect such transactions. It is not within the function of tribunals to read into treaties meanings that extend concepts beyond what sovereign states had intended so as to enlarge their own roles. To do so over-zealously would invite non-compliance and consequent injury to the system that has been built up. The legitimacy of foreign investment arbitration is increasingly questioned as a result of the expansive interpretation of the provisions of investment treaties.

Another case in which an expansive interpretation was taken was *Fedax NV v. Venezuela*. In this case, there was an assignment of promissory notes. The respondent state, Venezuela, argued that the assignment did not amount to ‘a direct foreign investment involving a long-term transfer of financial resources-capital flow from one country to another’. The claimant had in fact acquired its interest in the promissory notes by way of an endorsement of the notes by a separate company with which Venezuela had made a contract. The tribunal dealt with academic views on the subject and held that they all supported ‘a broad approach to the interpretation’ of the term ‘foreign investment’ in the ICSID Convention.

Some academic writers have also formulated wide definitions of the term ‘foreign investment’. Thus, Schreuer, after stating that the types of foreign investment have undergone changes, observed that ‘the precise legal forms in which these operations are cast are less important than the general economic circumstances under which they are undertaken’.

This is again a policy-oriented approach which invites the ICSID tribunal to broaden the meaning of the term ‘foreign investment’ beyond what the parties may have had in mind. It is clear that an opportunity for making new law by broadening the scope of foreign investment is being created by the *dicta* of the ICSID tribunals and in the academic literature. This enables the broadening of the jurisdiction of the tribunal beyond what may have been intended by the parties to the investment treaty. It is a trend that was a sign of a period in which neo-liberal views on foreign investment supported the broadening of the jurisdiction of the arbitral tribunals as well as substantive provisions of treaties through expansive

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46 Loans are traditionally protected through other techniques. Because of the immense bargaining power of the lender, he will be able to secure dispute resolution before the courts of his country and ensure that there is enforcement against the assets of the borrower in his own state. The need for the protection of loans as investments has seldom arisen.
interpretations. This is not a sound view as it will provoke obvious reactions from the states. A more cautious approach to treaty interpretation is necessary and is visible in some of the more recent awards.

Foreign investment attracts the greater attention of international law for the simple reason that it involves the movement of persons and property from one state to another and such movements have the potential for conflict between two states. It involves the securing of competitive advantages over local entrepreneurs both within the market as well as from the state authorities. The resulting integration of the foreign investor into the host economy makes his involvement in the internal economic and political affairs of the host state inevitable.\(^4^9\) Conflict is inherent in such situations. Disputes that arise between parties to international sales and financial transactions are largely settled through domestic courts or through international commercial arbitration. The intervention of the machinery of international law may become necessary for the settlement of disputes arising from foreign investment. Because movement of persons is involved, it is possible to link the protection of foreign investment to the already existing norms on the diplomatic protection of aliens. Historically, this area of the law has been built up as a part of the area of the diplomatic protection of citizens abroad and of state responsibility for injuries to aliens.\(^5^0\) Since the function of diplomatic missions was the protection of nationals living in the states to which the missions were assigned, the protection of the property of these nationals also became a concern of such missions.\(^5^1\) The right of diplomatic missions to intercede on behalf of the property rights of their nationals came to be asserted in the diplomatic practice of capital-exporting states. Since this right of protection of the alien can be extended to the protection of foreign investment, it was a logical step to argue that this right could be utilised to protect the investments made by aliens. The roots of international law on foreign investment lie in the effort to extend diplomatic protection to the assets of the alien. The extension of the right was contested from the time it was asserted on the ground that it leads to unwarranted interference in the domestic affairs of the host state. Foreign investment is an essentially intrusive process which takes place entirely within the territory of a host state. To be able to lift that process out of the domestic sphere and subject it to international norms requires a nice balancing of international interests in the protection of the investment and the interests of the host state in regulating the process having its own benefits in mind. That is essentially what the international law on foreign investment is about. The definition of foreign investment must be rooted in this historical sense and not be extended beyond the meaning attributed to it in state practice and the precise words used in the treaties.


2. The history of the international law on foreign investment

2.1 The colonial period

The history of foreign investment in Europe can be traced to early times. There is no doubt that such investment existed in Asia, the Middle East, Africa and other parts of the world. Early European institutional writings on the treatment of aliens by their host states set the stage for later controversies in the area of foreign investment law. One view was that aliens should be given equal treatment with the nationals. Vitoria suggested that, because trading was an expression of the feeling of community that is inherent in man, the alien trader must be given equality with the national. This view would have justified trade and investment as natural rights. The alternative view required that aliens be treated in accordance with some external standard, which was higher than the national standard. The latter view was motivated by the concern that the standards of treatment provided to nationals in a host state may be low and therefore unacceptable. Both views were premised on the idea that the law should be designed to further the free movement of trade and investments across state boundaries. They were intended to serve the interests of states which had the ability to expand their overseas trade. The espousal of these views, and more famously of the freedom of the seas, by Grotius is seen by some historians as enabling the entry of European powers into Asia and Africa. In the context of modern times, the question whether history is repeating itself or is at an end remains a relevant one. It is possible to argue that there is an effort to attempt to impose standards of investment protection preferred by the more powerful states on other states through the instrumentality of international law. This is a proposition that deserves further exploration.

In the eighteenth and nineteenth centuries, investment was largely made in the context of colonial expansion. Such investment did not need protection as the colonial legal systems were integrated with those of the imperial powers and the imperial system gave sufficient protection for the investments which went into the colonies. Within the imperial system, the protection of investments flowing from the imperial state was ensured by the imperial

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53 Vitoria, De Indis, III, 5. The assumption was that this standard of national treatment was the highest he could expect and that he should not be discriminated against in the host state. The view was stated at the time of Spanish expansion in Latin America. Some writers have noted the duplicity that was inherent in this view. A. Anghie, ‘Francisco Vitoria and the Colonial Origins of International Law’ (1996) 5 Social and Legal Studies 256. Grotius also stated the freedom of trade and investment, but many believe that the sanctimonious efforts to promote such rights as natural rights hid the purpose of promoting Dutch colonial expansion in the Indies.
54 Vattel was among the first writers to favour an external standard. Vattel, The Law of Nations (1758), II, 8, 104.
56 One facet of this protection was to ensure that colonial legal systems were changed in order to accommodate European notions of individual rights of property and freedom of contract. See A.G. Hopkins, ‘Property Rights and Empire Building’ (1980) 40 Journal of Economic History 787, who pointed out that notions of collective ownership of property which were widely prevalent in the colonies were replaced by European notions of individual property.
57 This explains the reason why the law first grew in the American context, where investment flows from the United States into Latin America had to be secured in a non-colonial context.
parliament and the imperial courts. The power to lobby for such laws would have been enormous as it was the major trading companies which had first established colonial power in the states that were later integrated into the imperial system. Since the imperial system ensured the protection of the flows of capital within the system, there was no need for the growth of a separate system of law for the protection of foreign investments. Where investments were made in areas which remain uncolonised, a blend of diplomacy and force ensured that these states did not interfere with foreign investors too adversely. In states which stood outside the imperial system, enclaves into which the jurisdiction of the state did not extend were established so that trade and investment could be facilitated. The system of ‘extraterritoriality’ was imposed by treaties resulting from the use of force. In these enclaves, the law that was applied to European traders was the law of their home states.

Power was the final arbiter of foreign investment disputes in this early period. The use of force to settle investment disputes outside the colonial context was a frequent occurrence. The use of overt or covert force to coerce the settlement of disputes continued even after the Second World War and into the post-colonial period. There were spectacular instances of such uses of force. But, doctrine had to be constructed to justify the use of force. Capital-exporting countries, which operated outside the colonial context, were keen to devise some legal justification for pursuing the claims of their nationals and for the use of force if such use became necessary.

It was in the relations between the United States, still a fledgling power, and its Latin American neighbours that the need for the development of an international law relating to foreign investment played a role during the period prior to the Second World War. These developments have dictated the course of the law for a considerable period of time. In the foreign investment relations between the United States and the Latin American states, one sees the clash between the idea that an alien investor should be confined to the remedies available in local law to the citizen and the idea that he must be accorded the treatment according to an external, international standard. It is an interesting aside to note that the United States in its formative years, as an importer of European capital, had experiences similar to those which developing countries presently have, and took stances not dissimilar to those developing countries now take. But, after its emergence as a regional economic

58 Thus, Britain relinquished control over the legislatures of the Empire settled by Anglo-Saxons in 1932 with the Statute of Westminster. The Asian and African colonies had to wait until after the end of the Second World War.
59 The British and Dutch East India Companies played major roles in the establishment of their respective states’ colonial rule.
60 The system of extraterritoriality caused as much resentment as colonialism. In Asia, such enclaves existed in China, Thailand and Japan. The practice was also prevalent in the Middle East. See L. T. Lee, Consular Law and Practice (1991), pp.8–9.
61 The Rose Mary [1953] 1 WLR 246 is an example. The overthrowing of the governments of Mossadegh in Iran and Allende in Chile are the more obvious instances in recent history of forcible, though covert, interventions to assist foreign investment.
62 As, some would argue, was the case with the invasion of Iraq in 2003. One of the first acts of the administration that was set up in Iraq after the invasion was to liberalise the entry of foreign investment, particularly into the oil sector. This sparked off speculation that oil was the reason for the intervention.
64 A. Chayes, T. Ehrlich and A. F. Lowenfeld, International Legal Process (1969), p. 851: ‘When the United States was a less developed state, it had experiences with foreign investors not unlike those of today’s developing societies.’ Now that it is becoming one of the largest importers of capital, it is becoming conscious of the need to assert regulatory controls over foreign investments.
power, it insisted that its Latin American neighbours should treat foreign investors in accordance with international standards. The Latin American states vigorously pursued the debate by insisting, in a series of conventions and in their own laws and constitutions, that the provision of equal treatment to foreign investors satisfied the requirements of international law. In many ways, this tussle between the United States and the Latin American states was to be replayed on a global scale in the post-colonial period. But, the law that was generated in the early period of this confrontation between the United States and the Latin American states had little to do with the taking of alien property to bring about economic reforms. It involved instead cases of attacks by mobs or political vendettas carried out for profit by juntas in power. The takings of foreign property that were involved in these early disputes are qualitatively different from the takings that resulted from economic reforms in later periods both in Latin America and elsewhere. The uniform application of principles to both types of interference with foreign investment is an unfortunate facet of the law which was introduced by early writers who failed to see the distinction between the two types of interference with foreign investment. The capricious grabbing of property for the personal advancement of elite groups is different from the taking of property by a government for the purpose of economic reform. But, early writings failed to emphasise this distinction. This initial failure continues to affect the law, which often fails to make a qualitative distinction between the two types of taking.

The Russian revolution and the spread of communism in Europe led to the taking of foreign property which was justified on the basis of economic philosophy. This initiated a debate among international lawyers as to the standards that should be satisfied to make such interference with foreign property acceptable in terms of international law. Many of the claims which arose as a result of these nationalisations were eventually settled by lump-sum agreements. They reflect a compromise between the two conflicting views as to the appropriateness of the standards that have to be met for valid interference with foreign property. Though important as indicating state practice, the use of lump-sum agreements did not shed any light on the resolution of the question as to the external standard that had to be satisfied for a valid interference with alien property rights.

2.2 The post-colonial period

It was only after the dissolution of empires that the need for a system of protection of foreign investment came to be felt by the erstwhile imperial powers, which now became the exporters of capital to the former colonies and elsewhere. It is convenient to divide the post-war developments into four periods in order to trace the developments which took place. The period immediately following the ending of colonialism witnessed hostility and

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65 The inspiration was provided by the writings of Carlos Calvo, an Argentinian foreign minister and jurist. In his *Le Droit International* (vol. 6, 5th edn, 1885), he said: ‘Aliens who established themselves in a country are certainly entitled to the same rights of protection as nationals, but they cannot claim any greater measure of protection.’ This statement, that aliens are entitled to national treatment only, was adopted in the First International Conference of American States (Washington, DC, 1889) and included in the Convention on the Rights and Duties of States adopted at the Seventh International Conference of American States (Montevideo, 1933).
antagonism towards foreign investment generated by nationalist fervour.\textsuperscript{66} Such nationalism was itself a result of the anti-colonial movements which spread throughout the colonised parts of the world. There was also a need felt on the part of the newly independent states to recover control over vital sectors of their economies from foreign investors, largely nationals of the former colonial powers. The result was a wave of nationalisations of foreign property. These nationalisations resulted in intense debates as to what the international law on foreign investment protection was, each opposing group of states contending for a different set of norms in the area. In this period of political nationalism, there was more rhetoric generated than law. But, in the course of the conflict, there was also an effort to articulate the conflicting principles through the use of legal terminology. The capital-exporting nations argued for an external international law standard protecting foreign investment, whereas the newly independent nations argued for national control over the process of foreign investment, including the ending of foreign investment by nationalisation.

These feelings of hostility have now been largely assuaged as the rearrangement of the economies of the newly independent states has been completed. In the second period, the developing states took a more selective and measured approach to foreign investment. In the natural resources sector, particularly in the oil industry, dramatic changes took place as a result of the collective action by the oil-producing nations which ended the dominance of the industry by the major oil companies. These processes were accompanied by the articulation of new principles by the capital-importing states. Though nationalism still remains a threat to foreign investment,\textsuperscript{67} it is unlikely that a new wave of nationalism will sweep across a vast area of the globe as it did during the immediate post-war era. Yet, individual states or regions may go through the same phenomenon, and the arguments which were used during the period of nationalism will once more be dusted off and used.\textsuperscript{68} If one looks at the controversial areas of international law as involving a process of argument, then the arguments used during one period are likely to be used when conditions similar to those in that earlier period recur. The arguments which were formulated during this period of nationalism to oppose the more established norms of the capital-exporting states will be used again in appropriate circumstances. The package of norms which came to be called the ‘New International Economic Order’ (NIEO) contained the norms favoured by the newly independent states.

One major change in this period was the increasing acceptance that nationalisation in pursuance of economic reform or reorganisation will not be considered unlawful in international law.\textsuperscript{69} This change indicates the capacity of movements within international relations

\textsuperscript{66} Much of it lingered on for some time. See, for example, C. Himavan, The Foreign Investment Process in Indonesia (1980), for the antagonism that the prolonged colonial struggle left in Indonesia.

\textsuperscript{67} On the role of economic nationalism in international society, see J. Mayall, Nationalism and International Society (1994), pp. 70–110.

\textsuperscript{68} As in the case of Iran, for example, where a once-thwarted nationalism took a more virulent form later, leading to the overthrow of the Shah and the expulsion of US businesses from the country. In both instances, the nationalisations which resulted gave rise to celebrated disputes. The first resulted in the Anglo-Iranian Oil Company Case [1952] ICJ Reports 93 and the second led to the creation of the Iran–US Claims Tribunal which considered the claims of US citizens who had suffered injury during the uprising.

\textsuperscript{69} It is difficult to show that nationalisation in pursuance of economic reform was ever considered unlawful in international law. It is simply the case that, in earlier times, the law was discussed in the context of takings by states controlled by dictators for the
to displace prevailing norms with those which more readily reflect the trends within the international community.

The second period was a period of rationalisation undertaken by the state. Though, at the international level, the capital-importing states continued to maintain collective stances, requiring changes to the rules relating to the conduct of international economic relations (including foreign investment), they were also busy adjusting their own legal systems. These adjustments reflected more pragmatic approaches to issues of foreign investment. Thus, there was a divergence between the attitude a state may take at the international level through the articulation of the package of norms associated with the New International Economic Order and what it may take at the domestic level. While, at the international level, a state may join other states in taking a stance as to the international law position it supports, its domestic position may be different as it may seek to attract foreign investment as a strategy of economic development. It may also sign bilateral investment treaties that are at variance with its international position. This pragmatic position was adopted in response to the need to maintain the idea of sovereign control over foreign investment at the international level while at the same time being able to attract multinational corporations into the state through the creation of an appropriate climate favourable to foreign investments. This explains the variation that exists between the stances that states have taken at different levels of interaction in this field.70

Several factors have led to this inconsistency of attitudes at these different levels. At the domestic level, the debates as to the role of multinational corporations within the host economies of developing states led to the view that even small states could utilise the resources of multinational corporations to encourage economic development. The success of small states like Singapore and Hong Kong demonstrated this. Ideology and economic nationalism gave way to more pragmatic attitudes whereby states which formerly saw the need to assert the sovereignty of the state over foreign investment now sought to use that sovereignty in a more constructive fashion. This explains the apparent inconsistency in the stances of developing countries. While supporting normative changes at the global level that were protective of sovereign control over foreign investment, they were busy making bilateral investment treaties which strengthened the structure of foreign investment protection and foreign investment codes concerning tax and other incentives.71

The third period took pragmatism in this area even further. There had been significant shifts in the international economic scene. Communism had receded, and the existence of an ideologically based source of counter-norms that were hostile to notions of property on which foreign-investment protection is based had lost its force. Developing countries

benefit of the ruling coterie, and the rule extended to takings in pursuance of economic reforms. However, there are assertions of the legality of takings in pursuance of economic reforms in early literature. See J. Fischer Williams, ‘International Law and the Property of Aliens’ (1928) 9 BYIL 20, who denied the existence of any rule preventing nationalisation in international law. Also, see A. P. Fachiri, ‘Expropriation and International Law’ (1925) 6 BYIL 159, in accord. Both writers discussed the issue in the context of takings inspired by economic reforms.

70 Sometimes, the wrong conclusions are made from this variance. It is an error to conclude that a state which has altered its domestic law on foreign investment to favour such investments or which has concluded a large number of bilateral investments has thereby given up its desire for sovereign control over foreign investments. Such an error is too often made in the literature on the subject. This point is discussed further in Chapter 3 below.

progressively introduced more open policies on foreign investment. This was not only because the prevailing economic philosophy favoured the liberalisation of foreign investment regimes, but also because there was competition for the limited amount of foreign investment that could flow into these states. The old distinction between capital-importing and capital-exporting countries also became blurred. Europe and the United States were now among the largest recipients of foreign investments. The free movement of investments within areas in North America and Europe, where liberal regimes of foreign investment flows had now been established through regional treaties, created tension among these states. The inflexible stances to foreign investment that were taken in the past on the basis of ideological predispositions no longer had any force. There was, as a result, a willingness to compromise over what the law required.

To a large extent, in the period after the ending of the Cold War, the events that occurred in the area of foreign investment were also furthered by the rise to dominance of neo-liberal policies promoted, largely by the World Bank and the International Monetary Fund. These required liberalisation of the entry of foreign investment, national treatment after entry, protection against violation of certain guaranteed standards of treatment, and secure means of dispute settlement. These policies needed to be implemented if states were to secure financial assistance from the international financial institutions. States also had to sign bilateral investment treaties providing guarantees for the protection of foreign investment. This neo-liberal package significantly influenced attitudes to investment law. It is possible to detect trends which show that arbitrators sought to interpret the texts of treaties in such a manner as to further neo-liberal prescriptions rather than give effect to the intention of the parties to the treaty.

Another feature of the law in this third period was that developed states are now experiencing situations that were confined in the past to developing states. The United Kingdom and Canada revised their petroleum contracts by legislation on the ground that they had become disadvantageous to state interests. The United States enacted legislation controlling the inflow of foreign investments which raised national security concerns. Under NAFTA, itself a product of neo-liberal tendencies, the provisions covering investment, which were originally intended to impose obligations of protection on Mexico, the developing country partner, soon became the basis for claims of violations of investment obligations against the United States and Canada. Disputes brought against the latter two states have shown the extent of the adverse use to which treaty principles could be put and

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72 Aid had dried up due to recession as well as policies unfavourable to the granting of aid. Banks did not provide loans to states after the petrodollar crisis, leading to a greater awareness of risks in sovereign lending. This left foreign investment as the only available means of external finance for economic development.

73 The European Union is committed to internal flows of investment within its member states. In North America, Chapter 11 of NAFTA contains investment protection rules which parallel the US model bilateral investment treaty. Clashes will occur when the treaty rules are seen as eroding the sovereignty of the participating states to an unacceptable degree.

74 There are two clear instances of such compromise positions in recent times. One is the American Law Institute’s Restatement on Foreign Relations Law, which deviates from the previously accepted official position of the US State Department on the issue of compensation for nationalisation. The other is the World Bank’s Guidelines on Foreign Investment (1992), which also depart from the traditional norm of full compensation in favour of the formula of appropriate compensation, but redefine appropriate compensation to mean usually market value compensation.

75 P. D. Cameron, Property Rights and Sovereign Rights: The Case of North Sea Oil (1983).
the types of claims that inventive lawyers could make based on the texts of treaties, thus opening a Pandora’s Box of problems for states (and lucrative opportunities for ‘lost lawyers’). Canada has been concerned with decisions under the provisions of NAFTA which appeared to interfere with its power to regulate the environment. The extent of the litigation brought under the investment provisions of NAFTA have subjected the two developed states to the same experience of having to defend their regulatory policies before foreign tribunals that developing countries had earlier been subjected to. There is considerable opposition to the system within the United States and Canada to this restraint on the regulatory powers of the state.

Developed states have now become the largest recipients of foreign investments. As a result, they may come to question facets of the law that they themselves had helped to fashion as they increasingly become targets of litigation under regional and other treaties. Evidence of this is beginning to appear. The issue as to whether an interference on environmental grounds amounts to a ‘taking’ of property which has to be compensated has arisen in many cases concerning Canada, the United States and Mexico. The modern treaties of both the United States and Canada contain strong statements permitting regulatory action taken to preserve the environment. Likewise, the issue as to whether a foreign investor should be given the same treatment as a state corporation in a mixed economy under the national treatment provisions of an investment treaty arose in a case involving Canada, but the tribunal sidestepped a decision in the case.

In the 1990s, neo-liberal theory required a market-oriented approach to the problems of the world. Relevant aspects of the theory were the liberalisation of capital markets and the assurance of freedom of movement to multinational corporations. The rapid economic progress made by East Asian states fuelled notions of economic liberalism, and pressure to open up markets was directly applied. This was despite the fact that the East Asian economies progressed without themselves adopting neo-liberal policies, as state control was the dominant policy in all the economies of East Asia. The World Trade Organization (WTO), which is committed to a philosophy of free trade, came into formal existence in 1995. It adopted instruments which affected investments. The OECD embarked on an attempt to draft a Multilateral Agreement on Investment (MAI), though this was discontinued in 1998. But, the endeavour showed that, by the middle of the 1990s, the fervour for economic liberalism had reached a high point. Ideas such as rights of entry and

76 The term ‘lost lawyers’ is borrowed from A. Kronman, The Lost Lawyer: Failing Ideas of the Legal Profession (1993).
77 Ethyl v. Canada was based on the claim that an announcement that the production of a chemical additive manufactured by the US company would be banned caused a depreciation in the price of the shares of that company, and hence amounted to a taking. Canada asked for a reconsideration of the takings provision in NAFTA after this case.
78 For the impact of this on constitutionalism, see D. Schneiderman, Constitutionalising Economic Globalisation: Investment Rules and Democracy’s Promise (2007).
80 United Parcel Services v. Canada.
82 The extent to which they affect investments is surveyed in Chapter 6 below.
establishment dominated the discussion of investment principles and found their way into some treaties.\(^83\) Treaties were concluded which contained the prior consent of states to the arbitration of any disputes which arise from foreign investments at the unilateral instance of the foreign investor. The ability of the foreign investor to invoke such arbitral procedures gave rise to an increase in the number of arbitration awards involving foreign investments, thus contributing further precedents to the law. This was a period that generally saw the triumph of liberal economic views of foreign investment and an attempt at the transposition of these views into international law.

The fourth period saw the prevailing fervour for economic neo-liberalism rolled back by the economic crises precipitated by the growth of liberalisation that induced not just the flow of funds into developing states in the good times but also a rapid outflow of those funds when things turn bad. The successive economic crises in Russia, Mexico, Asia and Argentina have led to much rethinking of the prescriptions of economic liberalism. The increasing gap between the rich and the poor on a global scale, and the resulting schism in the attitudes to globalisation, have also led to a review of the wisdom of unmitigated capitalism. This rethinking is also reflected in the law. The ability of capital to move around without restriction has been seen as the cause of much of these woes, and capital controls have been seen as a remedy by some states as well as by economists.\(^84\) Coming at a time when the opposition to the MAI led to its withdrawal, the Asian economic crisis also contributed to a rethinking of the premises on which foreign investment law was based.

The attitudes that will be adopted to foreign investment will go through cyclical changes. It could well be that the very favourable climate that existed for foreign investment in the last decade of the twentieth century may give way to a lukewarm attitude in the future, particularly if the promises of liberalisation do not materialise. Globalisation, which proved favourable to foreign investment, has also released forces of fundamentalism and ethnic identity which compete against further liberalisation of the economy. In ensuring that these forces are placated, the state may have to rein in the trend towards further liberalisation.

But, the institutions that were created on the basis of economic liberalism may not maintain their original vigour in the years to come. Despite the demonstrations against it, the World Trade Organization remains in place, but with a developing-country group that vociferously demands that attention be given to the problems of economic development. They demand the removal of measures adopted in the TRIPS Agreement that deny access by poorer peoples to medicines. They quarrel with the ideas behind the General Agreement on Trade in Services (GATS) that enable the total liberalisation of trade sectors. The Doha Development Round captures the discontent and the willingness of developing states to resist rules they feel lack fairness. These rules were forced through in times of neo-liberalism, but, with the rejection of neo-liberalism, are coming to be contested. At the Singapore Ministerial Meeting of the WTO, the issue of an investment code was mooted, but

\(^{83}\) The US bilateral investment treaties recognise such rights but they are entered into subject to broad sectoral exceptions. NAFTA also contains provisions on pre-entry rights.

\(^{84}\) Malaysia and Argentina resorted to capital controls in order to deal with their economic crises. George Soros, at whose door the Asian economic crisis was laid by the Malaysian Prime Minister, himself advocated the need for controls.
at Doha there was a requirement that the issue of investment should be considered in light of the development dimension. At the Cancun Ministerial Meeting, which was concluded in September 2003, the larger developing countries opposed consideration of investment unless there was agreement to expand the discussion to include not only the protection of investment but also the potential liability of multinational corporations for the harm they may cause to the host state. As a result, investment has been removed from the agenda of the WTO. Another episode during the height of the period of economic liberalism was the effort on the part of the OECD to draft the MAI. Though the MAI failed, there will be fresh efforts made to bring about multilateral and regional investment treaties which have the promotion of investments through protection as their aim. But, the effect of the attempt to agree the MAI was to marshal the forces opposed to the impact of economic liberalism and the expression of the principles behind it in the form of binding codes. Those opposed to the MAI argued that there was too great a concentration on the protection of foreign investment, thus favouring multinational corporations, without any concern for issues such as protection of the environment, the development of poorer states and the protection of human rights.

The forces hostile to liberalisation have already left their mark on the law. They will also gather strength in the future. The movement for corporate responsibility will not be confined to the domestic spheres but will seek to create a global system that recognises the liability of multinational corporations. There is an increasing awareness of the need to develop rules relating to the environmental liability of multinational corporations through international law. There will be greater concern with the impact of the activities of multinational corporations on human rights, economic development and the rights of indigenous communities in the host states. These trends will counterbalance the trend towards enhancement of the protection of the investment of multinational corporations and their ability to move capital and profits freely around the world. New interests have been brought into the existing conflict of interests.

These developments have shifted the focus onto new areas that had hitherto not been the focus of international investment law. Developments in the area of human rights gave an impetus to some of these changes. As domestic courts declared that they could exercise jurisdiction over crimes against humanity, there was a growing number of prosecutions brought against multinational corporations before the courts of the home states of the parent companies for the damage they caused to the environment or human rights in host states. In the United States, the Alien Tort Claims Act, an obscure statute enacted in 1876, gave jurisdiction to the US courts over any wrongs against public international law. The statute was the basis on which many actions against torture committed in various countries of the world were brought in the United States. An offshoot of such litigation was allegations of torture done in the course of the exploitation of natural resources or the construction of large projects by multinational corporations. There have been many instances of such litigation in which jurisdiction was assumed. So far, there have been no instances in which damages have been awarded. There are, however, many instances of settlement of the cases through the payment of monetary compensation to the affected
claimants by multinational corporations. In addition, other common law jurisdictions are receptive to the idea of litigation concerning torts committed by multinational corporations outside the jurisdiction.

The most important of the changes in the modern period is the rise of the large developing states, Brazil, China and India. They are the homes of large multinational corporations. Brazil has stood outside the investment treaty system and is not a party to the ICSID Convention. It belies the neo-liberal theory that says that, unless states participate in such a system, investment flows will not take place. These three states also have large multinational corporations with the capacity to invest overseas. Already, there is visible evidence of companies from these states taking over large failing companies in the United States and Europe and becoming significant investors in both regions. The states in Europe and North America will increasingly become respondents in claims brought by these companies before arbitral tribunals. It will be interesting to see the response of these erstwhile capital exporters when faced with legal claims based on the laws they themselves had created for the protection of their own investors. Lawyers in these countries will invent new defences to liability, or the states themselves may seek to withdraw from the system that they created. Withdrawal is a technique that the United States has previously used to express displeasure with international systems.

Disparate forces will be at work within the law in this area. The forces of economic liberalism did have a nearly complete sway in the last decade of the twentieth century, but competing forces began to appear as a result of a succession of economic crises and a definite change in the global situation. The NGOs which have sectional interests will be powerful players exerting pressures towards the acceptance of their favoured solutions. Developing states may discover their previous solidarity, in this field at least, as they did in beating back the provisions of the WTO instruments that seemed unfavourable to their interests. Each of these opposing groups will support a different set of norms relating to investment protection. They will also differ on issues such as rights of access, types of treatment of investment and dispute resolution. The impact of the interplay of these forces on the international law on foreign investment is difficult to assess. These forces will always be extant within the international community, with ascendancy of one group of norms at one period and a decline at another. At each stage of this cycle, marks will be left on the law, because law is the instrument through which expression is given to the fundamental tenets of each group of ideas. These marks can never be wholly erased by either set of norms, which makes the study of this area challenging. The law that can be stated lacks clarity. To those who see law not as a set of static rules but as an evolving process, this situation should be taken as a normal phenomenon in the law.

85 An Indian national has brought an ICSID claim against the UK. Sanchetti v. UK (for the facts, see the Court of Appeal judgment regarding a stay order, reported at [2008] EWCA Civ 1283). A Chinese national has a pending ICSID claim against Peru. Tza Yup Shum v. Peru, ICSID Case No. ARB/07/6 (Decision on Jurisdiction and Competence, 19 June 2009). There is a claim pending against Germany: Vattenfall AB v. Germany (request filed on 30 March 2009). The long lists of NAFTA cases against the United States and Canada are well known and can be found on several websites, including that of the US Trade Representative.

86 The United States withdrew from systems it did not favour, or refused to participate. It has pursued a unilateralist policy in many fields. It did not subscribe to the International Criminal Court. It kept out of discussions of human rights.
3. An outline of the book

The purpose of Chapter 2 is to identify the factors which work to shape the law on foreign investment. The major events in the historical development of the subject are identified at greater length than explained in this introductory chapter. The nature of the multinational corporation and its counterpart, the state corporation, and the legal problems involved in the manner of their organisation are identified. The sources of international law which have been used to fashion the contending principles are described. It is shown that the sources in the construction of the contending sets of principles are weak sources of international law. What is passed off as custom by the different contending groups can hardly satisfy the stringent standards required by international law for graduating state practice into custom. There is an absence of multilateral treaties which have a direct bearing on the subject of foreign investments. Indeed, the recent unsuccessful efforts of the OECD in bringing about such an instrument demonstrate the difficulties inherent in such an attempt. There are many arbitral awards and opinions of jurists supporting one system of rules, and there is a series of General Assembly resolutions supporting the other. It will help in the understanding of the nature of the area to accept that both contending sets of principles are, at present, based on the weakest sources of a weak system of law. There is little to be achieved through the pretence that one set of norms has displaced the other. Both rely on weak sources of the law. Chapter 2 outlines the nature of the sources that have been used to construct the competing structures of the international law on investment.

Chapter 3 contains a study of the nature of the control that legislation in developing countries seeks to exert over foreign investment. The assertion of control over the process of foreign investment has been an aspect of the strategy of the capital-importing countries in seeking to contest the older norms on foreign investment protection. While contesting these norms at the international level, they also enacted legislation which exerts national control over the entry, establishment and operation of foreign investments. The aim of such legislation is to attract foreign investment into the state while ensuring that the investment is geared to the economic goals of the state and that the potential harmful effects on such goals are eliminated. There are three levels at which host states take stances. These stances may be at variance with each other but they are explicable on grounds other than inconsistency in attitudes. At the domestic level, states are inclined to enact legislation having their domestic goals in mind and in such a manner as to exploit fully the advantages of foreign investment and diminish the possible harmful effects. At the bilateral level, states make treaties, again often having particular objectives in mind. These objectives may be at variance with the stances they take at the multilateral level. At the multilateral level, developing states may have common objectives which they seek to pursue in order that change may be effected to international law at a global level. The charge of inconsistency merely fails to take into account the fact that the objectives at the three levels are induced by different considerations.

Chapter 4 deals with the controls that the home state of a multinational corporation may exercise over the corporation’s activities abroad. Flowing from this control, the issue is
addressed as to whether the home state has the duty to control abuses committed by the multinational corporations that affect the host state and its citizens. The extent to which home state measures could control the misdeeds of multinational corporations has increasingly attracted attention, particularly in relation to stances made by states and other actors in opposing multilateral agreements on investment.

Chapter 5 traces the development of the customary rules advanced by developed states which constrain the power of the host state and create rules which confer protection for foreign investments. This chapter is important, as it illustrates the system that had been advanced on the basis of an international minimum standard which creates responsibility in the host state. Such a minimum standard, and other standards of treatment, act as constraints on the power of the host state. This chapter bridges the two parts of the book, for it demonstrates how the rudimentary system of investment protection was supported. It thus serves as a prelude to the later chapters discussing liability arising from failure to conform to treatment standards and from expropriation.

Chapter 5 contains an analysis of the trends that can be seen in these bilateral investment treaties. The rapid increase in the number of these treaties has been a phenomenon of the modern law. Many claims are made that they constitute customary international law. Such claims are based on superficial analyses. It is evident that, though the outer shells of these treaties are similar, their contents vary markedly. They strike internal balances between notions of protection and notions of sovereignty in different ways. The chapter contains a study of the content of these treaties and an analysis of their impact on the law.

Chapter 6 contains a survey of the efforts made by international institutions to bring about uniform norms in the area. There have been many guidelines and draft codes generated by these organisations. None of them has been successful. The most recent of them has been the draft Multilateral Agreement on Investment (MAI) prepared by the OECD. The inability to bring about a multilateral code indicates the existence of a division of views among developing states and developed states. The failure of the MAI illustrates that even developed states may disagree on certain aspects of the law on foreign investment. The protests generated by the MAI indicates the extent to which the international law on foreign investment has become embroiled in the politics of globalisation. Yet, in the recent past, there have been successes with regional agreements on investments. They have been able to set up viable dispute-settlement processes which give effect to the rules contained in these agreements. Also, the project to bring about a multilateral agreement has been handed over to the World Trade Organization, where it has met with resistance from developing countries. Yet, it has to be recognised that, in certain areas such as technology and services, there has been progress made in the context of the WTO and there is a possibility that the impact of the WTO on the international law of investment will be greater in the future. Its present and future impact therefore has to be assessed, and this is an additional task this chapter attempts.

The final chapters deal with issues of dispute settlement and liability. Such liability flows from breaches of treaty and other obligations. Chapter 7 deals with breaches of contractual obligations. The proliferation of investment-treaty-based arbitration has diverted attention away from this important area which was the original basis of investment law, in the context
of which much theory was formulated. It captures the policy clashes that dominate all areas of investment law. It continues to be important, as many arbitrations are still conducted by both ICSID and non-ICSID tribunals on the basis of contracts alone. The significance of this type of arbitration to the law must not be lost sight of through an over-concentration on treaty-based arbitration. The latter captures the attention of the practitioner but at the cost of history and theory which are rooted in contract-based arbitration. The two interact in many ways. If international law is being fragmented, then there is further fragmentation of the area of international investment law where the tendency is to treat the waxing phenomenon of treaty-based arbitration as a distinct area. This is unsound in the context of the criticism that awards are being made purely on commercial grounds without an understanding of the principles of international law or public law which should be the underlying factors for an appreciation of the problems in the area.

Chapter 8 commences consideration of the settlement of disputes that arise from allegations of treaty violations. It deals with the jurisdictional issues, and the later chapters deal with the substantive law. As the number of arbitrations commenced on the basis of treaty violations increases, states are increasingly contesting the jurisdiction of arbitral tribunals. The tenacity with which states have contested jurisdiction in many cases indicate that they did not expect that the treaty provisions relating to jurisdiction would be used in the manner in which they are being used. As a result, many jurisdictional objections on grounds that may not have been thought of earlier are being used in order to challenge jurisdiction. It is a phenomenon that may also indicate some negative features of treaty-based investment arbitration that are becoming apparent. These trends are analysed in this chapter.

Chapter 9 deals with the breach of treatment standards. The breach of treatment standards has become an important cause of action in recent times, as a result of NAFTA litigation. Developed countries seldom expropriate property. The opportunity to level charges of violations of treatment standards particularly in the context of the use of regulatory powers, remains, however. The NAFTA litigation against Canada and the United States is a novel phenomenon, in that developed states have now become the targets of a law that they themselves helped to create. The use of treatment standards in such litigation opens up new possibilities in the area. There has been a shift in the area, discernible in the more recent awards, to the ‘fair and equitable’ standard of treatment. There has been creative use of this standard, and new rules are being formulated by tribunals on the basis of this standard. This has raised issues as to the legitimacy of the techniques used by tribunals.

Chapter 10 deals with the issue of taking of property. The central feature of expropriation had earlier been the debate as to the standard of compensation. This has been displaced in modern times by the issue of what amounts to a taking. Again, there have been fluctuations in the fortunes of neo-liberal attempts at expansion, which considered any depreciation in the value of property to be expropriation, to a reaction that has forced the admission of an exception that recognises that the exercise of regulatory powers is not expropriation under treaty. These different trends are explored in Chapter 10.

87 The umbrella clause and the issue of the exclusivity of the arbitration clause in the contract are but two instances.
Chapter 11 deals with the controversial question as to the nature of compensation for the expropriation of foreign property. This again is a theoretical dispute in international law. Its significance may have passed, yet it affected much of the thinking in the development of the law. For this reason, the chapter is kept virtually intact from the previous edition, and the old debate on the subject continues to be relevant. The new developments are taken into account. Inflexible stances have been taken in the past on this issue. There is a general acceptance that compensation must be paid. The ideological position that no compensation needs to be paid has lost support. The quantum of compensation still remains subject to dispute. The Hull standard of ‘full’ compensation seems to have gained support, particularly in bilateral investment treaties, but the alternative standard of ‘appropriate’ compensation still retains vigour. There has been an effort to transfer the emphasis onto valuation standards, but these efforts have not diminished the fact that the issue of the standard of compensation has to be settled first.

The final Chapter deals with the growth of defences to liability. As in the case of resistance to jurisdiction, states are reacting to the expansionary views taken by tribunals either by creating defences in the newer treaties they make or by pleading defences either on the basis of the interpretation of the text of the treaty or on the basis of customary international law. This chapter surveys a growing and innovative phenomenon that is a response to the increase in the number of investment arbitrations.

The issue of compensation for expropriation is of historical value as most litigation takes place on the basis of treaties which specify the standard of compensation. Yet, the debate exposes the extent of the divisions that existed on this subject, and provides an interesting clash in international law between the different groups of states. For that reason and because there are still cases being brought on the basis of customary law, the area will continue to be of importance.

The book seeks to identify the major features of an international law on foreign investment. It demonstrates that such a branch of international law is in the process of development and can be isolated for separate study. The fact that many of the areas in it are replete with controversies is not a reason against its separate treatment. The major areas of international law, such as the law on the use of force, are similarly controversial. But, that has not impeded its treatment as a distinct branch of international law. The time is now ripe for the isolation and separate development of this branch of international law. The separate treatment of controversial areas, such as that of foreign investment, will help in the identification of the nature of disputes in this area and lead to the formulation of acceptable solutions. This book is a contribution to the development of this important area of international law.