The Limitation of State Sovereignty in Hosting Foreign Investments
And The Role of Investor-State Arbitration to Rebalance The
Investment Relationship

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The candidate confirms that the work submitted is his own and that appropriate credit has been given where reference has been made to the work of others.
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Abstract

This research examines and critically analyses to what extent the host states might use their sovereignty in a manner that may be counterproductive to the interests of foreign investors on their territory; and the role played by international investment law in its regulation. Further, it considers the extent to which investor-state arbitration, under both the inter-state bilateral investment treaty (BIT), and investment contract, can be used to rebalance the uneven investment relationship arising from the adverse effect of host state sovereignty. The importance of the investor-state arbitration is based on the fact that such a process will be of no value if its award is not enforceable against sovereigns. It is therefore argued that arbitration enforcement against states must be augmented by further safeguards mechanisms.

Challenges are faced by international investment law to minimise the possible adverse effect of host state’s sovereignty, in order to require states to respect investment agreements. Responsibility will be asserted by a wronged foreign investor if the state breaches customary international law when it hosts the foreign investment and if there is a violation of the specific investment agreement. Such challenges expose the limitations on how states can use their sovereign powers (whether legal, economic or political), against foreign investors and question the clarity of such boundaries. An unsuccessful litigant state will often seek to resist award enforcement, claiming sovereign immunity against its execution. International investment law and applicable national and regional bodies must find a balance between the interests of the foreign investor and the host state. This research concludes that the adjudication system used in England provides a framework in which a foreign investor can seek recognition of its claim and thus enforce a foreign arbitral award against recalcitrant states, but improvements could still be made as explained in thesis.
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Abbreviations

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AA 1966: British Arbitration (International Investment Disputes) Act 1966
ADR: Alternative dispute resolution
AJA 1920: British Administration of Justice Act 1920
ASEAN: Association of South East Asian Nations
BIT: Bilateral Investment Treaty
CAFTA: Central American Free Trade Agreement
CPR: Court Procedural Rules (England)
ECT: Energy Charter Treaty
FDI: Foreign Direct Investment
FJA 1933: British Foreign Judgements Act 1933
FSIA: Foreign State Immunity Act 1976 (United States)
GAFTA: Grain and Feed Trade Association
Geneva Protocol: Protocol on Arbitration Clauses Signed at a Meeting of the Assembly of the League of Nations on 24/9/1923
ICC: International Chamber of Commerce
ICJ: International Court of Justice
ICSI: European Convention on State Immunity 1972
ICSID: The International Centre for Settlement of Investment Disputes
ILC: International Law Commission
IMF: International Monetary Fund
MIGA: Multilateral Investment Guarantee Agency
MIT: Multilateral Investment Treaty
NAFTA: The North American Free Trade Agreement
OECD: The Organisation for Economic Co-operation and Development
OPIC: Overseas Private Investment Corporation
PPP: Public Private Partnership Contracts
RSC: British Rule of Supreme Court
SCC: Stockholm Chamber of Commerce
UNCTAD: United Nations Conference on Trade and Development
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1.1 Introduction

International investment agreements in such spheres as hydrocarbon exploration, natural resource exploitation and mining, for example, have a particular quality distinguishable from the common type of trade agreement which a state enters into with foreign partners. They have significant impacts on national income and security and involve generally highly speculative, but substantial, financial commitment from both host states and investors. This demands a high level of collaboration and the avoidance of costly delay, or indeed any other impediment to the stable operation of the project.

Whenever there is such delay or impediment, a foreign investor loses a considerable tranche of its investment and indeed trust in its partner and the host state faces much detriment in its national investment plans and economic interests. It is therefore an investment relationship imbued with natural desire to maximise benefits in circumstances of much potential loss and which requires complex, protracted negotiations to reduce manageable risks. Pre-contractual bargaining will of course specify the duties and responsibilities of the host sovereign state and foreign investor, but must also encompass methods of problem and dispute resolution. It is not proposed in this research to examine in detail issues relating to the purely commercial aspects of investment agreements, but to investigate and discuss the function of international investment laws and their interaction with state sovereignty, a principle which prima facie places the state in the position of dominant partner.

Investment is enticed by state authorities through attractive incentives, perhaps tax benefits, interest free loans or other such financial inducements, and foreign business is persuaded to place its money, technology and expertise in a project which appears to carry all the promise of wealth in return. It would be prudent of course to
investigate the efficacy of such pledges, because when the deal is done and the technology is in place, it is the nature of such contracts that disputes will arise, and by then the adequacy of the inducements will appear somewhat less potent. It is now that the investor will come to face the apparent power of sovereignty.

States understandably are very protective of their domestic security and autonomy whilst still requiring international investment to enhance their economic advancement through foreign technology in the exploitation of its natural resources.\(^1\) Herein lies the potential conflict with sovereignty which international investment law has sought to ameliorate to protect joint interests of the parties, which involves a number of principles designed to restrict state acts which are contrary to the foreign investor interests. The achievement of balance of rights and obligations is onerous, with jurists seeking an acceptable and enforceable equilibrium between traditional international values and the protection of relatively modern investment needs. This includes the placing of boundaries on the states entitlement to legislate on matters in its own territory where it affects foreign investment interests.

Sovereignty is a key and somewhat overwhelmingly precious attribute of statehood. It is worthy of its own detailed examination, which is beyond the scope of this thesis. It is proposed to identify the minimum standards which international investment law requires of the state in the exercise of sovereign power where it affects the foreign financier and its interests. The sovereign actions of a recalcitrant state which bring harm to foreign investors’ interests will be examined to seek guidance for the apparently weaker contractual party to put into effect rules to ensure effective compliance. A blueprint is proposed for the investor to protect their interests against the action of host states. A differentiation will be drawn between sovereign and commercial risks; in order to undertake its enterprise, the foreign investor is expected to undertake, and abide by, its own commercial risk assessment, as in the nature of any speculative project.

1.2 The Main Research Issues and the Need for Effective Legal Regimes to Protect Foreign Direct Investment’s from State Sovereign Powers

The principle of ‘State Sovereignty’ is a generally accepted principle of customary international law. This principle effectively determines the autonomy of a government to control all what happens on its territory, including the right to freely legislate, determine policy and control and maintain its subjects or citizens.\(^2\) These constitute non-commercial, political, economic and legal decisions made on principles beyond the usual business decisions made in the conduct of its economic duties. Business and commercial decisions of its partners can often be anticipated by an astute foreign investor because that is the realm in which it operates. The host state use of sovereignty, legislative, executive or judicial power which compromise the agreement rights of the investor is however less predictable and comes in many forms. International investment law has developed restrictions on the principle of absolutism in sovereignty, and consequently controls on claims of immunity from suit and enforcement in the event of a dispute, formulating a more commercially attractive and limited concept which will still preserve the state interest.

The three main axes for this examination are: i) limits imposed on states for its sovereign actions against foreign investors under customary international law; ii) limits on states for sovereign actions in the context of investment contracts and BITs and iii) Limits on sovereign immunity in the context of the investor-state arbitration.

The simple solution to the issue of loss of sovereignty is isolationism, withdrawal from investment treaties, and to suffer strangulation of an underdeveloped economy as a result of failure to engage with the global market. Such effects are economically damaging in the long term, therefore state liability and fault can generally be recognised where its actions are a breach of a bilateral investment treaty (BIT) or multilateral investment treaty (MIT); it effectively imposes a restriction on its own absolutism of sovereignty. This piece of research will focus on the effectiveness of practical solutions under international investment law for settlement in the event of

\(^2\) For further reading please see Ersun N. Kurtulus, *State Sovereignty: Concept, Phenomenon and Ramifications* (Palgrave Macmillan 2005)
sovereign state action such as Arbitration. As will demonstrate later in the thesis arbitration not only has the ability to resolve basic contractual conflicts for which the actions of the state impose responsibility or blame, but issues of the sovereign immunity.

1.3 Research Aims and Contribution

It is proposed that this thesis will explain the necessity of the limitation of traditional principles of sovereignty of host states in the attraction and utilisation of foreign investment to facilitate the development of its economic and social progress in the quest of a nation to participate more fully, for its own benefit, in the vast arena of world trade opportunity. Analysis and explanation of duties which become incumbent on countries which host foreign investment through the implementation of international agreements will be undertaken as a basis for determining the effectiveness of international arbitration obligations incorporated in inter-state negotiated BITs and investment contracts and how they can be utilised to remedy abuse by the host state of sovereignty powers. The aims of this study have been specifically selected due to their importance in the context of host state and foreign investor relationship. This is particularly true when consideration is given to the more controversial types of analyses incorporated in both investment case law and the writings of academics on the subject.

The pursuit of this examination will involve a detailed analysis of the ICSID Cases, under the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of Other States, otherwise known as the ‘Washington Convention’ or ‘ICSID Convention’, established to assist in the resolution of disputes between states and foreign investors. Therefore, the International Centre for Settlement of Investment Disputes (ICSID) established thereunder by signatories to facilitate the submission and adjudication of disputes will be germane in this research.

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3 Convention on the Settlement of Investment Disputes between States and Nationals of other States. Washington, 18/3/1965. – (Hereinafter “ICSID Convention”)
It is anticipated and intended that this research will be of considerable value and
guidance to the legislators, and indeed executive, of host states in the utility and
drafting of national law, treaties and contracts commensurate with their economic
interests in the pursuit of FDIs. It is also expected that the study will serve as useful
guidance to the foreign international investors who seek to prosecute business
advantage in the development of interests in the economic advancement of other
states, and need to be acutely aware of the disadvantages as well as benefits and
entitlements in the context of host state sovereignty. Further, it is to be wished be of
assistance to academics in any future studies in the field of international investment
law.

1.4 Research Questions

This research considers five key issues, seeking resolution and answers:

i. The limits of a state’s sovereignty where it conflicts with the rights of a foreign
   investor;

ii. The differentiation between a state’s responsibility for sovereign actions in
customary international law and, alternatively, its contractual liability in an
   investment relationship, and the impact of such dual liability;

iii. The role of investor-state arbitration in re-balancing the difference of influence
    between a host state and foreign investor;

iv. The role and impact of state’s sovereign immunity in investor-state arbitration;

v. The ability of a foreign investor to enforce its award in England and the procedure
   for application, should the state fail to comply with it’s obligations.

Even though a number of jurisdictions will be discussed through-out this thesis where
needed. However, the main discussion will revolve around cases/authorities in
England and Wales (hereafter “English courts” or “English Jurisdiction”, depending
on context). England has a historically more advanced juridical legal system than
many other nations with considerable experience and a reputation for impartiality in
the protection of the foreign investors particularly on the issue of enforcement of
arbitral awards against recalcitrant states. Given the extent of the doctrine of sovereignty, focus will be directed herein upon issues most likely to arise in international investment law litigation before arbitral tribunals and ultimately the English jurisdiction.

1.5 Structure of the Thesis

This thesis will attempt to add to the body of literature and knowledge of international investment law and to suggest an effective legal framework for the protection of foreign investors against the vagaries of host state exercise of sovereign powers in contravention of the investment agreement, BIT and international investment law. Accordingly, the thesis is divided into eight chapters. An introductory chapter that will provide a detailed summary of the research problems, issues and aims. Chapter Two will seek to define the investment relationship and the parties to it, namely the host state and the foreign investor. It will differentiate between the portfolio investment, which will not attract the protections of the international investment law framework, unless otherwise agreed, and foreign direct investment, which does. Moreover, a comparison of commercial and non-commercial risks which pervades the adjudication of international tribunals will also be discussed in this chapter.

A pertinent definition of state sovereignty in the investment context will be constructed in Chapter Three. The interaction between investor interests and the role of the sovereign state in the foreign direct investment relationship will then be examined. The host state which voluntarily enters into a contract must necessarily sacrifice a part of its sovereignty in return for the benefit to be accrued as a result of that agreement, accepting its provisions for the protection of its investors. In the determination of the likelihood of the cogency of such promises of protection, ‘country risk’ may be utilised in the assessment of how prudent it is to enter a particular relationship with a specific host state for foreign investors.

4 The ‘English Jurisdiction’ and ‘English Courts’ will be considered as benchmark of this study beside the customary international law and international investment law.
Chapter Four will attempt to identify the main limitations on sovereign action by a host state, the stepping beyond which will be considered a wrongful act under customary international law. The most obvious and generally litigated principles of what may be considered ultra vires behaviour affecting the contractual entitlements of the investor are denial of justice, unjust enrichment, failure to protect projects and failure to provide fair and equitable treatment.

Then chapter Five will then discuss investor-state arbitration as a method of protection of the investor from the effects of the harmful action of the host state. This may be provided for in the particular investment agreement or bilateral investment treaties (BITs) between interested states. Given the importance of arbitration, the choice of venue is highly significant, particularly to avoid the problems associated with dual jurisdiction. In this context the role of the host state domestic courts and the utility and effectiveness of an investment agreement umbrella clause is examined to analyse the comparative benefits and problems associated these provisions and courses of action. Arguably, arbitration under the international conventions is the only independent method of ensuring restitution to the foreign investor. Complications arise further with the civil law jurisdictions of the administrative contract and the ‘act of the prince’ theory and the effect on the investor.

Chapters Six discuss the impact of the state’s claim of sovereign immunity on investor-state arbitration and then, examine the role the UK State Immunity Act 1978 can play in the adjudication of such assertions. This is further considered when, in the face of a lawful award, the state declines to comply, by putting forward the sovereignty argument. Assistance and advice is given to foreign investors about their options for enforcement and ultimately collection of what is lawfully adjudicated as being due to them. Here again assistance can be sought under English law in Chapter Seven of this thesis. Chapter Eight is where the proposals are suggested.

1.6 Research Methods

Black-letter analysis in the use of case law, statute and, to an evidently productive extent, academic commentary is focused on primary sources, ensuring each issue
discussed is considered from both a theoretical and practical perspective. Numerous solutions for dispute resolution proposed by esteemed authors in texts, articles and projects are examined in conjunction with laws and conventions developed by such academics and public international organisations. Qatar will largely benefit from the utility of this methodology, because although the nation does not have, at the time of writing this thesis, legislation which regulates the immunity of states and suits in the Qatari courts, it is anticipated that this research will provide a solid basis for the drafting of such law. Challenges have been experienced in the effective utility of this methodology due to important cases, related directly to this study, being classified by the veil of confidentiality.

The rules of permanent arbitration institutions instituted by international conventions assist in considering the practicality of the application of the theory. The library of the University of Manchester and Manchester central public library have proved invaluable for research, and on my travels I have been permitted to utilise the libraries of Oxford University, Harvard University, the Georgetown and Qatar University Libraries in Qatar, as well as that of the British Library in London. In addition, the author has contacted and received guidance in the search for materials from a number of publishers such as Sweet and Maxwell, Butterworths, LexisNexis, and Hart Publishing; other sources have been accessed via the Internet. Inter-library loan facilities have also been utilised, in order to obtain the sources that were unavailable in the John Ryland library of the University of Manchester.

The practical perspective examines judicial interpretations of law and theory made by arbitral tribunals and the English courts, with relevant court decisions analysed and compared to identify the application which a foreign investor can practically use to pursue redress. Occasionally, there has been interpretive divergence which required further case law consideration from other jurisdictions to help identify the most persuasive and logical outcome within the framework of the law discussed. The literature is extensive and occasionally conflicting. Therefore, an attempt has been made to resolve issues arising between theory and practice before proposing solutions.
Chapter Two

Overview of the Research Issues Relating to the Investment Agreement Between Host States and the Foreign Investors

2.1 Investment Agreement and Protection of Foreign Investments under Customary International Law and International Investment Law

At the outset, it is important to build a cohesive and consistent analysis of the investment relationship, and to clearly define the nature and status of the parties to investment agreements (namely the host state and the foreign investor), which have resulted in many of the litigious disputes that provide key evidence in this study. This includes the type of investments protected by international investment law, and the characteristics that differentiate it from the other types of investment that do not attract such protection; and their role in a state’s development. In the context of defining the contracting parties, concepts of ‘nationality’ and ‘investment’ will be examined. Whilst these concepts are the main jurisdictional requirements of the Washington (or ICSID) Convention, they lack clarity in international agreements of dispute resolution. This has practical consequences for parties to an investment agreement, and therefore it is necessary to consider what level of discretion is given to the parties to define such concepts by the Convention.

It is important to identify the themes that engender the more significant problems of international investment in order to illustrate the interaction between the host state and the foreign investor, which usually begins with an investment agreement. By way of introduction, it is proposed to identify the nature of the investment that is protected under international investment law, along with the rationale behind such safeguards. This begins with a definition of the parties, and in particular an examination of the importance of who represents the host state when it deals with a foreign investor. The nationality of the foreign investor, protected under international investment law is also of considerable significance, and it is necessary to consider the main theories that encapsulate this. In the functioning of the ICSID Convention, ‘investment’ and ‘nationality’ are concepts of vital importance left to the relevant parties to determine
in the context of BITs. It is argued that such discretion has often led to results and decisions apparently beyond jurisdictional limits. This is coupled with the principle that in the tribunal context, the judge is the arbiter of his own competence, and as such may make decisions that are in fact contrary to the perceived aims of the Convention.

As part of this introductory analysis section, the principle of ‘investment’ under the ICSID jurisdiction will be defined. Following the analysis of parties to the investment agreement in Section 2, Section 3 will discuss the principle of ‘nationality’ of the natural person and legal corporate investor within the meaning of Article 25 of the ICSID Convention. A conclusion will then follow, incorporating an analysis of the key factors of the international investment concept and its parties, as developed by case law conducted under the Convention.

2.1.1 The Five Characteristics of Investment that Attract Protection under International Investment Law

International investment agreements can be differentiated from standard investment agreements by identifying their characteristics and parties. The ICSID Convention links notions of ‘investment’, protected under its auspices, with notions of ‘dispute’. Article 25(1) of the ICSID states: ‘The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment’. However, whilst this clearly demonstrates the importance of ‘investment’ to the issue of jurisdiction, it does not actually define the term. Indeed, there is no universally accepted explanation for such a fundamental fiduciary arrangement in any international agreement, although international tribunals, BITs and academics have each attempted to develop certain investment principles to reflect the main characteristics of the concept. This provides a general understanding of what is considered to be an ‘investment’ that attracts the protection of international investment law and the jurisdiction of the ICSID.

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6 ibid
7 Art. 25(1) ICSID Convention (n3)
Case law provides useful examples of the insight given by tribunals. In *Fedax v Venezuela*, the tribunal sought to classify five common characteristics for each qualifying investment. They are (i) certainty of duration, (ii) regularity of profit and return, (iii) risk, (iv) the substantial nature of the investment and (v) it must relate to the development of the State. It stated that:

1. The duration of the investment in this case meets the requirement of the Law as to contracts needing to extend beyond the fiscal year in which they are made.
2. The regularity of profit and return is also met by the scheduling of interest payments through a period of several years.
3. The amount of capital committed is also relatively substantial.
4. Risk is also involved as has been explained. And most importantly, there is clearly a significant relationship between the transaction and the development of the host State, as specifically required under the Law for issuing the pertinent financial instrument. It follows that, given the particular facts of the case, the transaction meets the basic features of an investment.

In the *Joy Mining Machinery v Arab Republic of Egypt* case, problems arose in an agreement made to provide equipment for a mining project. In the course of resolution of the dispute, the tribunal found that:

1. The duration of the commitment is not particularly significant, as evidenced by the fact that the price was paid in its totality at an early stage. Neither is therefore the regularity of profit and return. Risk there might be indeed, but it is not different from that involved in any commercial contract, including the possibility of the termination of the Contract. The amount of the price and of the bank guarantees is relatively substantial, as is probably the contribution to the development of the mining operation, but it is only a small fraction of the Project. Certainly there is nothing here to be compared with the concept of "contrats de développement économique" or even contracts entailing the concession of public services.

Therefore, in this case, the tribunal held that the undertaking of the claimant, in the context and purpose of the ICSID Convention, did not amount to an investment.

In 2009, Schreuer adopted these five criteria as a guide to establishing whether a particular type of dispute can be considered as ‘investment’ related and therefore

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8 *Fedax N.V. v Venezuela*, ICSID Case ARB/96/3 Decision on Objections to Jurisdiction 11 July 1997
9 ibid Para 43 at 1378
10 ibid
11 *Joy Mining Machinery v Arab Republic of Egypt*, ICSID Case ARB/03/11, Award of 6 August 2004
12 ibid Para 57
13 ibid Para 58
qualifying for ICSID Convention protection. Broadly, one-time sales or purchases of goods or short-term commercial transactions would not normally be considered a qualifying investment. This addresses a desire on the part of a host state to encourage commitments of capital from abroad, upon which it can rely for economic development. Although the North American Free Trade Agreement (NAFTA), of January 1994, did not define the term of “investment”, it does assert, albeit implicitly, that it will not include short-time or one-off sales as an investment worthy of international protection;

Investment does not mean claims money that arise solely from commercial contracts for the sale of goods or services by a national or enterprise in the territory of Party to an enterprise in the territory of another Party […].

A qualifying investment would normally display a regularity of profit and returns, although this may include circumstances where no profits are eventually realised. It is the expectation of a return that is the typical aspect of such an investment. Brownlie, in *CME* case, agrees, and suggests that this is a fundamental aspect of any genuine investment, describing it ‘as a form of expenditure or transfer of funds for the precise purpose of obtaining a return’. According to this interpretation, infusions of capital made without reasonable or substantiated belief that profit would result may be excluded from the definition of ‘investment’.

The third factor governing the definition of investment requires the assumption of commercial and non-commercial risk affecting both parties. Commercial risks may include a significant rise in costs of the project; or agreed materials being undelivered or late and thus hindering the operation. These may interact with non-commercial risks that result from the actions and powers of states, which hinder or prevent the operation of the project by a foreign investor. The importance of the concept of risk is

14 Christoph H. Schreuer and others, *The ICSID Convention: A Commentary* (2009 Cambridge University Press) 139-140. Schreuer indicates these are not requirements, but characteristics that most investments will share; Norbert Horn and Stefan M. Kröll, *Arbitrating Foreign Investment Disputes*, (2004 Kluwer Law International) 297
16 Art. 1139 NAFTA 1994
17 *CME Czech Republic B.V v The Czech Republic* UNCITRAL Final Award (14 March 2003)
18 ibid Final Award Separate Opinion of Ian Brownlie 34
19 ibid (n17) Para 20, and see *Metalclad Corp. v United Mexican States* ICSID Case ARB(AF) 97/1 Award of 2 September 2000 Para 122
reflected in the BIT between the U.S. and Chile (2003), which explicitly states that ‘Investment means every assets that an investor owns or controls, directly or indirectly, that has the characteristics of investment, including such characteristics as the […] assumption of risk’. The element of risk can also be related to the fourth of the qualifying investment characteristics. Investment commitment should be “substantial”, referring to the proportionality of the amount to the overall resources of the parties. Horn and Kröll propose that this factor is the ‘least convincing’ of those asserted by Schreuer, given that the term “substantial” relies on the financial position of the investment parties. A commitment of $100,000 USD, for example, may be a major expenditure of resources for a start-up company, but represent mere incidental expenses for a major petroleum company.

The fifth factor differs significantly from the preceding elements, and involves ascertaining the importance that the investment will have in the development of the host state. Duration, risk, expectation of profit and the commitment of resources are primarily characteristics of an investor’s participation, while here the emphasis is on the motivation of the host state in the operation of the project, exemplified by the fact that such investments are directly connected to national resources and the enhancement of national income. One of the primary benefits of foreign investment is the promotion of economic growth in the host country, accompanied by technological transformation that ultimately advances economic development. An important component is the creation of employment in local economies and the benefit derived by domestic based companies in the promotion of their own intrinsic growth, utilising foreign contacts initiated by their host state’s involvement in international trade. Foreign investment is expected to establish, facilitate and enhance the production of wealth, all of which are of particular significance for developing countries. If foreign investment is to have a significant impact, it will add to available resources of internal investment and the capital accumulation of a

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20 Art. 10.27 Free Trade Agreement between the Government of the United States of America and the Government and the Government of the Republic of Chile (U.S.-Chile BIT) 6 June 2003  
21 Horn and Kröll (n14) 298  
22 ibid  
23 Rubins (n15) 299  
developing country, promoted by an influx of production technology, skills and innovation capacities to the host country. Organisational and managerial practices are shared between parties, as well as providing access to marketing and other international networks.

Foreign investment can therefore be a vital component of economic and political growth for a country, promoting innovation and competition in domestic markets through the adoption of efficient new methods of investment in human and physical capital. Expectations are increased regarding domestic commercial operations requiring such local industries to adapt methods of production to facilitate greater efficiency and cost effectiveness.\(^{25}\) China provides a pertinent example of such effectiveness. Since the state initiated considerable economic reform in 1978, China has been very successful in attracting foreign investment, so that by the end of the twentieth century, it had approved over 324,700 foreign investment projects, with a contractual value of US$572.5 billion.\(^{26}\) It is expected that the foreign investment itself will provide a considerable immediate stimulus to the macro economy of the host state by increasing productivity.

Macroeconomics studies the behaviour of the aggregate economy, examining national issues such as changes in unemployment, income, growth, gross domestic product, inflation and price levels.\(^{27}\) International investment agreements should directly influence growth and, it is hoped, efficiency, in the use of resources in the recipient economy through three basic channels: (i) use of links between the foreign investment and its associated trade flows, (ii) the benefits of the relationship on the existing and developing business sectors of the host; and (iii) the direct impact on structural factors in the host economy.\(^{28}\)

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\(^{25}\) Sandy Kyaw, *Foreign Direct Investment to Developing Countries in the Globalised World* (9/2003) Paper Presented DSA Conference, University of Strathclyde  
\(^{28}\) OECD, *Foreign Direct Investment for Development - Maximising Benefits, Minimising Costs* (2002 OECD) 9
The five characteristics of investment as recounted activate protection of international investment law. In most FDI projects, the time element is vital; it facilitates the analysis of costs and potential profit return. The term of the resultant project will generally be decades, perhaps longer so the investor needs to rely on the state and its goodwill. There appears little commercial reason for the state to inhibit profit making, which it will share so non-commercial justifications will be the main scope of this study. For the sake of completeness of this consideration of the characteristics of investments that qualify for international protection, it should be reiterated that any investment must be lawful, and should not be a transaction considered unacceptable or illegal under international investment norms. This may include the trade in broadly prohibited drugs or material for use in the weapons of mass destruction, depending on agreements to the contrary.

2.1.2 The Differentiation Between the Bilateral Investment Treaty (BIT) and the Investment Contract in the Context of Investment Protection

The Bilateral Investment Treaty (BIT) is an agreed basis for a relationship and a set of terms between two sovereign states, which serves to attract foreign investment by reducing the likelihood of unprincipled and arbitrary actions by the host recipient. It further contributes to good governance, a necessary condition for the achievement of economic progress in the host state.\textsuperscript{29}

The BIT offers foreign investors a set of specified substantive rights that include the promise of fair and equitable treatment by the recipient state, with guarantees of appropriate compensation for the expropriation of resources contributed by the investment party. Protection is both physical and legal, through the application of state law. The home state of the investor and the host state will seek to ensure that the investment of its national will be treated according to international law.\textsuperscript{30} A properly


negotiated BIT will enable the investor’s home state to anticipate and provide for non-commercial risks with another sovereign nation, creating an umbrella set of provisions to protect their nationals, whether individuals or corporate investors. Since the inception of the BIT (first acknowledged to have been concluded between Germany and Pakistan in 1959), it has been recognised as a cornerstone of protection of foreign investor interests in international law. \(^{31}\) Currently, more than 3000 BITs have been entered into worldwide. \(^{32}\)

However, international investment agreements and contracts revolve around the agreement of a specific project, which should contain all particulars and details, including the rights and obligations of the parties, namely the foreign investor or corporation, and the host state, either by itself or one of its composite representatives. In its project specific content, it differs from the inter-sovereign state relationship and broad protectionist terms of the BIT. It is usually more of a set of commercial rules to promote the commercial project and protect the interests of investors who seek such contractual transactions with a foreign host state. It should also be noted that disputes arising between a host state and a foreign investor can constitute either a breach of the BIT or of the investment contract or both. The relevance of investment contracts is of course vital given the effect that a proper negotiation process may limit, or indeed expand therein the sovereignty of the state. This will be examined in depth in chapter 5.

2.1.3 International Investments Types and their Importance in the Context of the Protection of International Investment Law

International investments can be divided into two principal categories: (i) the Foreign Direct Investment (FDI) and (ii) the Portfolio Investment. \(^{33}\) The differentiation is of

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\(^{32}\) For further information please visit the ICSID website at <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDPublicationsRH&actionVal=ViewBilateral&reqFrom=Main> accessed on 12 June 2013

considerable significance, not least for the purposes of this examination, which focuses on state sovereignty and the problems arising from the misuse of such authority by the state.

The concept of FDI has been examined and defined extensively by international bodies, generally in broadly similar terms. The Organisation for Economic Co-operation and Development (OECD) states that;

Foreign Direct Investment (FDI) is a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is resident other than that of the direct investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise. The direct or indirect ownership of ten per cent or more of the voting power of an enterprise resident in one economy is evidence of such relationship.  

Therefore, the contributor to a FDI has an actual physical presence in the host state.

The International Monetary Fund (IMF 1993) Section 359 defines FDI in a similar manner, namely as an

[I]nsvestment that reflects the objective of obtaining a lasting interest by a resident entity in one economy in an enterprise resident in another economy [...]. The lasting interest implies the existence of a long-term relationship between the direct investor and the foreign enterprise and a significant degree of influence by the investor on the management of the enterprise.  

Once again, the physical presence in the host territory and an almost personal relationship between the state and individual or corporate investor is stressed.

Finally, the description of the United Nations Conference on Trade and Development (UNCTAD) 1999 ought to be mentioned:

An investment involving a long-term relationship and reflecting a lasting interest and control of a resident entity in one economy - foreign direct investor or parent enterprise - in an enterprise resident in an economy other

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Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law (Cameron May Ltd, 2005) 47  
than that of the foreign direct investor (FDI enterprise, affiliate enterprise or foreign affiliate).  

Sornarjah comments that FDI is 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’.

Each definition contains similar characteristics of the investment FDI, and further includes specifications of a long-term relationship between two interests with the objective of economic advancement, which requires ‘significant influence’ from the foreign investor of the management of a company on foreign territory. However, the OECD advanced another more precise factor of involvement, namely ten per cent of the voting power being evidence of a management relationship. This assertion loses much of its evidential cogency in the context of the FDI definition, due to the fact that such proportions of control remain unmentioned in the other definitions.

The other major classification of capital commitment is termed the ‘Portfolio Investment’, an ‘investment in debt and equity securities that is intended only for financial gains and that does not signify a lasting interest in or control over an enterprise’. Here the purchase of bonds, or debt securities, which have little if any physical manifestation on host state territory, may qualify as investments; but it is generally accepted that the investor takes on any risk involved in the making of such a transaction. This form of financial investment does not entitle the bearer the commencement of suit for loss against the domestic stock exchange, or indeed the public body operating the bond. There is no remedy to the investor for losses incurred in the trading of foreign shares, bonds or other financial instruments. Sornarjah asserts that portfolio investment is not protected by international investment law, because it does not embody the main characteristics of the qualifying

36 Imad Moosa, Foreign Direct Investment Theory, Evidence and Practice (Antony Rowe Ltd 2002) 1
37 Muthucumaraswamy Sornarjah, The International Law on Foreign Investment (Cambridge University Press 2010) 8
38 J. Anthony Van Duzer, Penelope Simons and Graham Mayeda, Integrating Sustainable Development Into International Investment Agreements – A Guide for Developing Country Negotiator (Commonwealth Secretariat 2013) 57
39 Fedax N.V. v Venezuela (n8)
40 Sornarjah (n37) 8-9
41 ibid
‘investment’ attributes.\(^{42}\) Furthermore, portfolio investors are more likely, subject to market movements, to be able to recover the value of their investments and then withdraw from the host state if it acts contrary to their interests. This course of action is, of course, more difficult for investors who have acquired ownership and control of actual property in a host state under an FDI.\(^{43}\)

Arguably, the major differences between the FDI and Portfolio Investment arise from issues of management and control. An investment can be considered an FDI when the share owned by the investor is sufficient to facilitate control of the company, whereas the mere provision of a financial return for the undertaking of risk is a portfolio investment.\(^{44}\) This generally relegates the portfolio investment from the realm of protection by international investment law, deeming it to be an ordinary commercial risk of which the investor ought to have been aware; even though it may suffer from the risks resulting from state action. In consequence, international investment law and rules developed in ICSID case law allow portfolio investments to be protected against non-commercial risks under the principle of state responsibility.\(^{45}\) This must be included in the inter-state BIT in order to receive the benefit of Article 25(1) ICSID Convention protections as a qualifying investment. The United States - Sri Lanka BIT (1991) provides an example of such investment protection instruments, providing in Article 1(1):

\[
\text{(a) ‘investment’ means every kind of investment in the territory of one party owned or controlled directly or indirectly by nationals or companies of the other party, such as equity, debt, and service and investment contracts; and includes: (i) tangible and intangible property, including rights such as mortgages, liens and pledges; (ii) a company or shares of stock or other interests in a company or interests in the assets thereof; (iii) a claim of money or a claim to performance having economic value, and associated with an investment;[...].}\]^{46}

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\(^{42}\) ibid

\(^{43}\) Alexander Böhmer, *The Struggle for a Multilateral Agreement on Investment: An Assessment of the Negotiation Process in the OECD* (1998) 41 German Yearbook of International Law 267-278 also see Van Duzer and others (n38) 58

\(^{44}\) ibid

\(^{45}\) *Fedax N.V v Venezuela* (n8)

\(^{46}\) Art. 1(1) Treaty between The United States of America And the Democratic Republic of Sri Lanka concerning the Encouragement and Reciprocal Protection of Investment With Protocol and a Related Exchange of Letters (United States-Sri Lanka BIT) 20 September 1991
It appears that this inclusion of the portfolio type of investment in a BIT should arguably determine its categorisation as qualifying as an investment for protection in the ICSID or similar tribunal adjudication. In the Joy Mining case,\textsuperscript{47} the ICSID expressed a different point of view:

The fact that the Convention has not defined the term investment does not mean, however, that anything consented to by the parties might qualify as an investment under the Convention [...] there is a limit to the freedom with which the parties may define the investment if they wish to engage the jurisdiction of ICSID tribunals. The parties to a dispute cannot by contract or treaty define as investment, for the purpose of ICSID jurisdiction, something which does not satisfy the objective requirement of Article 25 and its reliance on the concept of investment, even if not specifically defined, would be turned into a meaningless provision.\textsuperscript{48}

The tribunal adopted the five characteristics of the FDI to define the status of the investment discussed here.\textsuperscript{49}

Parties to an international investment agreement therefore have limitations placed on their own capacity to define the nature of the investment that they intend to pursue under a BIT or in an investment contract, and the adjudication tribunal has a discretion to determine the protection which may be affordable regardless of the specifications or intention of those involved in its formation. There is no obligation to use the ICSID Convention route of resolution on the part of investors or their home state, unless this is provided for in the agreement, as an arbitral institution and indeed jurisdiction can be excluded. The autonomy of parties in reaching an international investment agreement should therefore entitle them to incorporate their own choice of what constitutes investment, provided of course that it does not involve materials or products that contravene international trade laws.

\textbf{2.2 Parties To International Investment Agreements}

This section will consider the relationship of parties to an investment agreement, and the status of the signatory for the host state. The identification of the state body, agent or representative dealing with the foreign investor and questions of authority are vital.

\textsuperscript{47} Joy Mining Machinery Limited v Arab Republic of Egypt (n11)
\textsuperscript{48} ibid Paras 49-50
\textsuperscript{49} ibid Para 53
to ascertaining whether the host state itself may be subject to wrong-doing. This section will enable us to conduct a comprehensive examination, in Chapters 4 and 5, of the importance of the investment protection of the foreign investor from actions by the host state, where these are identifiable in accordance with customary international and more specific, the international investment law.

It is the nature and status of the parties to international investment agreements that (to a large extent) differentiates this form of agreement from other commercial deals. This has a significant effect on the entitlements and burdens that affect state signatories, subject to the application of international investment law, and the subsequent jurisdictional involvement of arbitration conventions, designed to resolve investment disputes. For example, Article 25 ICSID Convention, declares:

The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.50

An attempt must therefore be made to ascertain and define the parties to an investment agreement, particularly who represents the host state when the BIT or international investment agreement is signed; and the consequential effect this has on the protection of foreign investor under international investment law, when non-commercial risks become apparent and effective in the exercise of state sovereignty.

2.2.1 Host State as a Party to International Investment Agreements

The host state is a legal body that can be described as the prime subject of public international law. It possesses overall sovereign power within its territory, and by virtue thereof, in the context of this study, may enter into an investment project and contract with a foreign investor on behalf of its people and itself in accordance with a set of prescribed conditions agreed upon. Effectively, therefore, that engagement can obligate a nation.

50 Art. 25 ICSID Convention (n3)
There is no particular difficulty in determining the nature of the host state as a party to an investment agreement when it conducts contractual deals through its government. The problem arises when the signatory appears to be a more general commercial body, independent both financially and legally from the government. This is before consideration is given to the nature of its relationship as a subordinate organisation of the host state, and whether it has the capacity or authority of such a government to make agreements that may potentially bind the state. Basically, such an apparently commercial party may create obligations for the state in major financial agreements where it has questionable authority to do so. This question may be resolved by considering pertinent legal and economic criteria, and will have significant impact on the application of immunity to a state body.\textsuperscript{51}

i) Legal criteria:

This criteria applies to any entity constituted or organised under applicable law in a host state, whether or not for profit, governmentally controlled either functionally, structurally or through ownership interests, by the state; and ‘includes a corporation, trust, partnership, sole proprietorship, branch, joint venture, association, or other organisation’.\textsuperscript{52}

Where the party signing the contract has independent legal identity from the host state, under this criterion, it then follows that it should take on the full responsibility without sharing its obligations with the state. As a result, the host state should not suffer any contractual responsibilities entered into because it is not a party to the contract. However, in such scenario, the host state would not share in the potential benefit derived from any signed agreement.

\textsuperscript{51} This is further examined in Chapter 6
ii) Economic criteria:

The status of being legally independent does not necessarily mean that the commercial entity does not represent the state in a legal form, where it enters into a contract committed to implementing and developing strategies of the state. In such circumstances, it would effectively be a promoter or representative of the political, economic and social interests of the state. Whilst it would appear to have an independent legal character, it is subordinate to the authority of the host state, which would guide and supervise in issues relating to capital or business management. This would make it difficult to differentiate the contracting party from the state, and as a result, the state will generally be expected to bear part of the responsibility if the commercial entity does not meet its contractual obligations to the foreign investor.

The practical and legal importance of the differentiation is the attribution of compensatory responsibility for wrongful acts which may be caused by an organ of the state, and whether this may cause adverse consequences to the state itself in terms of the creation of responsibility under contractual obligation or customary international law. There are indeed several state and commercial bodies involved in international transactions that can potentially bind the state itself.

A) Host State’s Provinces and Municipalities

Provinces and municipalities form territorial subdivisions of the host state that are controlled by the state and considered as subdivisions of the national host state. In the context of investment treaties, protections negotiated may only apply to the law of such specific regions. Article 23(1) of the Energy Charter Treaty (ECT), for example, provides for the observance of the treaty by sub-national authorities:

Each Contracting Party is fully responsible under this Treaty for the observance of all provisions of the Treaty, and shall take such reasonable measures as may be available to it to ensure such observance be regional and local governments and authorities within its Area.53

Arbitral tribunals have also as a matter of course decided that central governments are to be held responsible for the actions of its territorial units. The tribunal in *Vivendi I* case stated:54

[…] it is well established that action of a political subdivision of federal state, such as the Province of Tucuman in the federal state of Argentine Republic, are attributable to the central government. It is equally clear that the internal constitutional structure of a country cannot alter these obligations.55

This reflects the principle of dependency of provinces and municipalities on the central governance of the host state itself. The result is that there should not be a separation of responsibility for the actions of sub-national bodies from the host state itself in dealings with foreign investors and this has a significant impact in the activation of ICSID jurisdiction when a dispute occurs.

**B) Host State Governmental and Semi-Governmental Organs and Representatives**

In order to achieve development potential and to fulfil its economic strategies, a host state may seek to conclude numerous agreements with foreign investors. This will generally be effected directly through one of its official delegates as a representative of the country: this may include the head of state, the prime minister or any minister with the appropriate authority. The binding of the state will often be legislatively decided, and expressed specifically, a revealing example being that of the Republic of the Maldives:

All foreign nationals investing in tourism shall sign an agreement with the Ministry of Tourism. Similarly those investing in all other sectors shall sign an agreement with the Ministry of Trade and Industries. This agreement in respect of the investment shall set out the terms and conditions and the manner of implementation of the investment scheme and programme.56

The International Law Commission (ILC) draft article on state responsibility includes legislative, executive and judicial organs of the state, or indeed those with “any other function” as being capable of binding the state in its dealings. Clarity is expressed in

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54 *Compañía de Aguas del Aconquija, S.A. and Compagnie Générale des Eaux v Argentine Republic* ICSID Case No. ARB/97/3 Award 21 November 2000
55 ibid Para 49
56 Art. 3 Law No. 25/79 Law on Foreign Investment in the Republic of Maldives
Article 4(2): ‘An organ includes any person or entity which has that status in accordance with the internal law of the State’. The ILC draft on state responsibility avers:

The generic term ‘entity’ reflects the wide variety of bodies which, though not organs, may be empowered by the law of a State to exercise elements of governmental authority. They may include public corporations, semi-public entities, public agencies of various kinds and even, in special cases, private companies, provided that in each case the entity is empowered by the law of the State to exercise functions of a public character normally exercised by State organs, and the conduct of the entity relates to the exercise of the governmental authority concerned.

Agreements may also be concluded indirectly by a sub-governmental or governmental entity. Sub-governmental is used to reflect a decentralising shift of authority from central (federal) government to a local body such as an individual state, province or district. Article 25(1) ICSID Convention includes these agencies with the description ‘any constituent subdivision or agency of a Contracting State designated to the Centre by that State’. In the Azurix v Argentina case, the tribunal relied on Customary International Law principles, incorporated by the ILC Articles on state responsibility, holding that

The responsibility of States for acts of its organs and political subdivisions is well accepted under international law. The Draft Articles [...] are the best evidence of such acceptance and as such have been often referred to by international arbitral tribunal in investor-State arbitration.

Representation of the host state in commitments with investors must be determined from the circumstances in which the Acts of State organs are to be attributed to the state under international law. The ILC approves of this view and states

The conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organisation of the

57 ibid Art. 4(2)
58 ibid Commentary (2)
60 Muthucumaraswamy Sornarajah, The Settlement of Foreign Investment Dispute, (Kluwer Law International 2010) 86
61 Azurix Corp. v Argentine Republic ICSID Case No. ARB/01/12 Award 14 July 2006 Para 50
62 ILC Draft Articles on Responsibility of States for Internationally Wrongful Acts, with Commentaries 2001
State, and whatever its character as an organ of the central Government or of a territorial unit of the State.\textsuperscript{63}

The term ‘conduct’ in the context of state responsibility has a broad meaning, whereby the signing of investment contracts or treaties by a part of the host state apparatus is considered to be an act of the host state itself.

This considerably widens the scope of parties who may bring international obligations into the realm of state responsibility, whether legislators, ministries of the executive or judges. It becomes detrimentally wide when civil servants of a somewhat lesser status, in any part of the government sphere, can, according to Article 4(1), potentially bind the state as a result of their conduct and interaction with foreign investors. For the sake of completeness, even semi-governmental authorities or ‘parastatal’ bodies (which are owned or controlled by the government), are included by the ILC, who argue that

The justification for attributing to the State under international law the conduct of ‘parastatal’ entities lies in the fact that the internal law of the State has conferred on the entity in question the exercise of certain elements of the governmental authority.\textsuperscript{64}

This means any ‘entity’ which exercises elements of governmental authority is considered to be a part of that state and thus is a representative of it in transactions with the foreign investors when it signs an investment contract. This gives rise to the question of whether commercial corporations in which the state has an interest or control are also included in the state ‘entity’ definition.

\textbf{C) Host State Corporations}

Host state corporations play an important role in developing countries, ensuring that profitable sectors of the economy are operated for the benefit the state, by directing revenue from private companies into the state treasury for the nation as a whole.\textsuperscript{65}

Such corporations will generally have monopoly commercial control in sectors traditionally attractive to multinational companies, particularly in the realm of natural

\textsuperscript{63} ibid Art. 4(1)
\textsuperscript{64} ibid Commentary (5)
\textsuperscript{65} Sornarajah (n60) 64
resources. Often multinational businesses can only gain access to countries through host state legislations and by a joint venture agreement.66

Note should be taken of the ILC Draft Article on Responsibility of States for Internationally Wrongful Act, which stated that:

The conduct of a person or entity which is not an organ of the State under Article 4 but which is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance.67

The status of such a corporation does not appear to be equal to a person or entity working as a governmental or semi-governmental entity of the host state; it may however be empowered by the host country legislature or executive, under domestic law, to exercise governmental authority within the remit of its business area.68 In that sense it can be viewed as an organ of the state, and thus part of the apparatus established for financial and commercial purposes. Difficulties may arise in the identification of a corporation as the property or an organ of the state, and in the event of a dispute its capacity to bind the state is decided on a case by case basis by the adjudication tribunal.

2.2.2 The Foreign Investor as a Party to International Investment Agreements

The foreign investor acting as a party to international investment agreements is a natural or legal person or entity. The designation of ‘foreign’ refers to the national origin of the party, in order to differentiate it from the nationality of the host state with whom it is contracting. Article 25(2) of the ICSID Convention should be considered in detail, where it refers to the foreign investor as:

(a) any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered pursuant to paragraph (3) of Article 28 or paragraph (3) of Article 36, but does not include any person who on either

66 ibid
67 Art. 5 Draft Articles: Wrongful Acts 2001 (n62)
date also had the nationality of the Contracting State party to the dispute; and (b) any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.  

It is a basic principle of ICSID jurisdiction that parties entitled to the protection of their investment are clearly identifiable, and that the ‘foreign investor’ hails from another contracting state, and possesses a nationality other than that of the investment host state, which is a party to the ICSID tribunal dispute. It can be either a natural or legal person, individual or corporation.

i) Natural Persons as Foreign Investor

Where a natural person is investing in a host state, their nationality, citizenship or domicile will determine whether they are protected by the specific investment agreement or treaty, and are thus entitled to utilise the dispute resolution procedures provided by it against the host state. This is reflected in Article 4 of the ILC Draft Articles on Diplomatic Protection 2006, concerning the issue of the nationality of a natural person:

For the purposes of the diplomatic protection of a natural person, a State of nationality means a State whose nationality that person has acquired, in accordance with the law of that State, by birth, descent, naturalization, succession of States or in any other manner, not inconsistent with international law.

Customary international law adopts the criteria of citizenship as a benchmark to determining the nationality of the natural investor; an approach adopted by numerous international conventions and treaties. Article 13(a)(i) of the Convention of the Multilateral Investment Guarantee Agency (MIGA), a subsidiary of the World Bank, defines ‘investors’ as a category of natural persons eligible for its political risk

69 Art. 25(2) ICSID Convention (n3)  
71 Art. 4 Draft Articles; Diplomatic Protection 2006
insurance coverage, a ‘national’ of a member state. The Agency provides insurance to eligible foreign investors against political risks such as host state expropriation, war and civil disturbance, or failure to honour sovereign obligations under contract. Some BITs tend to have the same approach: for example, the treaty between Switzerland and Pakistan refers to the term ‘investor’ in the context of natural persons as nationals of either contracting state,\(^\text{72}\) as do those between the United States and Uruguay,\(^\text{73}\) and Korea and Japan.\(^\text{74}\)

An issue of some concern arises when a foreign investor establishes a company in the host state, where said company becomes deemed a company of the host state under its regulations and law. The individual foreign investor will hold the national identity of a different state and yet have an interest in a company on the territory of the host state; this is not so much of a problem for dispute adjudication when the natural investor holds nationality elsewhere; the difficulty arises when the investor holds nationality for both the host and foreign states. The conundrum that arises for investment protection purposes is the ‘choice’ of nationality made by the investor and its impact on the availability of ICSID jurisdiction. The issue of dual nationality and its effect on foreign investors and their rights needs more detailed examination.

A) International Law and Determining the Nationality of the Natural Investor - the Nottebohm Case 1955 and the Real and Effective Link Test

The Nottebohm case came before the International Court of Justice (ICJ) in 1955, becoming a case of some note in international law on the investor’s nationality issue.\(^\text{75}\) Nottebohm emigrated to Guatemala, and later acquired numerous investments there; and on the commencement of the Second World War was purported to relinquish his German citizenship; adopting the nationality of neutral Liechtenstein

\(^{72}\) Art. 1 Agreement between the Swiss Confederation and the Islamic Republic of Pakistan Concerning the Reciprocal Promotion and Protection of Investment (Swiss–Pakistan BIT) 11 July 1995

\(^{73}\) Art. 1 Treaty between the United States of America and the Republic of Uruguay Concerning the Encouragement and Reciprocal Protection of Investment, (United States–Uruguay BIT) 7 September 2004

\(^{74}\) Art. 1(1)(a) Agreement between the Government of the Republic of Korea and the Government of Japan for the Liberalization, Promotion and Protection of Investment (Korea–Japan BIT) 22 March 2002

\(^{75}\) Nottebohm case (Liechtenstein v Guatemala) I.C.J. 4 Second Phase, Judgment of 6 April 1955 - hereafter cited as ‘Nottebohm case’
despite never having established a residence there. In 1943, Guatemala classified him not as neutral, but as a German citizen and subsequently classed him as an ‘enemy alien’. As a consequence, he was deported to the United States and Guatemala treated his assets as enemy property.\(^76\)

Liechtenstein brought an ICJ claim on behalf of Nottebohm against Guatemala after the war, arguing that he should have been regarded as a citizen of non-combatant, neutral Liechtenstein, and not treated as an enemy alien. In a definitive judgement, the ICJ stated that: ‘international law leaves it to each State to lay down the rules governing the granting of its own nationality’.\(^77\) However in the circumstances of this particular series of events, notably the absence of any ‘real prior connection’ between Nottebohm and Liechtenstein; and the ‘exceptional circumstances of speed and accommodation’ in which Liechtenstein furnished him with a passport, Guatemala was not required to recognise Nottebohm’s Liechtenstein citizenship.\(^78\)

Nottebohm has long been a benchmark decision in the determination of nationality. The Iranian revolution and consequent deprivation of investor assets led to a tribunal being established in Algeria in 1981 to deal with claims for compensation; with the interests of the citizens of both states to be included.\(^79\) The Claims Tribunal addressed whether a dual Iranian-American national could be regarded as a United States national, notwithstanding their Iranian citizenship, and would thus be entitled to the international protections afforded to a foreign investor. In support of their contention, those with dual nationality argued that Nottebohm created a permissive form of doctrine, enabling the Tribunal to disregard the Iranian nationality. The rationale argued was that such individuals had a more genuine and effective connection with the United States than with Iran. The Tribunal in this matter, known as Case 18, accepted this argument and held that it


\(^{77}\) Nottebohm case (n75) 23

\(^{78}\) ibid 26

[H]ad jurisdiction over claims against Iran by dual Iran-United States nationals when the dominant and effective nationality of the claimant during the relevant period from the date the claim arose until 19 January 1981 was that of the United States.\(^{80}\)

In addition, ‘Real and Effective Nationality’ was the terminology adopted in the Mergé case.\(^{81}\) It found that nationality was measurable by an individual’s circumstances, such as ‘habitual residence, his participation in public life, attachment shown by him for a given country and inculcated in his children’.\(^{82}\) The Nottebohm case was decided under customary international law, connecting the nationality of the natural investor and applying the “real and effective link” test. It is worth examining whether the ICSID convention applies the same test to those natural investors holding more than one nationality.

B) Nationality of Natural Investors under the Perspective of the ICSID Convention

The rule governing determination of a natural investors’ nationality in ICSID cases is Article 25(2)(a) of the ICSID Convention, which defines ‘national of another contracting state’ as:

> Any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration […] but does not include any person who on either date also had the nationality of the Contracting State party to the dispute […].\(^{83}\)

It specifically bars claims brought by an individual who is a dual national of the host state and the home state; the term ‘other than the State party’ is clear on this issue. However, the Convention does not routinely prevent claims from those holding more than one nationality. In the Olguin case, the ICSID tribunal upheld jurisdiction in a claim brought under the Peruvian-Paraguayan BIT, by a claimant who possessed dual

\(^{80}\) Decision Concerning Jurisdiction over Persons with Dual Nationality (2002) 5 Iran-U.S. Cl. Trip. Rep. 265
\(^{81}\) Mergé Case, 14 R. International Arbitration Awards Italy-United States Conciliation Commission 1955 236
\(^{82}\) ibid at 244 citing Nottebohm
\(^{83}\) Art. 25(2)(a) ICSID Convention (n3)
Peruvian-American nationality. In that case, the Claimant referred to ICSID a dispute that arose from the Claimant's investment in a finance company in Paraguay. The Claimant alleged that a finance company, Mercantil SA de Finanzas, had defaulted on payment of investment bonds in relation to a food supply company in Paraguay, and that the Government should be regarded as a guarantor of the said investment. The Claimant invoked the provisions of the Convention between the Republic of Peru and the Republic of Paraguay on the Reciprocal Promotion and Protection of Investments of 31 January 1994.

It is curious that the ICSID arbitration did not specifically use the Nottebohm test when resolving the foreign investor dual nationality issue. The answer may be found in ICSID case law such as the Micula v Romania case, which is the most recent adjudication to address the nationality of the natural investor. Two brothers, Romanian expatriates who had applied for, and acquired, Swedish citizenship at the time of the subject investment, made claim under the Sweden-Romania BIT. One claimant had acquired citizenship lawfully through marriage to a Swedish woman. The tribunal also found that the other brother, over Romania’s objection, had also acquired citizenship under Swedish law, asserting that ‘the record [did] not include any elements which should lead the Tribunal to investigate’ suggestions that his Swedish citizenship was fraudulently obtained.

Romania sought to invoke Nottebohm’s ‘effective link’ test as a means of defeating the jurisdiction assertion, arguing that the ‘Swedish nationality of Messrs Micula is not effective and cannot be opposed to Romania because of their strong links with Romania and their lack of genuine and effective links with Sweden’.

84 Olguín v Paraguay ICSID Case No. ARB/98/5 Decision on Jurisdiction on 26 July 2001
85 Micula v Romania ICSID Case No. ARB/05/20 Decision on Jurisdiction and Admissibility 24 September 2008 Para 11
86 ibid Para 90
87 ibid Para 92-95
88 ibid Para 98
However, the Tribunal disagreed, asserting that ‘the role of a genuine or effective link with the state of nationality is disputable in public international law, and is indeed disputed, particularly in the case of a single nationality’. 89

Attempts to invoke the ‘effective link’ test were therefore unanimously rejected in this case, as Nottebohm, decided the tribunal, was a decision made on its ‘peculiar facts’ and did not support a wider application, and that more generally, ‘there is […] a clear reluctance in public international law to apply the genuine link test where only a single nationality is at issue’. 90 The facts clearly demonstrated that the brothers only possessed one nationality, that of Sweden, and thus the ‘effective link’ test of Nottebohm did not apply. The tribunal considered obiter dictum, that even if it did apply to the facts in theory; in practice, according to the ICSID Convention, and indeed the specific provisions of the treaty between Romania and Sweden, the operation of the test was excluded; they provided criteria for determination of nationality, and there was no basis for superimposing a ‘genuine link’ test. 91

In the Champion Trading v Egypt case, 92 the complainants operated a cotton company in the defendant state territory, and asserted that Egypt had unlawfully expropriated their interest. They claimed to be American citizens and thus sought protection as foreign nationals under the ICSID Convention under the bilateral investment treaty between the US and Egypt. In reality, the three complainants (who were siblings), held dual Egyptian and American nationalities. Whilst they may have been born and raised in America, their Egyptian father accorded them automatic citizenship of his home nation, and as such they would not be entitled to international protection against the actions of their own state. For this reason, their claims of American nationality were challenged by Egypt, who argued that they had no standing to bring the allegations to the international tribunal, being barred by Article 25(2)(a) of the ICSID Convention. The brothers sought to prevent the application of Article 25(2)(a), citing both Nottebohm’s ‘effective link’ test and the Iran-United States Claims Tribunal Decision in Case 18. They asserted that their automatic citizenship of Egypt, gained

89 ibid Para 99
90 ibid
91 ibid Para 100-101
92 Champion Trading Co v Egypt ICSID Case No. ARB/02/9 Decision on Jurisdiction 21 October 2003
through their father, should be discounted because their ‘effective nationality’ was their actual place of birth.\(^\text{93}\) The tribunal, somewhat surprisingly, rejected this argument; ruling that Nottebohm and Case 18 principles regarding issues of dual nationality did not apply where the ICSID had jurisdiction, because the Convention incorporated ‘a clear and specific rule regarding dual nationals’.\(^\text{94}\) Effectively, the cases had not been adjudicated upon in the context of the ICSID Convention, and could not be used as authorities. In order to avoid potential criticism of the Convention, the ICSID needs to ensure that individuals with legitimate dual nationality, and strong claims thereto have the right to be protected against the host state’s action within the ICSID arena.

The issue of dual nationality, where one of the states involved is party to the dispute, is thus potentially a major problem facing the natural investor. The status as a foreign investor, of a ‘legal personality’, such as a company or other commercial organisation in a host state, requires further analysis, given the complexity of the problem of determination, particularly in the realm of multi-national trade.

**ii) Legal Person as a Foreign Investor**

It has been noted that a number of theories have evolved in an attempt to resolve nationality questions and criteria arising from descriptions of the parties and the definition of their status as foreign investors. The level of complexity increases where the determination involves the nationality of legal persons, usually companies.\(^\text{95}\) The examination of status is particularly important, given that the foreign investment laws of states often require that investment entry must be made through a locally incorporated company in the host state. The states where such investment requirements apply, generally require their own nationals to hold over 51% of the shares in the established corporation. Such regulations would make the company into which the foreign investment had been staked, a corporate national of the host state, thereby disqualifying it from international protections, and instead it would arguably

\(^{93}\) ibid  
\(^{94}\) ibid  
\(^{95}\) Christoph Schreuer, *Shareholder Protection in International Investment Law* (2005) Transnational Dispute Management 34
be subject to local law. It has therefore been necessary to devise a means of protection for the locally incorporated vehicle that comprises, at least in part, of the foreign investment.  

Theories and tests of the nationality of ‘legal persons’ formulated in international customary law are discussed by Judge Jessup in the Barcelona Traction case.

[T]here are two standard tests of the “nationality” of a corporation. The place of incorporation is the test generally favoured in the legal systems of the common law, while the siege social [‘real seat’ theory] is more generally accepted in the civil law system.

To those may be added a third, the ‘control theory’. BITs may resolve the issue by broadening the nationality criteria assessment of the investment. Such treaties tend to regard the locally incorporated company as protected if it is controlled from abroad by a parent company.

In any case, the objective of a foreign investor, whether a natural or legal person, is to show that despite the amalgamation of its money with that of a host state business in a joint enterprise, the company remains foreign in terms of nationality, thus qualifying for international investment protection. An attempt must therefore be made to assess the factors that assist the tribunal in determining the nationality of legal, normally corporate ‘persons’.

**A) The Nationality of the Foreign Company, Regardless of the Shareholders’ Nationalities (Incorporation Theory)**

The prevalent theory of nationality is the incorporation test, which applies to legal entities incorporated or constituted in accordance with the laws of a particular state. This is the main process by which customary international law determines the

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96 Somarajah (n60) 324  
97 *Barcelona Traction, Light and Power Company Ltd (Belgium v Spain)* New Application 1962 Judgment of 5 February 1970 separate opinion of Judge Jessop  
98 ibid Para 39 (emphasis added)  
100 ibid  
nationality of legal persons. It is frequently utilised by states who operate a system of common law and reflected in it are regulations governing international investments and BITs: and corporations can therefore be protected under a bilateral investment treaty, binding its home state and the host state.\textsuperscript{102} This theory has also been adopted by MITs; Article 7 of the ECT states that ‘Investor’ means: (ii) a company or other organization organized in accordance with the law applicable in that Contracting Party.’\textsuperscript{103}

Article 9 of the United Nations Draft Articles on Diplomatic Protection also refers to the ‘incorporation theory’. It maintains that for the purposes of the diplomatic protection of a corporation, the State of nationality means the State under whose law the corporation was incorporated’.\textsuperscript{104}

The International Court of Justice adopted this position on incorporation as proof of national identity in the \textit{Barcelona Traction} case,\textsuperscript{105} where the shareholders of a foreign corporation could not be protected by their home state of Belgium, this being the duty of Canada, the company’s state of incorporation.

In the \textit{Tokios Tokeles v Ukraine} case,\textsuperscript{106} a company incorporated in Lithuania alleged violations by Ukraine of the Lithuania-Ukraine BIT. Two Ukrainian nationals owned 99% of shares in a Lithuanian company, which was managed by one of them. The issue of the nationality of the company, and therefore the jurisdiction of the tribunal to adjudicate on the dispute, was challenged by Ukraine.\textsuperscript{107} Their argument was that the purpose of the BIT was to protect foreign investors and not nationals of the host state; and ICSID jurisdiction only arose where there was a dispute between a state and a foreign national, with the Ukrainian owners not so designated.\textsuperscript{108} However, the tribunal looked at the nationality of the ‘legal person’, namely the corporation, as the

\textsuperscript{102} Canada Model Foreign Investment Promotion and Protection Agreement (2003), Art. 1 Definition of “Enterprise”; United States Model Bilateral Investment Treaty (2004), Art. 1; Agreement for the Promotion and Protection of Investment (UK–Lebanon BIT) 16 February 1999 Art. 1, 1(b); and see Michael Waibel, \textit{The Backlash against Investment Arbitration: Perceptions and Reality} (Kluwer Law International 2010) 7
\textsuperscript{103} Art. 7 (ECT) (n53)
\textsuperscript{104} Art. 9 Draft Article: Diplomatic Protection 2006 (n71)
\textsuperscript{105} \textit{Barcelona Traction Case} [1970] (n97) ICJ Reports 3
\textsuperscript{106} \textit{Tokios Tokeles v Ukraine}, ICSID Case No. ARB/02/18 Decision on Jurisdiction 29 April 2004
\textsuperscript{107} ibid Para 42
\textsuperscript{108} Sornarajah (n60) 328
claimant, who was held to be a foreign investor under the treaty, and that the ‘claimant is a thing of real legal existence that was founded on a secure basis in the territory of Lithuania’.  

The ‘incorporation’ criterion was utilised by the Arbitration Committee in the Amco v Indonesia case. The claimant was titled ‘Indonesia P.T Amco’, a legal entity which had a base in Indonesian territory, and which was established under Indonesian law. The claimants asserted that their investment in the building and management of a hotel in 1968 had been agreed by the Republic of Indonesia to last for a period of thirty years. However, the Republic seized the investment in an armed military action in 1980 and then cancelled the investment license. In the view of the Tribunal, Amco was governed by the law of the state of Delaware, as this was the state of incorporation.

The ‘incorporation test’ appears simple in its utility. A joint venture company may be established on the territory and in accordance with the law of the host state. The nationality of that ‘legal person’, formed in the mixing of foreign and domestic investment, can be determined by looking to the state in which it is incorporated, largely through the examination of its memorandum of association or other such evidence. International investment protection can then be claimed by invocation of the appropriate BIT agreed between the incorporation home state and that of the investment host.

A rather astute litigation tactic has been occasionally implemented by companies, where in the case of a dispute it would seek to ‘migrate’ its nationality status from a country which is not a signatory to a BIT with the host state, to another which has; in pursuit of international protection. The Agus del Tunari v Bolivia case involved a consortium of companies involved in a project to supply and operate water and sewage utilities for a city in Bolivia. Agus del Tunari therefore belonged to a complex corporate chain, with its founding stockholder an American company,

109 Tokios Tokeles (n106) Para 30
110 AMCO v Republic of Indonesia, ICSID Case, Resubmitted Case Decision on Merits 10 May 1988
111 Ibid Para 1-8
112 Ibid Paras 104–109
113 Agus del Tunari v Bolivia, ICSID Case No ARB/02/3 Jurisdiction Award 21 October 2005
Bechtel Enterprises Holding Ltd. *Bechtel* in turn owned a company called *International Water Ltd.*, incorporated in the Cayman Islands, which owned 55% of *Agus del Tunari*.\(^{114}\) In the course of a corporate restructure, the holding company ‘migrated’ its nation of incorporation from the Cayman Islands to Luxembourg, and was controlled by a company incorporated in the Netherlands. In the event of an investment dispute with Bolivia, *Agus del Tunari* argued that it was now protected by the Netherlands -Bolivia BIT because it was directly or indirectly controlled by a Dutch corporate national.\(^ {115}\)

At the time of the actual investment, the claimant was a Bolivian corporate national controlled by a Cayman Islands company. It was not therefore protected under the United Kingdom-Bolivia BIT because UK treaties do not generally extend to the Cayman Islands, which is a British dependent territory where companies find it useful to incorporate for taxation purposes. It should be noted that the migratory restructuring from Luxembourg to the Netherlands occurred after the dispute with Bolivia arose so that the protections of the Dutch investment treaty with Bolivia could be invoked. However, the tribunal, by a majority, rejected the argument of Bolivia that the migration was a fraudulent device to secure jurisdiction under the treaty with Netherlands. It also rejected the contention that the controlling company was actually American and that the Dutch company was inserted into the structure merely to obtain jurisdiction.\(^ {116}\) The ‘state of incorporation’ test proved a simple device to ascertain jurisdiction and protection in a complex corporate structure.

The tribunal in *Wena Hotels v Egypt* held that a company incorporated in the United Kingdom could bring a case against Egypt for violation of the UK-Egyptian BIT, even though the British company was owned and controlled by an individual who was an Egyptian national.\(^ {117}\) In contrast, the *Banro v Congo* case saw migration of the nationality of incorporation of the claimant company from Canada to the United

\(^{114}\) ibid Para 70  
\(^{115}\) ibid Para 69  
\(^{116}\) ibid Para 207  
States, when the former was not at the time a party to the ICSID convention.\textsuperscript{118} The migration was carried out post dispute and immediately prior to the institution of the claim, so that ICSID jurisdiction could be obtained. The tribunal denied jurisdiction in these circumstances, as the ‘legal person’ was rather too obvious in circumventing restrictions on protection.\textsuperscript{119}

**B) Controlling Shareholders’ Nationality (The Control Theory Test)**

This test aims to determine corporate nationality according to that of controlling shareholders.\textsuperscript{120} According to Schreuer, the control theory test originated as a concept in customary international law following World War One, as a result of concerns over pre-war German economic penetration into the economies of the Allied States.\textsuperscript{121} Its primary purpose at inception was the determination of the nationality of corporations, in order to ascertain if they were of ‘enemy character’,\textsuperscript{122} with the problem to be identified was whether real control over ostensibly domestic companies was in foreign hands.\textsuperscript{123} The test is now utilised to determine the nationality of corporation, in order to ascertain whether it is protected by the apparent home state of its owners (where that is identifiable), or if it is actually incorporated in the host state with whom it is in dispute. In the *Elettronica Sicula SpA (ELSI)* case,\textsuperscript{124} the ICJ accepted the claim of international investment protection by foreign shareholders based on their personal nationality, rather than the state where the actual business was incorporated. The ‘nationality’ of the company was indeed that of the host state, so this finding meant shareholders were not deprived of protection.\textsuperscript{125}

\begin{itemize}
  \item \textsuperscript{118} *Banro American Resources, Inc. and Société Aurifère du Kivu et du Maniema S.A.R.L. v Democratic Republic of the Congo*, ICSID Case No. ARB/98/7 Award on 1 September 2000
  \item \textsuperscript{119} ibid Para 26
  \item \textsuperscript{121} Schreuer and others (n14) 279
  \item \textsuperscript{123} Vaughan Williams and Matthew Chrussachi, *The Nationality of Corporation* (1933) 49 Law Quarterly Review 337
  \item \textsuperscript{124} *Elettronica Sicula SpA (ELSI)* (United States v Italy), Judgment 20 July 1989 (1989) ICJ Reports 15
  \item \textsuperscript{125} ibid Paras 15, 23, 48
\end{itemize}
Article 25 (2)(b) of the ICSID Convention deals with the issue of foreign shareholders of a company incorporated in a host state, with which there is a dispute; determining nationality for the purposes of protection qualification, as available to

Any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.126

The Convention itself does not define foreign control, and is adjudicated upon in each case by the relevant tribunal. Schreuer points out that

The existence of foreign control is a complex question requiring the examination of several factors such as equity participation, voting rights and management. In order to obtain a reliable picture, all these aspects must be looked at in connection. There is no simple mathematical formula based upon shareholding or votes alone.127

The relationship between foreign control and the agreement between the parties was examined by the tribunal in the Liberian Eastern Timber Corporation (LETCO) v Liberia case. The LETCO arbitration involved a forestry concession granted in 1970 by the Liberian government to LETCO. The concession operated from 1972 to 1980, at which time, based on LETCO’s alleged shortcomings in and concern over conservation and the proper utilisation of timber resources, Liberia drastically reduced the scope of the concession, later terminating the concession entirely. ICSID arbitration was instituted, and on 31 March 1986, an award of almost US$9 million was made in favour of the claimant. As far as control theory is concerned, the tribunal found that ‘it must be presumed that where there exists foreign control, the agreement to treat the company in question as a foreign national is ‘because’ of this foreign control’.128

In the task of defining the nationality of an investor and their qualification for investment protection, the most complex test looks to the nationality of the corporate entity or legal person that has ‘control’ over the investment vehicle. This factual

126 Art. 25(2)(b) ICSID Convention (n3)  
127 Schreuer and others (n1) 327  
based enquiry necessarily relies on the parties’ concept of ‘control’, whether direct or indirect. Some BITs anticipate and address the issue of an investor with one corporate nationality, particularly where incorporation is in a third party state, but where the business is owned or operated by investors who actually hold the nationality of a party to the project contract. The ‘legal person’, or corporate investor will not be permitted to bring claims under the treaty it seeks protection from if it has already brought these claims under a treaty involving the third country.\textsuperscript{129}

However, the control theory is open to criticism. Schill argues that while the test may be feasible in simple two or three level corporate structures, but becomes increasingly difficult to apply where the company has an increasing numbers of shareholders and potentially a number of nationalities involved.\textsuperscript{130} It should be noted, however, that the criticism does not mean parties will neglect the control theory test as a basis for the definition of nationality of the corporation by the BIT or contract. The investment tribunal will then have narrow scope to define or interpret the nationality of the corporation via the other tests. Even customary international law utilises shareholder nationality as a basis for determining the nationality of a corporation. In a development of the ‘real seat theory’, Article 9 of the Draft Articles on Diplomatic Protection asserts:

\begin{quote}
When the corporation is controlled by nationals of another State or States and has no substantial business activities in the State of incorporation, and the seat of management and financial control of the corporation are both located in another State, that State shall be regarded as the State of nationality.\textsuperscript{131}
\end{quote}

The control theory must take account of the potentially diverse nationalities of shareholders, whilst the incorporation theory, in contrast, is simpler to determine and apply. However, ascertaining the national affiliation of a majority of shareholders on the presumption that investor has ‘control’ over that company is problematic, as if the foreign natural or legal person does not in fact hold the majority of the shares, only a wide definition of the term of investment in BIT can provide a remedy.

\textsuperscript{129} Agreement on the Promotion and Protection of Investment (Australia-India BIT) 26 February 1999 Art. II (3), and Agreement on the Promotion and Protection of Investment (Australia-Uruguay BIT) 3 September 2001 Art II (4) and see Waibel (n102) 8
\textsuperscript{130} Schill (n120) 235
\textsuperscript{131} See the “Real Seat Theory”
Minority shareholders, or those with an actual influence on the management of the corporation can also receive protection in a properly drafted BIT utilising the control test.\textsuperscript{132} In the \textit{Vacuum Salt v Ghana} case, the claimant shareholder owned only a fifth of the shares in the aggrieved company.\textsuperscript{133} In principle, no specific proportion of share ownership is stipulated by a tribunal, in order to constitute or establish control by a foreign investor that would qualify an application to an international tribunal to resolve a grievance. It is clear that one hundred per cent share ownership ‘almost certainly would result in foreign control, and that a total absence of foreign shareholding would virtually preclude the existence of such control’.\textsuperscript{134} The denial of jurisdiction to the claimant, a Greek national, was based on the finding that he had a more technical than administrative role in the company, and so he was ‘not capable of strongly influencing critical decisions on important corporate matters’.\textsuperscript{135}

C) The Headquarters Criteria or Real Seat Theory (Siège Social)

The headquarters criteria, otherwise known as the siège social theory (meaning real or effective ‘seat’), refers broadly to the main management centre of the foreign investor; including where the major controlling decisions are made, the financial administration is undertaken and where the general assembly of company operations and other administrative or technical authorities lie. In this determination of corporate nationality, the seat of management of the company is a decisive factor and it must be able to show a functional connection in order to be viewed as a company of that state.

In the \textit{Tokios Tokeles v Ukraine} case, the reasoning of the tribunal concluded

\begin{quote}
In our view, the definition of corporate nationality in the Ukraine - Lithuania BIT, on its face and as applied to the present case, is consistent with the Convention and supports our analysis under it. Although article 25(2)(b) of the Convention does not set forth a required method for determining corporate nationality, the generally accepted (albeit implicit) rule is that the nationality of a corporation is determined on the basis of its siège social or place of incorporation.\textsuperscript{136}
\end{quote}

\begin{flushright}
\textsuperscript{132} Albath (n99) 173
\textsuperscript{133} \textit{Vacuum Salt Products Ltd. v Republic of Ghana}, ICSID Case No. ARB/92/1 (1997), 9 ICSID Review Foreign Investment Law Journal 73
\textsuperscript{134} ibid Para 43
\textsuperscript{135} ibid Para 55
\textsuperscript{136} \textit{Tokios Tokeles} (n106) Para 42
\end{flushright}
Nevertheless, state parties can decide the definition of the nationality of a corporation within the BIT and indeed mix the criteria of the incorporation, control and real seat theories in their determination. Article 1(2) of the China-Portugal BIT brings together elements of the incorporation and siege social tests.\(^\text{137}\) In respect of Portuguese nationality, an ‘investor’ is deemed to mean ‘legal entities, including companies, associations, partnerships and other organizations, incorporated or constituted under its laws and regulations and have their seats in Portugal’.\(^\text{138}\) Article 1(b) of the Netherlands-Venezuela BIT amalgamates the control, incorporation and siege social analyses, asserting that ‘nationals’ are

ii. legal persons constituted under the law of that Contracting Party; iii. legal persons not constituted under the law of that Contracting Party but controlled, directly or indirectly, by natural persons as defined in (i) or by legal persons as defined in (ii) above.\(^\text{139}\)

It is not only the BIT that determines the nationality qualification of the legal person. National laws of the host state may define the nationality of the foreign investor whether natural or legal. Such investment laws may consist of several criteria in one piece of legislation, an example being the foreign investment law of the Republic of Montenegro. Article 2 describes the foreign investor as a (i) foreign legal entity whose headquarters are abroad, (ii) foreign citizen, (iii) Yugoslav citizen whose residence or stay abroad is longer than one year, (iv) company with over 25% foreign capital; or (v), a company established or founded by a foreigner in the republic.\(^\text{140}\) Moreover, it is a sovereign right of the state to choose its own criteria to define the foreign investor nationality.

Each of the theories has their own unique components that differentiate it from the others, although the parties to an agreement or BIT may wish to choose one or all of them to determine the nationality of the foreign corporation. If they do not, the arbitral tribunal of the ICSID will, using wide discretion to define the nationality of

\(^{137}\) Agreement between the Peoples Republic of China and the Portuguese Republic on the Encouragement and Reciprocal Protection of Investments (China-Portugal BIT) 4 February 2010

\(^{138}\) ibid Art. 1(2)

\(^{139}\) Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Republic of Venezuela (Netherlands–Venezuela BIT) 22 October 1991

\(^{140}\) Art. 2 Foreign Investment Law in Republic of Montenegro
the foreign corporation. It will base this decision on argument, evidence and proof presented by litigants seeking to advance their particular position.

2.3 Conclusion

This chapter has sought to determine the constitution of an international investment agreement, and the types of foreign investor and host state parties to it. The discussion of these basic, but essential, concepts is a vital precursor to the consideration of the issues that will tackled in this research in the coming chapters. The host state, as a party to an investment agreement, is unlike any other commercial entity, given the sovereign jurisdiction it has over its own territory in which the investment project operates. This gives it a considerable influence and authority that is not available to even the largest of commercial investors. An investment commitment between the host state and the foreign investor can generate a mutually fruitful relationship, but can also result in considerable financial loss as a result of any unreasonable behaviour on the part of the host state.

There are two elements to any international agreement: national private law involving the direct host state and investor in an investment contract; and international law in the case of BIT between states. Both involve the host state as a party, with the former joining the foreign investor alone, the latter a foreign investor and their home state. This gives rise to investor nationality issues, and customary international law has been developed to resolve this in the case of the natural investor; for example, in the Nottebohm case, with its ‘effective link test’, and the Barcelona Traction case, where the ICJ gave support to the ‘incorporation theory’ for corporate ‘legal persons’. International investment law has resulted in the adjudication of nationality for both the natural and legal investor under the ICSID jurisdiction. There is significant interaction between both bodies of law, although the findings may not concur.

This may be due to distinctions in the principles they are based upon. Customary international law is typically defined as a ‘general and consistent practice of states
followed by them from a sense of legal obligations’, 141 with treaties often used as evidence of its application. 142 These treaties are express promises, embodied in written form, often with a built-in dispute resolution mechanism through the international courts. This body of law is said to originate from the decentralised practice of nations; and Goldsmith and Posner assert, in answer to questions regarding its existence, that nations utilise international courts, such as the ICJ as well as international treaties entered into under its auspices. ILC Draft Articles and academic research and opinion also provide convincing evidence of this. 143 International Investment Law, however, is now the main regulator of practices between host nations, foreign investors and their home state. This body of law is made up of ICSID decisions, BIT adjudications and MITs, such as the NAFTA, CAFTA and ASEAN, seeking to ensure some protection to foreign investors against the arbitrary practices of host states.

As an example to clarify this issue, the Mondev International Ltd v United States of America case concerned a dispute involving a Boston mall and Canadian real estate developer. The Canadian subsidiary had been successful in the trial, but not in the state appellate court. It therefore utilised the NAFTA investment chapter to pursue its claim against the USA, requiring the tribunal to seek definition of the differences between and relative authority of customary international and international investment law:

The term ‘customary international law’ refers to customary international law as it stood no earlier than the time at which NAFTA came into force. It is not limited to the international law of the 19th century or even of the first half of the 20th century, although decisions from that period remain relevant. In holding that Article 1105(1) refers to customary international law, the [Federal Trade Commission] FTC interpretations incorporate current international [investment] law, whose content is shaped by the conclusion of more than two thousand bilateral investment treaties and many treaties of friendship and commerce. Those treaties largely and concordantly provide for ‘fair and

142 Draft Articles: Wrongful Acts 2001 (n62) 52(5)
143 Goldsmith and Posner (n141) 1117
...equitable’ treatment of, and for ‘full protection and security’ for, the foreign investor and his investments.\textsuperscript{144}

The final remarks in the quote above encapsulate the current view that carefully defined treaties provide the main source of protection for the investor.

In Chapter Three, an attempt will be made to clarify the fields in which a state uses its sovereign powers and thereby affecting foreign investments on its territory. In doing so, it is necessary to define the meaning of ‘state sovereignty' in the context of the operation of the investment agreement and the relationship with non-commercial risks undertaken by an investor when committing to a project on sovereign territory. This chapter will seek to explain why customary international law and international investment law seek to protect foreign investments rather than the local investor in the host state. As has been shown, the sovereign powers of a host state can have a significant effect on the operation of an investment, and it is useful to consider the situation when such authority is not used in a positive manner.

\textsuperscript{144} Mondev International LTD v United States of America, ICSID Case No. ARB(AF)/99/2 Award 11 October 2002 Para 125 (emphasis added)
Chapter Three

State Sovereignty and the Challenge to Foreign Investments

This chapter will try to provide an explanation of the term ‘state sovereignty’ and to discuss the extent of its influence in the relationship between a host state and a foreign investor. Decisions made by host states using the authority of its sovereignty emerge from a concern to protect national independence, particularly regarding matters of territorial integrity. However, and as explained in the previous chapter, the sovereign powers of a host state can have a significant effect on the operation of an investment when such authority is not used to address legitimate concerns.

3.1 The Scope of Territorial Sovereignty: General Overview

State sovereignty has been defined as a country’s right and capacity to make authoritative decisions over its territory, without having to answer to any higher authority. It is commonly exercised by a ‘constitutionally recognised body acting on behalf of the state’, namely the government. The powers conferred by sovereignty include the structure of political, economic, social and cultural systems, and formulation of foreign policy. However, the freedom of decision-making is not unlimited, due to the impact of international relationships, alliances and trade; along with modern communications. The development of international law has had a profound effect on the utility of state sovereignty, given the fact that its application contains a considerable voluntary element.

Contemporary international system of sovereignty can be traced back to the treaties of Westphalia in 1648, when the major European powers of the time, after a protracted and expensive series of wars, gathered in Germany to agree to respect the

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146 International Development Research Center (IDRC), *The Responsibility to Protect: Research, Bibliography, Background, Supplementary Volume* (International Commission on Intervention and State Sovereignty 2001) 6
147 ibid
territorial integrity of signatory nations. The principle of state sovereignty proposes that states, whether monarchy, principality or republic, has the sole authority upon its territory and is not subject to the jurisdiction of any supranational power. As a result, host states and their governments, in their interactions with foreign investors, therefore enjoy considerable freedom in the operation of their territory, as a customary principle of international law. This principle also encapsulates, by virtue of sovereignty, the right to control entry and exit of persons and things in respect of the state terrain, and to regulate the activities of nationals or foreign persons and companies within their borders.149 In the context of international investment agreements and trade, this enables a state to decide whether or not, depending on its own perceived interests, to allow foreign nationals or companies to establish or acquire enterprises, or accept investment within its territory.150 This raises the question of the capacity and basis upon which the authority conferred by sovereignty is exercised, and the extent of limitations placed on the principle of absolutism in the modern international arena.

A potential answer is contained in Chapter II of the Charter of Economic Rights and Duties of States, and is worth quoting in full.151 Adopted by the United Nations General Assembly in 1974, Article 1 asserts that:

Every State has the sovereign and inalienable right to choose its economic system as well as its political, social and cultural system in accordance with the will of people, without outside interference, coercion or threat in any form whatsoever’ and further in Article 2, ‘Every State has the right (a) to regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities. No State shall be compelled to grant preferential treatment to foreign investment; (b) to regulate and supervise the activities of transnational corporations within its national jurisdiction and take measures to ensure that such activities comply with its law, rules and regulations and conform with its economic and social policies. Transnational Corporations shall not intervene in the internal affairs of a host State. Every State should, with full regard for its sovereign right, cooperate with other States in the exercise of the right set forth in this subparagraph.152

152 Ibid Art. 1 and 2
States may therefore assert an “inalienable right” to decide the particular method of administration of their political, economic and social system within their territory, preferably with the consent of the people, but without foreign interference. National political systems reflect many diverse styles of government, with the will of the people propounded by western democracies, either directly expressed in referenda or indirectly by representation. Monarchies may be absolute or constitutional, and dictatorships remain common in many parts of the world. The purpose of this analysis is not to differentiate between governmental forms and the consequent exercise of sovereignty, but instead to identify the effect its application has on foreign investment and investors. The host state decides the principles upon which it will operate its economic system and associated philosophy, often reflecting the political view of its system of governance. Capitalism comes in many different forms, including corporate, regulatory and free market, as does socialism, in the form of market, planned, welfare or social market principles. This too will affect the likelihood of investment.

3.2 State Sovereignty and its Relationship with Foreign Investment

The state as a party to an investment agreement is in a position of some considerable power to impose conditions that suit its sovereign interests over and above commercial considerations. As has been shown, the principle of sovereignty is outlined in Article 2 of the UN Charter of Economic Rights and Duties of States 1974, confirming that host states may regulate and supervise foreign direct investments in its territory. This includes an inherent right to supervise foreign financed projects; to, for example, ensure compliance with national laws, environmental issues as well as other domestic socioeconomic requirements. Such supervision can have a considerable influence on the operation of the investment, and thus requires further consideration.

A) The Right of Supervision

The basic principle that a host state is empowered by virtue of its sovereignty to supervise the investment project and its progress does not contradict the entitlement
of the foreign investor to manage the same. Its purpose is to ensure that the foreign investor complies with the corporate laws and regulations of the host state. Article 15 of the Foreign Investment Act in the Kingdom of Saudi Arabia, for example, asserts that ‘the Foreign Investor must abide by all regulations, rules and directives valid in Saudi Arabia together with international agreements in which it is a part thereof’. 153

Inherent in the concept of state sovereignty is the necessary supervision that ensures foreign companies realise that they are not free to behave in a manner which may harm or show disrespect for their host; and therefore are subject to the same constraints as domestic businesses.

The UN New International Economic Order (NIEO) 2009, emphasises ‘respect’ in the pursuit of economic goals by investors, and in host state oversight. 154 Article 4 of the Resolution expresses that the

New international economic order should be founded on full respect for the following principles: (d) the right of every country to adopt the economic and social system that it deems the most appropriate for its own development and not to be subjected to discrimination of any kind as a result; (e) full permanent sovereignty of every State over its natural resources and all economic activities. In order to safeguard these resources, each State is entitled to exercise effective control over them and their exploitation with means suitable to its own situation. 155

This emphasises the importance of the protection of national public interest in any investment project. A host state’s entitlement to “exercise effective control” over foreign investments includes such activities as registration, licensing, observation and inspection of corporation records, and as such is an overt and obvious expression of state sovereignty over any international investments on its land, demanding that foreign corporations work in accord with their raison d’être. Supervision allows governments to impose their particular economic principles on the commerce that they attract, and helps to ensure foreign companies comply with the political, welfare and environmental ethos of their host.

153 Art. (15) Foreign Investment Act in Kingdom of Saudi Arabia
154 The United Nations Resolution on the New International Economic Order (NIEO) 2009
155 Ibid Art. 4(d) and (e)
B) Environmental Protection and Public Health Policy

Environmental protection has a significant impact not only on an investment host state but also on the international community as a whole. Protection of the environment from pollution and other potentially environmentally damaging activities is expected of both states and investors in pursuit of their projects, especially given the relationship between environmental issues and public health. Article 19(3)(b) of the ECT defines the concept:

‘Environmental impact’ means any effect caused by a given activity on the environment, including human health and safety, flora, fauna, soil, air, water, climate, landscape and historical monuments or other physical structures or the interactions among these factors; it also includes effects on cultural heritage or socio-economic conditions resulting from alterations to those factors.  

Protections from the adverse impact of environmental harm are commonly enshrined in multilateral investment treaties, such as NAFTA and ECT; which explicitly address such concerns. Article 1114(1) of NAFTA asserts that

Nothing in this chapter shall be construed to prevent a Party from adopting, maintaining, or enforcing any measures otherwise inconsistent with this chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.  

In Paragraph 2, the agreement goes even further, verging on the imposition of a duty:

A Party should not waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor.  

This is confirmation of the authoritative powers of a participant state to put in place necessary measures to safeguard the environment.

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157 Art. 1114 NAFTA (n16)  
158 Ibid Art. 1114(2)
Article 24(2) of the ECT states that ‘Part III of the Treaty shall not preclude any Contracting Party from adopting or enforcing any measure i) necessary to protect human, animal or plant life or health’.\textsuperscript{159} However, the treaty aims to balance both the state sovereign entitlement to supervise environmental processes; and issues regarding investor interest. Article 19 asserts that

Contracting Parties agree that the polluter in the areas of Contracting Parties, should, in principle bear the cost of pollution, including transboundary pollution, with due regard to the public interest and without distorting investment in the energy cycle or international trade.\textsuperscript{160}

The parties to the ECT ‘shall accordingly […] promote market-oriented price formation and a fuller reflection of environmental costs and benefits throughout the energy cycle’.\textsuperscript{161}

State’s national laws now generally reflect concern for domestic and international environmental philosophies and their relationship with other areas of state, not least the health of its population. For example, Article 13 of the Qatar Investment Law no. 13 / 2000 states that

The foreign investor must preserve the safety of the environment against pollution, abide by all laws, regulations and instructions relating to public health and security.\textsuperscript{162}

Similar duties of protection were included in the UK’s Environmental Protection Act (1990).

However, supervision can be an onerous task for developing countries that attract international investors. Although such investment is enticing, few governments will have developed legal or technical processes to supervise or enforce environmental protection. Given the constraints imposed on investment activity by global environmental obligations, the lack of enforcement mechanisms may actually prove a considerable attraction in itself for investors who do not acknowledge their

\textsuperscript{159} ibid Art. 24(2) \\
\textsuperscript{160} ibid Art. 19 \\
\textsuperscript{161} ibid \\
\textsuperscript{162} Art. 13 of Qatar Investment Law no. 13 / 2000
importance. This does not mean that developing countries are not evolving their environmental systems in much the same manner as in the West, indeed, when environmental harm becomes evident and the health of the nation is affected due to the activities of a foreign investor, the host state will seek to contain damage as early as possible particularly where the activity may be inherently potentially harmful. This was the case in the matter of the Canadian company Agrium, which was finally resolved in 2008. The case involved a petrochemical project approved as a foreign direct investment by the Egyptian government. The project involved the production of agrochemical products, which involved the use of toxic materials prohibited on Canadian territory. The residents of the city where the plant was situated, and the Egyptian people in general raised such a level of protest that the government halted the project on the grounds of public safety. There is a clear balance to be struck between the investment a host state requires to pursue economic development, and the competing necessity of protecting the environment. Nevertheless, the state does not lack the sovereignty needed to protect its territorial environment if it conflicts with investor interest.

C) Employment and the Engagement of Domestic Employment

In the creation and operation of FDI enterprises, it is to be expected that a host state will exercise its sovereign authority in securing the employment of its domestic workforce in manufacturing, operational, technical and managerial roles. This promotes worthwhile goals of training, development and economic and social progress. According to Galavan, FDI will in principle improve local labour skills in commercial management; first, by raising productivity using better educated and trained employees with enhanced skills facilitating the capacity to compete with low cost suppliers; and secondly, managers working in multinational subsidiaries will be able to utilise their newly acquired skills in order to promote their local markets.

164 Sharif Elmusa and Jeannie Sowers, *Damietta Mobilizes for Its Environment* (21/10/2009) Middle East Research and Information Project
FDI makes provides training to the local workforce in the operation of foreign investment projects; and facilitates the transfer of skills through the use of the latest and best available technology, with the objective of enabling indigenous employees to use such scientific and technical skills in similar national companies. In pursuance of this, Article 12 of the Iraqi Investment Law, 2006; obliges foreign investors to use Iraqi nationals, who have the necessary qualifications and are capable of performing the tasks in question.\footnote{Art. 12 Iraqi Investment Law 2006}

The socio-economic benefits of any investment include the alleviation of poverty and the problems generally associated with it, including a high crime rate, lack of healthcare, malnutrition and the spread of bribery among state officials. The demand for the engagement of internal labour generates internal tax revenue, promoting welfare and indirectly stimulating growth. A foreign direct investor will also be expected to spend significantly on community development in the areas in which they operate.\footnote{Klein and others (n163) 15} The engagement of indigenous labour is another way for a host state to ensure respect for its sovereignty, and impose the interests of the nation. The message to the foreign investor is clear: they are invited and welcome, but not just for their own benefit; the host state and its people expect to be the main beneficiaries.

Nevertheless, the exercise of sovereign powers by the host state may conflict with the interests of foreign investors, and their own right to operate within the law. It is therefore useful to examine the consequences of the exercise of sovereign authority, and the effect it has on foreign investors in the operation of their projects and their relationships with their host in the next section.

3.3 The Embodiment of the Principle of State Sovereignty and Difficulties Facing Foreign Investors

It is important to analyse and understand the difficulties that may be encountered by foreign investors in developing countries; arising from the stability of state macro-policies, and to consider the effect of this on the exercise of state sovereignty. Three
key sovereign factors and their associated implications for investors will be considered. These can be summarised as (i) legislative, (ii) economic, and (iii) political.

Obstacles and challenges in the investment environment should be anticipated by foreign investors, and a lack of cohesive balance in the politics of a host state will result in the failure to attract a more cautious foreign entrepreneur; with a consequent loss of benefits to the sovereign host. Developing economies such as those of Latin America, East and Middle East Asia, Eastern Europe and Africa are obvious areas for consideration, as states in these regions have attracted substantial foreign investment over time, and yet have encountered more than their fair share of problems requiring dispute resolution.

3.3.1 The Legal Sovereignty of Host States

The pursuance of an open economic strategy requires a host state to develop its legal and political structure in a way that will attract investment; initiating measures that provide an acceptable level of stability for the investor needs and interests. In return the state can expect to achieve the economic benefit of the foreign investment project. If a state fails to adapt in this way, it will simply fail to attract investment. This study will not assess the propriety of the law of the host state; however an assumption is made that the foreign investor is comfortable with their business relationship. Focus instead will be directed at the actual and potential legal problems that can emerge in the implementation of an agreement, when principles of dispute avoidance or resolution will then apply. A sovereign state has a basic choice to make in the conduct of its affairs, which is broadly denied to a foreign investor; it can ensure fulfilment of the contractual relationship or impede its operation.

A) Legal Sovereignty of Host States and the Stabilisation Clause

Sovereign authority brings with it entitlement to the regulation of foreign investment in state territory. Article 2(a) of the ECT states that ‘every State has the right […] to regulate and exercise authority over foreign investment within its national jurisdiction
in accordance with its laws and regulations. It further asserts that ‘no State shall be compelled to grant preferential treatment to foreign investment’. BITs and investment contracts have attempted to ensure a level of equilibrium in the host state and foreign investor relationship, with the latter seeking assurance that a breach of such agreements will not occur, through regulatory change that may adversely affect their interests. This may be described as a ‘stabilisation clause’ in the investment contract or BIT, whereby the host state will agree either to no alteration in relevant laws, which would disadvantage the investor, or will confirm that necessary changes will not apply. The foreign investor must be able to expect an adequate and fair regulation system in which to practice business, without unnecessary concern for unusual risks posed by the actions of the sovereign authority; such as expropriation, nationalisation, double taxation or other forms of interference. Thus the stabilisation clause, inserted into the agreement will be sought before endorsement. The effect of the clause is somewhat ameliorated by the attitude and actions of a host state, which does not sign the agreement to suit the needs of an investor, but for its own ends. Subsequent changes in laws and regulations, in pursuit of sovereign authority or perceived national need, will mark a breach of the spirit of the agreement, and be contrary to its principles of establishment.

It is tempting to consider a stabilisation clause as an expression of preferential treatment for foreign investors, to the detriment of domestic investment. Such a term also appears to impose limitations on the sovereign authority of a host state. However, an effective stabilisation clause aims to protect investment contracts from becoming subject to adverse legislative or administrative measures post-agreement. Wolfgang highlights three formats that seek to provide stability to a foreign investors’ plans: (i) provisions affirming that investor rights will remain, regardless of subsequent legislative change; (ii) the anti-consistency rule, where the agreement will prevail

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over future regulatory change inconsistent with the contract; and (iii) incorporation and preservation of domestic law into the contract at a specific date.\textsuperscript{169}

The principle of \textit{pacta sunt servanda}, ‘an agreement must be kept’, as addressed by Article 26 of Vienna Convention on the Law of Treaties (1969), weighs against risks of instability arising from the conduct of the host state in the application of contractual provisions. This therefore, affects the inclination of foreign companies to actually invest and operate the project. Dispute arbitration case law provides numerous examples; such as the \textit{AGIP SPA (General Oil Company of Italy) v Congo} case in 1979; and the \textit{Libyan American Oil Company (LIAMCO) v Government of the Libyan Arab Republic} case in 1977; where claimants holding stabilisation clause protection still suffered the consequences of sovereign action of the host state.

\textit{AGIP SPA} and the Congolese government entered into a concession agreement in 1974.\textsuperscript{170} Article (4) thereof stated that ‘the government would not apply certain ordinances and decrees as well as all other ordinances and subsequent decrees’. This clause was designed to ensure that the state took no action to change by law the private joint stock company character of the claimant; thus prima facie protecting it from expropriation. Article (11) added:

\begin{quote}
In the event of modifications being made to the company laws, appropriate provisions would be enacted to ensure that these modifications did not affect the structure and composition of the organs of the Company provided for in the Agreement and the Articles of the Association of the latter, which provide a duration for the Company of 99 years.\textsuperscript{171}
\end{quote}

 Protections were therefore agreed to preserve the nature and make-up of the company, although the stabilisation clause was not intended to be an obstacle to the host state’s entitlement to regulate under major MITs, such as NAFTA and ECT. In reality, the Congolese government decreed that all assets and shares of the company be


\textsuperscript{171} Taida Begic, \textit{Applicable Law in International Investment Disputes} Eleven International Publishing 2005) 91
transferred to a state-owned company, without the payment of fair compensation. In
the resultant dispute the ICSID tribunal held that this decision conflicted with
Congolese domestic law, the investment agreement and international law. The
sovereign host state was therefore obliged to compensate AGIP for the resultant
damage caused by the unlawful decision that expropriated the company.\textsuperscript{172}

In 1955, the Libyan American Oil Company (\textit{LIAMCO}) obtained three concessions to
explore and exploit oil reserves in Libya. The Libyan Minister of Petroleum approved
the appropriate Deeds of Concession; and in order to ensure the protection of
\textit{LIAMCO}'s interests, the agreement provided a stabilisation clause. This was legally
authorised by the state and modelled on the standard clause of Schedule II Petroleum
Laws 1955 and 1965:

(1) The government of Libya, the commission and the appropriate provincial
authorities will take all steps necessary to ensure that the company enjoys all
the rights conferred by this concession. The contractual rights expressly
created by this concession shall not be altered except by mutual consent of the
parties; (2) This concession shall throughout the period of its validity be
construed in accordance with the petroleum law and the regulation in force on
the date of execution of the agreement of amendment by which this paragraph
was incorporated into this concession Agreement. Any amendment to or
repeal of such Regulations shall not affect the contractual rights of the
company without its consent.\textsuperscript{173}

This meant that any amendment of the petroleum laws subsequent to the date of the
agreement should not affect the contractual rights of the company. The principle of
state sovereignty permitted the government of Libya to amend pre-existing
regulations and create new laws, in accordance with public policy and interest, but
\textit{LIAMCO} was effectively exempt from any provisions adverse to its interests.

However, in 1969 there was a regime change, and Colonel Moammar Alkhadafi
assumed power. In 1973, the Libyan Revolutionary Command Council, in the
exercise of unilateral sovereign authority, issued Law No. 66, to expropriate 51% of
the concession rights of \textit{LIAMCO} (amongst other companies), and a year later the
remaining 49% interest was nationalised. The new law provided that recompense

\textsuperscript{172} \textit{AGIP SPA} (n170) Para 97
\textsuperscript{173} \textit{Libyan American Oil Company vs. Government of the Libyan Arab Republic Award 12 April 1977},
(1981) 20 International Law Materials 1 – cited as LIAMCO hereafter
would be available to the concessionaires, but *LIAMCO* had to resort to international arbitration as a result of the insufficient amount of compensation, as provided for in the original concession agreement.\(^{174}\) The tribunal held that the company was entitled to indemnification, in accordance with the proper construction of the concession agreements negotiated with the previous regime. These legal provisions were principles common to both national and international law, and should they be absent in the host state, damages should be determined according to ‘the general principles of law’.\(^{175}\)

Breach of obligations contained in the stabilisation clause may well be viewed as an aggravating circumstance when considering the level of responsibility and negligence in the actions of the contracting state. All breaches of obligations include this, but when it involves an explicit duty on the state to respect the agreement that it has negotiated, this arguably makes it more significant, and Garcia-Amador argues that the degree of responsibility will affect the measure of reparation.\(^{176}\) The principle of state responsibility and its effects will be discussed further in Chapter Four.

**B) Bureaucratic Administrative Systems in the Public Sector**

Feiler asserts that changes to the laws regarding foreign investment will fail if the bureaucracy did not act in the spirit of the law, as well as the letter.\(^{177}\) The state bureaucracy may be defined as practices, procedures and actions (or indeed inactions), to effect government policies; implemented by public servants, who in principle are politically neutral. Despite this, their activities may have an adverse impact on the effective operation of state interests in general, and investments in particular.\(^{178}\) If not properly overseen by the host state government, it will make the attraction and operation of foreign investment profoundly difficult, and will give the


\(^{175}\) *LIAMCO* (n173) 130-132, 149


\(^{177}\) Gil Feiler, *Economic Relations between Egypt and the Gulf Oil States, Petro Wealth and Patterns of Influence* (Sussex Academic Press 2003) 90

appearance of a lack effective state support. In the exercise of sovereignty, the state will claim much in terms of the remit of its powers; however, it should be remembered that the principle also applies to the control of its civil administration.

Bureaucratic resistance, whether intentional or arising as a result of incompetence, causes considerable risk to the investor and the project. A simple delay in the renewal an investor’s commercial licence can lead to problems in the operation of the investment project and a subsequent loss of revenue to both parties. Problems with the administrative system can potentially be resolved by the host state legislature enacting measures to regulate the relationship between the investor and the state bureaucracy. Legislating for periods and time limits within which the civil service must act in response to applications or requests may be particularly effective if supported by an implied affirmative decision in the absence of cooperation. This appears a wise exercise of sovereign control over the lethargy of those who work for the people.

Ineptitude, basic dishonesty and avarice in the civil service can cause considerable damage to the economy and the international reputation of a country, and indeed to its people. There is an endless series of opportunities for corruption, particularly where large amounts of money are to be made, or are at stake. It may be as simple as the perceived ‘requirement’ to bribe public sector officials, in order to influence the behaviour of those who have direct control over the administration through which the investor operates their project; or such matters as the production and renewal of investment licences or tax and revenue accounting. This is akin to an implied obligation on the part of the foreign investor to ensure the smooth operation of their business interests; an implicit suggestion that those who pay will get what they need.

The havoc that an inept or corrupt administrative apparatus may wreak is a potential catalyst for protest and unrest amongst the nationals of a state, heightening political instability from the inside. This has been evidenced by the recent riots and demonstrations, now commonly termed ‘People’s Revolutions’. These arise as a

179Richard Bendis and Stefan Craciunoiu, Overcoming Barriers to Technology Transfer and Business Commercialization in Central and Eastern Europe: Solution and Opportunities (IOS Press Netherlands 2002) 84
180John Baffoe-Bonnie and Mohammed Khayum, Contemporary Economic Issues in Developing Countries (Praeger Publications 2003) 135-136
result of persistent suffocation of civil society and the inability of ordinary citizens to access their government or control their own fates. In the context of the interaction of sovereignty, control and supervision, internal state operations may be considered a priority before dealing with foreign business activities, as inadequacies will cause damage to the national reputation in the global markets and thus inhibit investment.

### 3.3.2 Economic Sovereign Decisions of Host States and their Impact on Foreign Investment

Economic stability is an obvious factor in the attraction of foreign investors, and depends considerably on the decisions made by a host state, whether sovereign, political or commercial. A clear economic programme is indicative of a proactive government aware of its objectives, whereas the lack of such a vision promotes instability and alienates inward investment. Entrepreneurs may be attracted by risk, but an erratic sovereign outlook is a substantial deterrent, being a process of decision making indicative of economic instability. Complex analysis of the concept of volatility in developing countries is beyond the scope of this study; instead it is intended to focus on the examination of commercial decisions taken by a host state within the framework of its sovereignty; and the potential impact on foreign investment. Volatility occurs as a result of various events, including international sanctions, currency exchange fluctuation and financial crises. The impact of economic problems, both domestic and international, is generally related to the policy decisions of a state, and will affect its compliance with obligations to a foreign investor.

As has already been discussed, economic decisions are the sovereign actions of state and form a part of major multilateral treaties that generally prohibit the targeting of foreign investors and their projects, as shown by Chapter II Article 1 of the Charter of Economic Rights and Duties of States, 1974. To infringe this treaty would result in a breach of an appropriately drafted BIT or specific investment agreement. The

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181 ibid 136
Continental Casualty Company v the Argentine Republic case, adjudicated upon by the ICSID, provides an interesting example of sovereign measures taken by a host state to improve its economy.\(^{183}\) Continental, an American company incorporated in Illinois, had invested in and claimed to wholly own CNA Aseguradora de Riesgos del Trabajo S.A. (CNA), an insurance company incorporated in Argentina. In 2001, Argentina experienced a catastrophic financial collapse, and its economic recovery required drastic decisions, which caused considerable prejudice to Continental’s interests.\(^{184}\) In an attempt to salvage its economy, Argentina took steps to adjust and thereby devalue its currency.

The basis of its currency conversion was initially replaced with a dual exchange system, offering an official exchange rate of 1.4 pesos per dollar for public sector and most trade-related transactions, with all other transactions settled at prevailing market rates. In February 2002, the dual system was abolished by decree 260/02. When the market reopened for the first time under the unified regime, the exchange rate depreciated to 1.8 pesos per US dollar. Devaluation reached a trough of almost 4 pesos to the dollar in June 2002, before stabilising at around three pesos.\(^{185}\) In the meantime, in March 2002, a further sovereign decision (outlined in decree 471), converted all US dollar denominated government debt, “the law applicable to which is only Argentine law,” into pesos at the rate of 1 U.S. dollar to 1.4 pesos. As a consequence, US dollar denominated treasury bills (LETES)\(^{186}\) and Government bonds and loans (GGL) held by CNA were converted into pesos and indexed at the Constant Exchange Rate (CER) earning a much reduced interest rate.

As a result of these sovereign decisions, the CNA, and therefore Continental, found its interests severely compromised under both the investment agreement itself and the 1991 BIT between America and Argentina entitled the ‘Reciprocal Encouragement and Protection of Investment’. One particular consequence of the denomination of its

\(^{183}\) Continental Casualty Company v the Argentine Republic ICSID Case No. ARB/03/9 2003
\(^{185}\) Continental Casualty Company (n183) Para 142, 63
\(^{186}\) LETES were short-term debt obligations backed by the U.S. Government with a maturity of less than one year. Treasury bills were sold in denominations of $1,000 up to a maximum purchase of $5 million and commonly have maturity periods of four, thirteen or twenty-six weeks
currency at 1.40 Peso to the dollar was an increase in the peso value of CNA holdings to 40%; and the balance sheet of CNA showed a substantial capital gain (as did all companies in a similar position).

In January 2003, the ICSID received a Request for Arbitration from the Continental Casualty Company against Argentina, regarding alleged breaches of the applicant’s rights as investor under the 1991 BIT. Continental complained that although ‘the value of assets which had been converted was actually less in real U.S. dollars terms’, this capital gain was taxed at the statutory rate.\(^ {187}\) The tribunal decided that the Respondent state, Argentina, was liable to pay compensation to the Claimant As regards the claim relating to the Treasury bills, ‘LETEs’ in the principal sum of U.S. $2,800,000 (two million eight hundred thousand US dollars), and compound interest thereon at the rate of U.S.$ 6 month Libor (as published in the Financial Times) plus two per cent, compounded annually from January 1, 2005 until payment of the award was complete.\(^ {188}\)

Therefore, foreign investors must not merely depend on reliable legal advice, but also make a comprehensive examination of other factors such as the economic history and social stability of the host state. Possible sovereign decisions likely to be taken by a host state in order to alleviate the impact of instability in their economy are also crucial elements in the decision-making process of an investor. The state must ensure that regardless of the apparent seriousness of its situation and the difficult decisions necessitated as a custodian of the national interest, it still has international and contractual obligations to fulfil.

\(^ {187}\) Continental Casualty Company (n183) 64
\(^ {188}\) ibid Para 320(B)
3.3.3 Political Sovereignty of Host States and Implications to Foreign Investment

Political sovereignty is ever present in the government of a state, in the making of its laws and determination of its economic and social direction; and as such it is often used to guide and implement political philosophy. This ideology may find itself in conflict with international investment contractual obligations. It is clear that the state has a basic and inviolable right to make its own political decisions. However, in the context of foreign investment obligations, which arise outside of the sovereignty issue, poor political planning and decision-making may bring ‘instability in (the) political environment’ of the host state, broadly described by academics as “political risk”. Uncertainty about the potential actions of a host government, its institutions or administration, can cause disruption in the operation of multinational enterprises on its territory. This may be the result of international problems, for example, of insurgency, manifesting in the domestic arena, and thus political risk can be assessed by investors.

The stakes are raised phenomenally with a declaration of war. As a sovereign decision this brings massive political and financial risks for both the host and its investors. It results in questions of the progress of projects, whether established, newly instituted or anticipated. The range of political risks faced by foreign investors on host territory varies in terms of seriousness, and it is worth reviewing examples of how such risks can affect the philosophy and operation of state sovereign authorities.

A) Overthrow of The Previous Contracting Regime (coup d'état) and its Impact upon International Investment Agreements

The term coup d’état literally translates from the French as ‘a cut from the state’; the specific definition is the unlawful overthrow of the government, generally with violence. It may be the action of the national military armed forces, or undertaken by a domestically based opposition group or individual replacing the existing

190 ibid
government by revolution. The military deposition of a civil authority is generally an assertion of power by a small body of highly armed and trained servants of a weak state system, with a view to imposing ordered martial law. It differs from a civilian based revolution in the sense that the latter is commonly a political expression of a mass revolt, with the goals of social, economic or political reform.

In the context of international investment agreements, the overthrow of the host regime that negotiated and signed the relevant contract raises considerable risks for the efficacy of the project; given that fundamental political, social and economic reform will likely follow. There is effectively a ‘new’ power in charge, which may not consider itself bound in its sovereignty by the decisions of its predecessor. The obvious risks include the termination of the investment agreement, expropriation of the project without fair compensation, and a catastrophic loss to the foreign investor. A pertinent example is the Iranian Revolution of 1979, when the western supported Shah was deposed by religious Islamic authorities, after two years of protracted protest and upheaval.

Under the government of the Shah, Iran had a long history of working with western-based consortia and their affiliates, such as Mobil Oil Iran Inc., the San Jacinto Eastern Corporation, Arco Iran Inc. and the Exxon Corporation. In 1973, negotiations resulted in a twenty-year agreement with the Iranian state for the sale and purchase of all crude oil exploited from designated territories of the host state by members of the consortium. The 1979 revolution led to the withdrawal of all foreign expatriate personnel of the consortium for personal safety reasons, and the production of oil was interrupted by the state. This inevitably caused damage to the foreign investment project, which was formally terminated in 1980, when the new government of Iran nullified the agreement. In Mobil Oil Iran Inc. v Government of the Islamic Republic of Iran, the international adjudication tribunal which was established to determine the claims for compensation of the consortium parties, refused Iran’s assertion that the decision of the Revolutionary Council should be

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192 ibid 47-48
considered a ‘force majeure’. The new regime claimed that its new sovereign decisions on the international agreement were unavoidable and therefore released it from any liability regarding contractual obligations entered into by its predecessor sovereign authority.

The tribunal considered that the sovereign actions of the Iranian state were “expropriation” of the property, assets and entitlements of the consortium parties:

The fact that the negotiations did not succeed before November 1979 and were interrupted by the events which took place during that month does not relieve the Respondents from their obligation to compensate the loss sustained by the Consortium. This holds true irrespective of the legal characterization of these events: force majeure, as the Respondents contend, or acts of the Iranian Government entailing the international responsibility of Iran, as alleged by the Claimants. In the present context the Tribunal, therefore, neither must pronounce itself on this issue nor need it consider the Single Article Act, which entered into force at a time when the Agreement was already dead. In any event, such an Act has been characterized by Iran as an expropriation and must be analysed in this context.

This analysis led to the conclusion that, despite this being an exercise of a new sovereign authority, expropriation under the agreements meant that international law required fair compensation to be paid to the investor.

A broadly similar occurrence arose in Somalia following the coup in October 1969. PRODMA Ltd was a company established in the state, to trade in seafood fished from the Somali coast, through processing to exportation. Fearn International Inc. was an American company that owned 49% of PRODMA, the balance being held by Somali nationals. The new regime compromised the operation of the contractual process, victimising PRODMA staff and personnel, including their arrest and deportation; under the guise of sovereign entitlement, to wrest control of the company from its foreign investors. In pursuit thereof, unreasonable restrictions were placed on the use of company aircraft, and its depots were nationalised. As a result, in August 1970, the company effectively ceased operation. The American Overseas Private Investment Corporation (OPIC) invited the Somali authorities to purchase the assets that they had

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193 Mobil Oil Iran Inc. and Others v Government of the Islamic Republic of Iran Iran-United States Claims Tribunal Award No. 311-74/76/81/150-3 14 July 1987 16 Iran-U.S. Cl. Trib. Rep. 3, Paragraph 21; and see: Bishop and others (n170) 264
194 ibid Para 127
effectively seized, and the latter agreed to buy them for a total sale price of $345,713. Fearn filed a claim under the USAID (OPIC predecessor agency) Contracts of Guarantee asserting that the actions of the host government amounted to expropriation; the tribunal agreed, and appropriate compensation and restitution was ordered.195

It can be hard for a foreign investor to anticipate the risk of a coup d’État, but where an investor enters into an agreement, and invests money and resources, it is appropriate to expect compensation for losses as a result of the actions of the state. It is however, prima facie reasonable for a new government regime in a host state, to portray a revolution as a desire on behalf of the people to fundamentally change and reform the political and economic system and circumstances. The process of effecting reform can lead to a tendency to believe in the possibility of removing existing economic commitments with foreign companies and preventing the exploitation of national wealth. It has been noted that a coup d’État may enable a new sovereign authority to do just that, but obligations remain on a new government to respect the actions of its sovereign predecessor in international law and thus compensate a foreign investor in the event of expropriation or nationalisation.196

B) Civil War and Insurgent Forces

The concept of civil war is defined as ‘wars fought within internationally recognised boundaries to establish who will rule’, encompassing, for example, wars fought for control of a central government, to accede to power, to create a new government or system; or to redress the balance of power between central and regional authorities.197 In addressing the risk to its existence, and potential turmoil among its people, the host government may find that it must take drastic sovereign political, economic and military measures to ensure its continuity. Curiously, as has been noted, the efficacy

195 OPIC Memorandum of Determination 20 October 1973 cited and related in Bishop and other (n170) 548, also Mark Kantor, Michael D. Nolan and Karl P. Sauvant, Reports of Overseas Private Investment Corporation Determinations, Volume 1 (Oxford University Press 2011) 244-249
196 Chapter 4 herein further discusses ‘unlawful expropriation’ as a head of claim for ‘unjust enrichment’ by and of the state
197 Stephen Stedman, Donald Rothchild and Elizabeth Cousens, Ending Civil Wars: the Implementation of Peace Agreements (Lynne Rienner Publisher 2002) 22
of a foreign investment project may depend on this, although it is just as likely to suffer. However, sovereign measures must not adversely affect the foreign investment project in a manner tantamount to expropriation, or if they are deemed necessary by the host state, fair and adequate compensation must be paid. Should the forces of rebellion succeed, or the regime be replaced, the obligations under the investment agreement must still be honoured in international law, with the appropriate measures taken to enforce them.

Compensation and restitution was ordered to be paid to the Nord Resources Corporation, an American company based in Tucson, Arizona; as a result of losses incurred in a civil uprising in Sierra Leone. The corporation owned 50% of Sierra Rutile Holding Limited, the sole shareholder of Sierra Rutile Limited (SRL). Rutile is a crystal, sand-like substance widely used for industrial purposes. SRL owned, developed and operated a rutile project in Sierra Leone, and their earnings represented 40% of the country’s foreign exchange. In 1991, civil war erupted in the state, with battle reaching Nord’s rutile mine and processing facility in January 1995, when the mine was seized by rebels, before being retaken by the government. SRL eventually regained control of the site, but in the interim had incurred considerable losses, for which it was entitled to recompense.\(^{198}\) The sovereignty of the Sierra Leonean government was not inviolable, and it had a responsibility to protect the foreign investor interests it had invited onto its territory.

Another example occurred in the 1970s and 1980s as the Philippines suffered political upheaval due to a civil war arising from regional, religious and personal tensions. Philippine Geothermal Inc. (PGI) was an integrated energy company owned, by American-based Chevron. In 1971, it entered into a service contract with the National Power Corporation (NPC), a state-owned corporation in the Philippines. Its role was to provide support, money, technology and expertise to NPC for use in the exploration and exploitation of geothermal energy resources on the host state’s territory. In 1987, transmission towers owned by NPC were destroyed by rebel forces, which the government had been unable to subdue in the fifteen years since civil war erupted.

\(^{198}\) OPIC Memorandum of Determination 14 May 1998 Political Violence Claim of Nord Resources Corporation, Sierra Leon, Contract of Insurance No. A628 cited and related in Bishop and others (n170) 599
The inability of NPC to fully operate its power generating facilities prevented its American partner, PGI from receiving a portion of its payment under the service contract.\textsuperscript{199}

International investment law and customary international law acknowledges the sovereignty of state territory, but requires in its exercise, regardless of the risks to the existing government or regime change, that due diligence will be utilised to protect the assets of any foreign investments. Failure to do so is a breach of the responsibilities of the host state, which will be discussed further in Chapter 4.

C) Hostile Action

Hostile actions from other states do not necessarily amount to war; but according to Oliver, can be a major catalyst for it.\textsuperscript{200} They may potentially cause catastrophic instability in the investment environment, making it very difficult to secure foreign investment. There are clearly high risks involved in such situations, especially as hostility will require a host state to exercise sovereign decisions likely to affect foreign investments. \textit{F.C. Schaffer & Associates}, an American engineering company, was involved in a project in Ethiopia for the design, supply, construction and commissioning of the Finchaa Sugar Factory and the Ethanol Distillery. All supplies needed for the project had to be sent through the nearest port, which was located in Eritrea. The armed forces of both Ethiopia and Eritrea were engaged in hostile action, and on May 12, 1998, the government of Eritrea banned the passage of Ethiopian imports through its territory. Supplies for the project, which were sent by the insured claimant, \textit{Schaffer}, before the ban was implemented, were thus seized by Eritrea.\textsuperscript{201} Ethiopia had a sovereign entitlement to pursue government actions designed to protect its territory against threats from neighbouring states.\textsuperscript{202} One of the results of the ban,
deemed necessary to Ethiopia’s state interest, was that the claimant could not effectively operate its project.\textsuperscript{203}

Assessment of political risk is therefore a vital factor in any feasibility study undertaken by a foreign investor. Evaluation of the level of political stability of a host state will assist in determining whether investment is sensible, and a degree of equilibrium will assist in attracting and retaining foreign investment. Successor governments, who may operate a different political philosophy, must remain subject to the obligations of the agreement signed by its predecessor an enforceable principle of compensation rendered by tribunals in the event of a dispute with a foreign investor.

\textbf{3.4 Conclusion}

The host state will, by virtue of its territorial sovereignty, at times have a difficult, or even hostile relationship with a foreign investor. It may regard a long established foreign investment project as subject to its territorial jurisdiction, and believe that it is obligated to comply with its decision-making processes. However, a foreign investor has a firm interest in regarding its presence in the territory of the host state as an opportunity for participation in the local economy, in order to achieve mutual prosperity through the economic benefits of doing business. This logically raises the expectation of an entitlement to some state protection from potentially damaging sovereign decisions.

The relationship between the host state and foreign investor has to be carefully balanced in the context of its divergent interests. Sovereign actions are conducted to implement regime and host state policies on its territory and for its citizens. They are lawful when made in the public interest, and are usually made in good faith and not intended to harm the foreign investor. Examination of individual circumstances is required in order to identify less altruistic uses of sovereignty by the host state, or indeed a failure to act, with the full knowledge, or even intention of, causing harm to a foreign investor. Here, over and above investment contract stipulations, customary

\textsuperscript{203} ibid
international law asserts the principle of state responsibility for a state’s wrongful acts against foreign investments. Nevertheless some host state decisions are taken in bad faith, which have the potential to harm foreign investments. This has been addressed by a number of treaties and customary international law which deal with host state responsibilities as will be explained in the next chapter.
Chapter Four

State Responsibility for its Sovereign Actions in Hosting Foreign Investments
Under Customary International Law

4.1 Introduction

Disputes will arise between a foreign investor and a host state, where responsibility for the dispute lies with the state and its conduct. These ‘disagreements’ must result in effective protection under customary international law to the investor in an attempt to redress uneven power and influence between the parties. The host state, as has been noted, is sovereign in economic, political, social and legal decision-making. Under customary international law a host state must seek ways to redress and recompense the resultant loss incurred by the foreign investor. This will involve consideration of the extent to which state responsibility is mitigated by state sovereignty rights on national territory. Whilst respecting this principle, customary international law and international investment law have developed mechanisms to protect an investor against the potentially malign power of a state.

State conduct that constitutes, under international law, a wrongful act, will require recompense by the foreign party affected. Treaties are largely entered into voluntarily by participant states in order to facilitate trade and tangible economic benefit. Responsibility requires the rectifying of wrongs and for the state to be deemed liable for ‘just’ contract claims. The definition of ‘state responsibility’ in the context of sovereignty is a key step in dispute resolution.

4.2 Host States’ Responsibility and the Violation of Investors’ Rights under Customary International Law

‘Responsibility’, at its most basic level, requires the consideration of consequences of chosen behaviour, and for parties to act according to the principles of appropriate legal conduct. It does not demand a purely altruistic approach on the part of the state, but does require an understanding of the need for co-existence with others. This can be viewed as a mechanism to promote parity in dealings between a state and a foreign
investor, imposing limitations on the self-interested actions of individuals, organisations or communities in pursuit of their own ambitions, and allowing other participants in the negotiations to achieve their own objectives.\textsuperscript{204}

The requirement for co-operation means that states must accept responsibility for the consequences of their decisions and actions in terms of the effect on other members of the international community. Individual national sovereignty therefore should give rise to the recognition of the principle of sovereign equality between states. In international law, and indeed any national legal system, supplanting the legal interest of one judicial body by another, will raise issues of responsibility on the part of the usurper. The relationship between the new controlling entity and the injured party will be governed by the principle of the international responsibility of state, and restitution is a natural consequence of such actions.\textsuperscript{205} The state is responsible for its wrongful acts, which result in the compromising of interests of other states under international law. Rapporteur Huber, in the \textit{Spanish Zone of Morocco Claims}, asserted that ‘responsibility is a necessary corollary of a right. All rights of an international character involve international responsibility’.\textsuperscript{206} Put simply, with rights come responsibilities. The principle of responsibility brings a protection of rights to foreign investors, enhanced by the observation of international legal obligations by a host state. Such rights are more likely to develop when developed by a neutral source rather than by a domestic legal system over which the state is likely to have more control. Indeed, domestic safeguards may not exist, giving rise to the risk that a state will believe it possible to exercise its interpretation of sovereign power without limit. Therefore, external enforcement of responsibilities under international customary law is clearly necessary, in order to ensure respect for the entitlements of all parties.

Two basic conditions will initiate the application of state responsibility when a host state acts pursuant to its sovereign powers, and if such action directly breaches the

\textsuperscript{205} ibid
\textsuperscript{206} \textit{Spanish Zone of Morocco Claims Case (Spain v UK)}, II Reports of International Arbitral Awards (1925) 615 Translation cited and see Daniel-Erasmus Khan, \textit{Max Huber as Arbitrator: The Palmas (Miangas) Case and Other Arbitrations} (2007) 18(1) The European Journal of International Law 145 156
contractual relationship with a foreign investor.\textsuperscript{207} It is the principle of sovereign action that distinguishes host state conduct from that of a contracting party or mere merchant.\textsuperscript{208} There are consequently two forms of responsibility to be honoured by the host state: international responsibility, and contractual liability, and as a result, differing claims can be made under the treaty between nations and in contracts between a host state and a foreign investor.\textsuperscript{209} Irregularities in the actions of a state will prompt the principle of responsibility, as a breach of international law arises when it relates to a state’s conduct of its own affairs or that of its associated constitutional bodies.

Article 1 of the Draft Articles on Responsibility of States for Internationally Wrongful Acts provides that ‘every internationally wrongful act of a State entails the international responsibility of that State’.\textsuperscript{210} This is clarified in Article 2 as ‘an internationally wrongful act of a State when the conduct consisting of an action or omission: (a) is attributable to the State under international law; and (b) constitutes a breach of an international obligation of that State’.\textsuperscript{211} However, this does not specify in what cases a wrongful act can be attributed to the state, and thereby face the consequences of responsibility. In the commentary to the Draft it is claimed that ‘the element of attribution has sometimes been described as ‘subjective’ and the element of breach as ‘objective’, but the articles avoid such terminology’.\textsuperscript{212}

Further assistance appears to be provided later; although in fact, no definitive conclusion can be reached due to the proliferation of potential situations arising on a case-by-case basis;

Whether responsibility is ‘objective’ or ‘subjective’ in this sense depends on the circumstances, including the content of the primary obligation in question. The articles lay down no general rule in that regard. The same is true of other standards, whether they involve some degree of fault, culpability, negligence or want of due diligence. Such standards vary from one context to another for

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\textsuperscript{208} ibid 166
\textsuperscript{209} See Chapter 5 (BIT and Contract claims)
\textsuperscript{210} Draft Articles: Wrongful Acts 2001 (n62)
\textsuperscript{211} ibid Art. 2
\textsuperscript{212} ibid Commentary to Art. 2 Paragraph (3)
reasons which essentially relate to the object and purpose of the treaty provision or other rule giving rise to the primary obligation.\textsuperscript{213}

In the context of hosting foreign investments, the ILC asserts that international law is not necessarily contravened by the host state acting in breach of the specific contract. Such contraventions will only be considered when other factors occur that attract international scrutiny; particularly if there has been an attempt to resolve a dispute in a host state’s national courts by the aggrieved investor, and justice has then been denied.\textsuperscript{214} Where the breach of contract or of international law has been caused by the conduct of a host state, it is of no relevance how, or when it occurs; for example, where noncompliance with an agreement obligation (contractual issue) is followed by a denial of justice, this is a contravention of international law. The dispute must simply arise from the same investment.

The ILC cites ‘denial of justice’ as an example of a breach of international law.\textsuperscript{215} However, Slomanson advocates that state responsibility, in prejudice caused to foreign interests, is based on four types of violation; (i) non-wealth injuries, (ii) denial of justice, (iii) confiscation of property and (iv) deprivation of livelihood.\textsuperscript{216} Although international tribunals have expressed support for this categorisation, there are two further elements that should be examined in the context of international investment law. These are the full protection and security of the investment project; and the fair and equitable treatment of the investor. The concept of ‘denial of justice’ within the context of state responsibility in hosting foreign investments requires further assessment of its different forms and implications.

\textbf{4.2.1 Denial of Justice}

‘Denial of justice’ describes the actions of a host state and its use of its sovereign power in order to distort the national judicial process, in a manner considered inappropriate and wrong. This may be due to a simple procedural irregularity, through to the fundamental systemic adulteration of the principles of the entire judicial
system, in order to give the state an advantage over the foreign investor. Customary international law provides a pertinent example in the Chattin case. Chattin was an American employee of a Mexican railway company, who was arrested in Mazatlán for embezzlement. Tried and convicted in the Mexican courts in February 1911; he was sentenced to two years imprisonment. Revolutionary unrest in the area facilitated his release and he subsequently claimed that his arrest, trial and detention were illegal and furthermore, that the treatment he received in prison was inhumane. A General Claims Commission was established by a Convention between the American and Mexican nations in September 1923, to adjudicate claims brought by citizens of both the United States and Mexico, for losses suffered as a result of the acts of one government against nationals of the other. Reconstituted to deal with Chattin, it reached the conclusion that (i) illegality could not be established on the issues of arrest or detention, but that the trial was conducted in an illegal manner, through the Absence of proper investigations, insufficiency of confrontations, withholding from the accused the opportunity to know all of the charges brought against him, undue delay of the proceedings, making the hearings in open court a mere formality, and a continued absence of seriousness on the part of the Court.

Although allegations of mistreatment in prison, such as ‘filthy and unsanitary conditions, and frequent compulsion to witness the shooting of prisoners’ could not be proven. The Commission awarded Chattin $50,000, and more importantly to the issue of principle of state responsibility, reiterated the standards expected of judicial acts, and highlighted common acts which deny justice from the state: ‘outrage, bad faith, wilful neglect of duty, or manifestly insufficient governmental actions’.

The challenge for both domestic and international law is to develop a programme of general principles of justice standards, to regulate the state relationship in its dealings with foreign investors. This will also assist in the choice of tribunal of resolution,

218 B. E. Chattin (United States.) v United Mexican States (July 23, 1927) IV Reports of International Arbitral Awards (1927) Para 282
219 ibid Para 283
220 The Commission ran from 1924-1937
221 B. E. Chattin (n218) Para 30, 295
222 ibid Para 28, 294
223 ibid Para 11, 288
whether in a host state or internationally, for disputes. It will enable the foreign investor to make a reasoned judgement on the venue for their claim, subject to a judicial competence clause in the treaty or contract, maximising the opportunity to pursue justice.

According to Lissitzyn, denial of justice is any refusal to give a person their due, and consequently, in more specific terms, is any violation of any legal right, privilege, or immunity of any person. 224 Harvard Law School prepared a draft codification of international law relating to the treatment of foreigners; The Law of Responsibilities of States for Damages Done in Their Territory to the Person or Property of Foreigners, known as the 1929 Harvard Draft. In development of the legal understanding of the concept, it asserted that

Denial of justice exists where there is a denial, unwarranted delay or obstruction of access to courts, gross deficiency in the administration of judicial or remedial process, failure to provide those guarantees that are generally considered indispensable to the proper administration of justice or a manifestly unjust judgment. An error of a national court which does not produce manifest injustice is not a denial of justice. 225

Francioni considers that ‘denial of justice’ lies at the heart of the development of international law on the treatment of foreigners and their investments, 226 proposing that it is inextricably linked to broader concepts of access to justice, entitlement to the protection of the law, and the effectiveness of legal remedies from a national judicial authority. Expectations of a constitutional democratic system are embedded in the rule of law and judicial independence from the executive providing fundamental guarantees of individual rights and freedoms. The law should arguably prove more stable and dependable than the whim of a benevolent ruler. 227 However, the delivery of justice can be prejudiced by a deficient or manipulated legal process, or by inadequate remedies. Such failure of the protection of a foreign investor by a host state will result in a cause of action under international law, predicated on the ‘denial

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224 Oliver Lissitzyn, The Meaning of the Term Denial of Justice in International Law, (1936) 30 American Journal of International Law 632
of justice’. The wrongful act and any subsequent diplomatic protection claim to enforce international responsibility may be undertaken by the national state of a victim investor, against an offending host.

The ILC Draft Articles on Diplomatic Protection (2006) implicitly recognises that in customary international law denial of justice arises from a lack of effective redress for wrongs, undue delay or exclusion. It therefore provides a procedure that allows for the circumvention of the requirement to exhaust the procedures of a domestic judicial system before seeking an international remedy. Article 15 states that local remedies do not need to be exhausted where

(a) There are no reasonably available local remedies to provide effective redress, or the local remedies provide no reasonable possibility of such redress; (b) there is undue delay in the remedial process which is attributable to the State alleged to be responsible; (c) […] (d) the injured person is manifestly precluded from pursuing local remedies [...].

It is logical to surmise that in a context where justice is denied, there is little purpose in a requirement to exhaust the ineffective domestic process of a recalcitrant host state, as effectively, justice is not within its remit; and therefore the Article 15 exception will permit the injured investor to pursue international remedies under ‘diplomatic protection’ principles. Nevertheless, the situation remains that, in principle, in order to qualify for an international claim for denial of justice the local host state’s legal remedies must be exhausted first. This point will be explained in the following section.

i) Exhaustion of Local Remedies

The requirement of the exhaustion of local remedies by a wronged foreign investor has significant support in both legislation and case law. The issue of ‘Admissibility of Claims’ is dealt with in Article 44 of the Draft Articles of Responsibility of States for Internationally Wrongful Acts:

Actions in international law based on the responsibility of a state may not be invoked if the claim is one to which the rule of exhaustion of local remedies

228 Art. 15 Draft Articles: Diplomatic Protection 2006 (n71)
applies and any available and effective local remedy has not been exhausted.\textsuperscript{229}

Article 14 of the Draft Articles on Diplomatic Protection also requires the exhaustion of local remedies as a prerequisite condition for the injured party, prior to the institution of an international claim seeking diplomatic protection against the host state. It states:

1. A state may not present an international claim in respect of an injury to a national or other person […] before the injured person has, subject to Draft Article 15, exhausted all local remedies; 2. “Local remedies” means legal remedies which are open to an injured person before the judicial or administrative courts or bodies, whether ordinary or special, of the State alleged to be responsible for causing the injury; and 3. […] Shall be exhausted where an international claim, or request for a declaratory judgment related to the claim, is brought preponderantly on the basis of an injury to a national or other person referred to in Draft Article 8.\textsuperscript{230}

State sovereignty gives rise to a presumption that a nation will maintain a reasonable and fair justice system; which in turn is supportive of the convention that all domestic remedies should be exhausted before an aggrieved party turns to the international forum for adjudication, largely as a sign of respect for sovereign authority. In the Ambatielos Arbitration case of 1956, the Greek government pursued an international action on behalf of one of its citizens, Ambatielos, against the UK, claiming that the British government had reneged on an agreement for the purchase of ships, and claimed that the local courts had not acted with due diligence. The Tribunal stated that

\textit{[T]he rule requires that ‘local remedies’ shall have been exhausted before an international action can be brought. These “local remedies” include not only reference to the courts and tribunals, but also the use of the procedural facilities which municipal law makes available to litigants before such courts and tribunals. It is the whole system of legal protection, as provided by municipal law, which must have been put to the test before a State, as the protector of its nationals, can prosecute the claim on the international plane.}\textsuperscript{231}

As Ambatielos had failed to pursue an appeal to the House of Lords, he had failed to exhaust the remedies available in the domestic courts. The Greek government took the case, on his behalf, to the Arbitration Commission, on what would be deemed

\textsuperscript{229} Art. 44 Draft Articles: Wrongful Acts 2001 (n62)
\textsuperscript{230} Art. 14 Draft Articles: Diplomatic Protection 2006 (n71)
\textsuperscript{231} \textit{The Ambatielos Claim, Greece v United Kingdom} Commission of Arbitration Award 6 March 1956 120
‘diplomatic protection’ grounds. Although prima facie a somewhat altruistic act, it should be noted that Ambatielos had a brother working in the Greek Ministry of Shipping.232

The requirement to exhaust local remedies of a host state’s judicature should be considered in the context of three different issues and circumstances. The first is competence; where, subject to an agreement by parties to the contrary, it is presumed that the domestic jurisdiction is competent and its remedies suitable and sufficient to resolve problems without recourse to the international arbitration panel. As a consequence, it is thus premature and inappropriate to seek resolution in the international jurisdiction, and it will merely be remitted to the domestic tribunal for adjudication. In Elettronica Sicula S.P.A v United States Of America (ELSI), the ICJ stated: ‘for an international claim to be admissible, it is sufficient if the essence of the claim has been brought before the competent tribunals and pursued as far as permitted by local law and procedures, and without success’.233

The second point is that denial of justice by the host state responsible for the wrong usually cannot be supported in an international venue if the local courts have not been used to try to resolve the dispute. Legal action relating to investment contracts or BIT disputes, and a subsequent denial of justice interconnect strongly; and so it is puzzling that the problem has to pursue a local process in which justice is expected to be denied, before international judicial assistance can be sought. Nevertheless, this obligation gives rise to a third consequence; as the domestic court may settle the case with a decision in an investor’s interest, thereby alleviating the need to proceed to the international jurisdiction. However, analysis of recent investment disputes indicates that effective access to justice continues to be denied, even where investment guarantees exist under BIT. Municipal courts in host states appear to have found various methods by which they can deny justice to a foreign claimant, including arbitrary conduct, corruption of the judicial system and erroneous and unjust judgments, and each of these will now be explored in turn.

232 ibid 114
233 Elettronica Sicula SpA (ELSI) (n124) Para 59
ii) Arbitrary Conduct by the Courts of a Host State

Examples of case law, whereby differently constituted tribunals and courts have discussed, defined and adjudicated upon the concept of arbitrariness in judicial decision-making are numerous. The International Court of Justice considered this issue in the *ELSI* case, stating ‘arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law’. The Court in the *Asylum* case spoke of ‘arbitrary action’ being ‘substituted for the rule of law’, stating that it is a ‘wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety’.

The adjudication of the ICJ in the *Mondev International Ltd* case is noted in detail. Emphasis is placed on the arbitrariness of decisions that ‘shock’ the sense of legal decorum and rectitude, undermining investor confidence in even approaching the judicature of the host state for restitution. It stated that:

> The word ‘surprises’ does not occur in isolation. The test is not whether a particular result is surprising, but whether the shock or surprise occasioned to an impartial tribunal leads, on reflection, to justified concerns as to the judicial propriety of the outcome, bearing in mind on the one hand that international tribunals are not courts of appeal, and on the other hand that Chapter 11 of NAFTA (like other treaties for the protection of investments) is intended to provide a real measure of protection. In the end the question is whether, at an international level and having regard to generally accepted standards of the administration of justice, a tribunal can conclude in the light of all the available facts that the impugned decision was clearly improper and discreditable, with the result that the investment has been subjected to unfair and inequitable treatment.

The consequences of an improper or irrational decision in what should be the due process of law can have major consequences for an injured party, including the deprivation of livelihood or even individual freedom. Foreign businesses may lose not only their investment, but also their ability to operate at all. Arbitrariness

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234 ibid Para 128
235 *Asylum case* (Colombia v Peru) International Court of Justice Reports 1950 Judgment 20 November 1950, 284; *Elettronica Sicula SpA (ELSI)* (n124) Para 128
236 ibid
237 *Mondev International Ltd v United States of America*, ICSID Case No. ARB (AF)/99/2 Award 11 October 2002
238 ibid Para 127
fundamentally offends the principle that the law should have a high degree of certainty on which to base legal advice, decision-making and action.

An unforeseen, punitive verdict or derisory remedy may also be considered arbitrary in such circumstances. The sense of injustice is amplified when the process of appeal is made profoundly difficult. In the Loewen Group v the United States case, the Claimant, a large Canadian funeral company, had been sued in the American courts by an American business competitor, who complained of predatory behaviour and restrictive business practices. The strategy of the American plaintiff in the domestic case was to emphasise the merits of their local business, their commitment to serving the local community, and its struggle against the allegedly predatory practices of foreign corporate interlopers. Loewen complained the whole trial was imbued with continual reference to nationality and patriotism, with counsel for the plaintiff likening his clients’ current struggle with his heroic wartime battle against the Japanese.

The jury verdict awarded US$500 million to the American plaintiff, of which US$400 million constituted punitive damages. Although the opportunity to appeal was afforded by Mississippi state law, it required the posting of a financial bond in the amount of 125 per cent of the award before execution of the award could be suspended, pending an appeal. In the face of having to lodge in excess of US$600 million with the court to contest the exorbitant damages awarded, they settled the case.

The denial of justice to a wronged party appears to be of advantage to the host state in increasing its power, authority and influence in the domestic sphere, by exerting control on the judiciary. It may also act as an encouragement for judicial deceit. This need not be high level personnel misconduct, as a culture of corruption can infect the motivations and actions of the most lowly of civil servants.

239 The Loewen Group Inc. and Raymond L. Loewen v United States of America ICSID Case No. ARB (AF)/98/3, Award 2003
240 ibid Para 4
iii) Judicial Corruption

Judicial corruption tends to be elusive in both definition and testability; as it can be concealed by the wide variety of its forms and practices. In general it implies an abuse of judicial power for private gain or benefit and is a closely associated with weakness and decay of a political system. It encompasses a wide range of behaviours at all levels of authority; whether individual, institutional or systemic; and may occur at a regional, national or international level. The purpose and goal of corruption in the judicial sector may vary, but will generally distort the judicial process to effect an unjust outcome. Perversely, some may consider the use of this type of incentive, in order to guide or hasten the judicial process towards what may well be a just outcome. The impartiality principle of law renders neither acceptable, even where justice may ultimately be served in a particular dispute.

Transparency International’s *Global Corruption Barometer* (2006) surveyed 59,661 people in 62 countries. In twenty of those countries, more than ten per cent of respondents, who had interacted with the judicial system, claimed that they or a member of their household had paid a bribe to obtain what they termed a ‘fair’ outcome in their dispute.

The most common forms of corruption, particularly in relatively economically weak emerging states, are political interference in judicial processes, generally by the executive branch of government: and ‘local’ bribery of those employed at different levels of the court system.

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A) Political Interference in the Judicial Process

Despite several decades of efforts at reform, rising expectations of probity and international instruments protecting judicial independence; judges and court personnel around the world continue to face pressure to rule in the favour of powerful political or commercial bodies, rather than according to the law. According to Hossain, in his foreword to the *Global Corruption Report* (2007), judges thought ‘too’ independent in Algeria can find themselves penalised by being transferred to distant, and less influential locations. In Kenya, uncooperative judges may find themselves subject to politically expedient anti-corruption investigations, with unspecified allegations being made, and pressure placed on those so accused to resign their posts. Former president Alberto Fujimori of Peru, and the political authorities in Sri Lanka, have simply reassigned sensitive judicial posts or case from judges that they perceive as problematic to their more malleable colleagues. Interference may take the form of threat, intimidation or bribery of judges; or by the manipulation of judicial appointments, salaries and conditions of service. Such activity should not be viewed as a problem exclusive to developing nations; as the failure to maintain high international standards of judicial independence is evident in some countries that are considered relatively economically advanced. Both Russian and Argentinian politicians, for example, have a history of interference in the domestic legal process. A pliable judiciary provides protective cloak of legitimacy for those in powerful positions to implement their nefarious plans through embezzlement, nepotism, or personal amelioration of the political process.

In the investment context, the decision of the United Nations Commission for International Trade Law (UNCITRAL) in the *Chevron v Ecuador* case of 2008 requires detailed consideration, as it provides a good example of the effects that executive interference can have in a manipulated judicial process. The 1998 Constitution of Ecuador promulgates the principle of judicial independence, and, in the context of international trade, is fundamental to meeting obligations to provide foreign nationals with impartial justice. In late 2004, the defendant, a political

244 ibid
245 ibid
246 *Chevron Corporation (U.S.A.) and Texaco Petroleum Corporation (U.S.A.) v The Republic of Ecuador* UNCITRAL Interim Award 1 December 2008
department of the government, was cited in seven complaints by Petro Ecuador-Texaco Petroleum (TexPet), before the Ecuadorian courts. In response, Ecuador began to exert extensive control over its national judiciary, purging the existing Constitutional, Electoral and Supreme Courts and replacing constitutionally elected judges with political allies. Contrary to constitutional procedure, the Supreme Court was dismissed twice in less than three years, and the court hearing the complaints was not legitimately elected. The new Subrogate President of the Supreme Court had previously been a judge in three of TexPet’s cases against the government. Therefore, since 2004, judicial independence in Ecuador, as recognised by prominent international organisations and commentators, was virtually non-existent.247

In May 2006, TexPet gave notice to Ecuador of its intention to file for international arbitration, on the basis of flagrant delays in the litigation process, caused by the defendant’s government. By December 2006, the dormant and now-politicised courts acted, with the judge dismissing two of TexPet’s claims as ‘abandoned’, a decision based on the wrong and manifestly improper application of a Code of Civil Procedure provision. In one case, TexPet had in fact provided all evidence and taken all necessary steps; all that remained was a judicial decision of resolution. In the other, TexPet had made repeated requests to the court to move forward with the evidentiary phase of the case, but for 14 years the court had declined to schedule a judicial inspection. In a third case, the judge cited a clearly inapplicable Statute of Limitations for sales to retail consumers in order to dismiss the action. These decisions were not simply wrong; they were grossly incompetent, biased and manifestly unjust, showing a flagrant disregard for the clear principles of Ecuadorian law.

However, TexPet did not lose all its claims before the domestic court. Perhaps as a consolation prize, or to inject an element of credibility into the process, the smallest of their claims was successful. This claim was worth approximately one-tenth of one per cent (0.1%) of the total damages owed by Ecuador. Whatever the reason, this appears to show that even a manipulated judicial system can occasionally get it right; although the government is in the process of appealing that decision. The case

247 ibid Para 6
therefore continues to languish in the Ecuadorian courts without TexPet being able to collect on its judgment.\textsuperscript{248}

The conduct of the Ecuadorian government constitutes an undisguised denial of justice under customary international law as it has been stated by ICJ in the \textit{Asylum} case and in the \textit{Mondev International Ltd} case. To TexPet in at least two aspects: firstly, an undue delay in adjudicating on TexPet’s seven cases, which have been held up in the state courts for over a decade; and secondly, the grossly incompetent, overtly manipulated and manifestly biased decisions of the court, disregarding on occasion even its own domestic law. In this case, the foreign investor was not afforded (in compliance with the obligations of the state), an effective method of professing grievances and pursuing restitution. In particular, the investment made by TexPet was not granted adequate treatment, in a fair and equitable manner, and nor did it receive sufficient security and protection. Ecuador has treated these investments in an arbitrary and discriminatory manner, without recourse to law.\textsuperscript{249}

Attempts to inhibit this manner of corruption require constitutional and legal mechanisms that promote and entrench judicial independence from the executive, protecting judges from dismissal or transfer without an impartial inquiry. The conduct of Ecuador in the TexPet case illustrates how a state will make concerted efforts to compromise such safeguards, if it believes there will be an advantage to doing so. Ultimately, such short-term thinking will damage the future economic interests of a state. Judicial and political corruption of the executive is mutually reinforcing, as where a justice system is corrupt, sanctions on those who use bribes and threats to suborn politicians are unlikely to be enforced, giving the impression that, in the realm of public service, talented and honest candidates, free from the burden of dishonesty need not apply. Curative measures are within the sovereign authority and responsibility of the state, and a failure to act will deter positive investment, or attract unscrupulous speculators.

\textsuperscript{248} ibid Para 7
\textsuperscript{249} ibid Para 8
B) Bribery

An independent and impartial judicial system is the mainstay of any civilised community, reflecting a stable national community. Where it is corrupt, biased or dishonest, the whole country will be considered an unsafe location for investment by overseas investors. It is therefore to the state’s economic advantage to use its authority to impose a minimum standard on its judicial system. Efforts by the state to act properly suffer considerable compromise with the practice of bribery, its tolerance and implied acceptability. Bribery can be both a feature and stage of interaction in the judicial system: court officials may seek ‘rewards’ for their work; lawyers may charge additional ‘fees’ to expedite or delay cases; and their staff may direct a party to sympathetic or corruptible judges.

Judges can reap the greatest rewards from their control of the decision-making process. When litigants already hold a low opinion regarding the honesty of judges and the judicial process, they are far more likely to resort to bribing court officials, lawyers and judges in order to achieve their ends. An underpaid and potentially dishonest judicial officer with little hope of financial progression is an easy target for bribery, as they are vulnerable to temptation. The risks to the nation are high; an unscrupulous judiciary in a corrupt legal system can even trigger a collapse of the apparatus of state. This is illustrated in the case of Kenya, where some 18 judges were alleged to have been involved in corruption, giving rise to the popular saying, ‘why hire a lawyer if you can buy a judge?!’.

In the Chevron v Ecuador case, Judge Nunez’s decision was expected by early 2010. In August 2009, however Chevron announced it possessed pertinent video recordings of meetings held in Ecuador, that revealed an attempt to bribe the judge; whose price was $3,000,000 of environmental clean-up contracts, payable if Chevron were to lose the case. Whilst not evidence of Judge Nunez accepting such a bribe, Chevron argued that the neutrality of the judge was compromised and therefore that they could not receive a fair trial, because an illicit audio recording suggested he

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250 International Commission of Jurists (n241) 9
251 Chevron-Texaco (n246)
252 <http://www.youtube.com/watch?v=var67Gg9rKs> accessed on 2 June 2012
agreed with those in attendance that *Chevron* was at fault in the dispute. *Chevron* therefore requested his disqualification and an annulment of his prior rulings. In response, the Learned Judge denied that he had indicated which way he would rule, arguing instead that the recordings had been altered. This set in place a haphazard round of judicial replacement, suggesting a legal process in crisis. In September 2009, while continuing to deny impropriety, Judge Nunez recused himself from the case. Judge Nicolas Zambrano was duly appointed, before being replaced by Judge Leonardo Piña Ordonez in February 2010. Judge Ordonez then allegedly demonstrated bias against *Chevron*, and in October 2010 Judge Zambrano once again stepped in to hear the case.

A host state must monitor and regulate, through transparent investigation, such behaviour. Judges must, of course, be of unassailable reputation and probity, but temptation, especially in developing nations, where poverty is the norm, can prompt the submission to human need. Such individual actions are exacerbated when it is the executive itself that perverts the operation of its own legal system.

**iv) The Erroneous and Unjust Judgment**

The concept of the ‘erroneous and unjust judgment’ is defined as one that is not consistent or appropriate, in the context of an action against a foreign investor where they violate a host state’s national law or the investment agreement. The *Chevron v Ecuador* case again provides a useful example. In February 2011, Judge Zambrano ruled that *Chevron* must pay US$9.46 billion for environmental damage caused by Texaco; and stated that in the absence of an apology within 15 days, this amount would be doubled. *Chevron* refused to apologise, effectively doubling the damage award to nearly US$18 billion as a punitive measure. Although the original award

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254 Memorandum Of Law In Opposition To Chevron Corporation’s Amended Motion To Compel The Weinberg Group To Produce Documents Pursuant To Federal Rule Of Civil Procedure 10, available online at: <http://lettersblogatory.com/wp-content/uploads/2012/04/Weinberg-opposition.pdf> accessed on 22 August 2013

255 ibid

was affordable to them, *Chevron* would not accept the principle of responsibility for the damage caused, and asserted that there was no provision under domestic law for punitive damages. In March 2011, the company obtained an injunction in the U.S. District Court to prevent Ecuador seeking enforcement of the award in countries outside of their national jurisdiction. Furthermore, a claim was filed before the Permanent Court of Arbitration in The Hague, pursuant to the BIT between the United States and Ecuador; pleading that Ecuador had violated both the Treaty and international trade law, by influencing the adjudication of the case.

The erroneous and unjust judgment concept is not an appreciable diversion, and it would not constitute a ‘denial of justice’ in accordance with the Harvard Research Draft. A judgement by a national court that was determined to be erroneous or unjust would not in itself be considered a denial of justice, for the purposes of international law, in the absence of other probity related factors, such as corruption. The decision of Judge Tanka in the *Barcelona Traction* case is characterised by the expression of a need for a high level of respect for the judiciary, assuming judicial independence from the executive, and a belief that ‘no erroneous or even unjust judgment’ of a court will constitute a denial of justice. Again, in the absence of evidence of corruption, this principle is intended to avoid the decisions of national courts being questioned merely on the basis of disagreement and a hope that a persistent challenge will eventually lead to the ‘right’ result. Such action would be tantamount to the unwarranted supplanting of domestic jurisdiction by the international courts, virtually treating the latter as a court of appeal. The tribunal constituted under NAFTA in the *Azinian v United Mexican* case states that

> The possibility of holding a State internationally liable for judicial decisions does not […] entitle a claimant to seek international review of the national court decisions as though the international jurisdiction seized has plenary appellate jurisdiction. This is not true generally, and it is not true for NAFTA.

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257 ibid
258 *Chevron-Texaco* (n246) 12
260 Robert Azinian, Kenneth Davitian & Ellen Baca *v United Mexican States* ICSID Case No. ARB(AF)/97/2 Award November 1999
Nevertheless, erroneous and unjust judgments that flow from the inconsistent and irrational behaviour of judges are unacceptable in the context of providing a stable environment for the attraction of foreign investment. Judgments contain a ratio decidendi in order to provide consistency in the interpretation of law, a cogent basis for decision-making, and ultimately a gauge against which to measure the performance of the courts.

Even the most developed of nations can, on occasion, find their systems of law called into question. The responsibility of a state to ensure the stability of its justice system is a pre-requisite to the attraction of foreign investment. For the judiciary and executive to be integrally involved in the manipulation of the legal process in order to deny justice and restitution to those it has wronged can jeopardise economic advancement. States have various techniques that they can utilise against foreign investors, in the misguided belief that short-term gain will bring sustainable advantage. In the principles of state responsibility under international law to account for its actions, unjust enrichment at the expense of a foreign investor will be considered.

4.2.2 State Responsibility for Unjust Enrichment

Many jurisdictions have some form of ‘unjust enrichment’ principle written in law in order to regulate standards of probity in behaviour between citizens, the state and foreign investors. Examples in domestic law assist in the attempt to ascertain the general principles that are relevant to state-investor relations and disputes. In Qatari legislation, in the Civil Law Code, unjust enrichment is integrally linked with recompense:

Every person, even if he is not qualified legally, who enriches himself at the expense of someone else without a legitimate reason, is committed to compensate that person for such loss and within the extent of that enrichment. This commitment remains in place even if the enrichment situation is changed later. 261

In England it is largely the common law and equity procedures rather than legislation that recognises and applies the concept of unjust enrichment. In the Lipkin Gorman v

261 Art. 220 Qatari Civil Law No. 22/2004
Karpnale Ltd case, a partner and signatory of Lipkin Gorman stole the firm’s money, gambling it away at the defendant’s casino, Karpnale Ltd. The House of Lords ruled that the casino had to pay back the monies it had received, only to the extent that they had unjustly enriched it. Therefore, the amount was limited to the ‘unjust’ element of its enrichment. Given that the defendant acted in good faith, and the dishonest solicitor experienced periods of success at the casino, the defendant was permitted to deduct a sum equivalent to the winnings that it had paid out before making restitution to his firm.

The USA enacted the Third American Restatement of Restitution in 2011, affirming that ‘a person who has been unjustly enriched at the expense of another is subject to liability in restitution’. The principle may also be applied in an international arbitration claim for loss, and generally constitutes (i) the existence of an enrichment or benefit to the defendant, (ii) that benefit is gained at the plaintiff’s expense, and (iii) it is, for some reason, depending on the circumstances of the case, and this justifies restitution.

Although recognised as a general principle of law and justice, the nature, definition and effect of unjust enrichment still appears to be somewhat elusive. Academics make a commendable attempt to resolve the definition problem, on the basis that it is a principle applicable to domestic standards of behaviour and for the local courts to enforce. Mohebi asserts that

The concept of general principle of law has meanings. They are the selfsame fundamental principles or rules originating from different legal systems, and are considered as the common legal heritage of human communities, such as principles of good faith, respect of obligations, reparation of damage, etc. In fact, such fundamental principles constitute the foundation for legislative authorities in national systems to justify the legitimacy of their enactments.

262 House of Lords [1991] 3 WLR 10
263 The Restatement (Third) of Restitution and Unjust Enrichment (American Law Institute 2011) Art. 1
266 Ibid 122
International case law on instances of state enrichment at the expense of a foreign investor, who has suffered as a result of the unjust behaviour of the host state, provides a useful insight into its practical application. In 1925, Lena Goldfields Ltd (LGL) entered into an exploration and mining concession agreement for a period of 50 years, on over 20,000 square miles of Soviet territory. Any change of terms was to be by agreement. It was an expression of the regime’s new economic policy to encourage foreign enterprises to enter the Soviet Union in order to stimulate development and employment. This was to change four years later with the advent of the ‘Five Year Plan’, which dedicated the economy to communism and state control, thereby making the government both the supplier and the consumer, and devastating the plaintiff’s profitability. Further harassment followed, with the victimisation of LGL staff, police raids and arrests for spying and subversion. The Soviet government had ‘unjustly enriched’ itself by its actions in effectively seizing control of the project and all that flowed from it. LGL subsequently sued the Soviet Union in a Court of Arbitration, for damages sustained due to breach of contract. The claim was for (i) the present value of future profits lost as a consequence of the USSR government’s action, and (ii) for restitution to LGL of the full and present value of its properties. In September 1930, the Court held in their favour on both counts, awarding a total of £12,965,000.

This case has considerable jurisprudential importance, introducing in the late 1920s as it did a new era of resolution by international adjudication of state-foreign investor disputes, determining required standards of behaviour and implementing ‘unjust enrichment’ as a principle for judicial enforcement. Put simply, the Soviet Union breached its concession contract with the Lena Goldfields mining company, by creating circumstances that wrecked LGL’s business. Compensation was claimed for breach of contract and also “alternatively, restitution of the full present value of the Company’s property by which the government had been unjustly enriched”. The ad hoc arbitration panel had just one day to prepare for and hear argument and debate, before undertaking the ‘novel and politically charged task’ of ruling against a country

268 ibid
and awarding damages for unjust enrichment.\textsuperscript{269} Relying on both Soviet and continental European law, the court determined:

\begin{quote}
The conduct of the Government was a breach of the contract going to the root of it. In consequence Lena is entitled to be relieved from the burden of further obligations thereunder and to be compensated in money for the value of the benefits of which it has been wrongfully deprived. On ordinary legal principles this constitutes a right of action for damages, but the Court prefers to base its award on the principle of ‘unjust enrichment’, although in its opinion the money result is the same.\textsuperscript{270}
\end{quote}

Another notable case of unjust enrichment is known as the \textit{Chorzów Factory} case of 1928, which had its roots in the 1919 Treaty of Versailles, which specified that certain territories, including Chorzow, be transferred from German to Polish control.\textsuperscript{271}

Under the terms of the Geneva Convention, this meant that Chorzow was entitled to seize German property on its territory, as part of war reparation payments, and disputes thereunder were to be referred to the Permanent Court of International Justice (PCIJ). The domestic courts in one such case decreed that land belonging to a German company, Oberschlesische Stickstoffwerke A.G. (OSAG) be turned over to Poland under the terms of the convention. The question for the PCIJ to decide was its status, and whether it was national, German property and thus subject to seizure under the convention, or if it was privately owned. Poland was judged to have seized private property and was therefore liable to make restitution.

In the context of the protection of rights and the expectation of fair and just treatment of foreign investors, the ruling of the PCIJ is set out in detail:

\begin{quote}
[T]here can be no doubt that the expropriation allowed under Head III of the Convention is a derogation from the rules generally applied in regard to the treatment of foreigners and the principle of respect for vested rights. As this derogation itself is strictly in the nature of an exception, it is permissible to conclude that no further derogation is allowed. Any measure affecting the property, rights and interests of German subjects covered by Head III of the Convention, which is not justified on special grounds taking precedence over the Convention, and which oversteps the limits set by the generally accepted principles of international law, is therefore incompatible with the regime established under the Convention. The legal designation applied by one or
\end{quote}

\textsuperscript{269} Lena Goldfields Ltd v USSR (n267)
\textsuperscript{270} ibid 981
other of the interested Parties to the act in dispute is irrelevant if the measure in fact affects German nationals in a manner contrary to the principles enunciated above.\textsuperscript{272}

The seizure therefore did not comply with treaty regulations, and was not merely an expropriation from a nation state. It was instead an illegal seizure from a private foreign investor, meriting damages above and beyond restitution, the prescribed remedy for expropriation under the Geneva Convention.\textsuperscript{273} International law, as propounded in 1930, prohibited expropriation by a host state; and if it did occur, full compensation was required. The PCIJ asserted that a state that breaches international obligations has a duty of reparation to the state affected by its actions. In a reflection of the principle of the civil law of tort in English law, the offending state must ‘as far as possible, wipe out the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed’.\textsuperscript{274} In simple terms, it must right the wrong.

The prohibition of ‘unjust enrichment’ has become an entrenched principle in the international law governing the relationship between a host state and a foreign investor. The \textit{Saluka} Tribunal of 2006 deemed it of broader significance, and specified further conditions to give it effect:

\begin{quote}
The concept of unjust enrichment is recognised as a general principle of international law. It gives one party a right of restitution of anything of value that has been taken or received by the other party without a legal justification. […] more specifically there must have been an enrichment of one party to the detriment of the other, and both must arise as a consequence of the same act or event. There must be no justification for the enrichment, and no contractual or other remedy available to the injured party whereby he might seek compensation from the party enriched.\textsuperscript{275}
\end{quote}

Schwarzenberger somewhat obscures this debate on the application to national and international disputes however, seeking an alternative that appears to lack conviction:

\begin{flushright}
\textsuperscript{272} \textit{Factory at Chorzow}, (1926) Permanent Court of International Justice, Series A, Judgment on Merits No. 7, Para 29
\textsuperscript{273} \textit{Factory at Chorzow} (1928) Permanent Court of International Justice, Series A, Judgment on Merits No. 13 Para 181
\textsuperscript{274} ibid Para 71-74
\textsuperscript{275} \textit{Saluka Investments BV (The Netherlands) v The Czech Republic} 17 March 2006, Permanent Court of Arbitration, Geneva, Partial Award, Para 44, 92
\end{flushright}
‘on the fringes of international law, the principle [of unjust enrichment] tends to already be accepted as a general principle of law, recognised by civilised nations’. 276

However, it can be argued that unjust enrichment is a principle of natural justice rather than law, whose roots appear to lie in an historical setting, particularly in religious observance, which has long dictated behavioural requirements. An example is the prohibition of riba (interest) and usury in loans in the Quran, the Bible and the Old Testament. 277 Usury is understood as one of the many facets of unjust enrichment in matters of faith; from a secular or rationalist view, the lender is enriched at the expense of the creditor, and the interest charged may even exceed the sum of the original loan. 278 Arguably, a law that permits usury effectively protects the lender in his enrichment, thus failing to promote a central principle of justice. As a principle of natural justice, whilst prohibition of unjust enrichment may be desired in the implementation of the law, it is perhaps not always achievable. It must however have a legal framework within which to operate, and as such, principles of natural law are no different from other types of law and regulation of behaviour, such as legislation and common law. A system of equitable enforcement permits a higher degree of judicial discretion, based on the specific merits and justice of a case; providing a shield for the injured investor against harm, rather than a sword in the weaponry of sovereign control of a host state to effect its mischief. Unjust enrichment in terms of state responsibility, in both customary international law and international investment law, can be expressed as ‘expropriation without payment of fair compensation’ to the foreign investor. The concept of expropriation thus needs to be examined in the context of its different forms and limitations on recovery of loss.


277 Qur’an states that: ‘Allah has permitted trade and has forbidden interest’ Surah Albaqarah 275 and in Exodus ‘If thou lend money to any of My people, even to the poor with thee, thou shalt not be to him as a creditor; neither shall ye lay upon him interest’ Chapter 22:24

i) Expropriation and Rights of the Investor Under Customary International Law

The question to be considered is whether a state, using its sovereign authority, has a right to expropriate the property of a foreign investor, and the limitations on its exercise should such an entitlement exist. An answer is contained in Article 4 of the General Assembly Resolution on Permanent Sovereignty Over Natural Resources (1962):

Nationalisation, expropriation or requisitioning shall be based on grounds or reasons of public utility, security or the national interest, which are recognised as overriding purely individual or private interests, both domestic and foreign. In such cases the owner shall be paid appropriate compensation, in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law. In any case where the question of compensation gives rise to a controversy, the national jurisdiction of the State taking such measures shall be exhausted. However, upon agreement by sovereign States and other parties concerned, settlement of the dispute should be made through arbitration or international adjudication.

Further understanding of the concept is provided in Chapter II of the Charter of Rights and Duties of States (1974), reflecting the following provisions:

To nationalize, expropriate, or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely mutually agreed by all States concerned that other peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principle of free choice of means.

Evidently, authoritative international conventions give states the right to expropriate and nationalise foreign assets on its territory; which will be of considerable concern for those seeking to invest their money overseas. The General Assembly Resolution on Permanent Sovereignty Over Natural Resources; and the Charter of Rights and Duties of States do not provide a definitive definition of ‘expropriation’ or ‘nationalisation’. Many BIT or MIT investment treaties refer to these terms in a general manner, tending to focus on the conditions that must be met by states for such activities to be lawful. Article IV (I) of the Sweden–Mexico BIT, for example,

279 General Assembly Resolution Permanent Sovereignty over Natural Resources (United Nations No. 1803 (XVII) 14 December 1962)
280 Chapter II UN Charter (n147)
stipulates that ‘neither contracting party shall expropriate or nationalise an investment of an investor of the other contracting party, either directly or indirectly through measures tantamount to expropriation or nationalisation (hereinafter referred to as ‘expropriation’). Chapter 1110 of NAFTA even mentions the term ‘expropriation’ without providing any explanation of its meaning: ‘no party may directly or indirectly nationalise or expropriate an investment of an investor or another party in its territory or take a measures tantamount to nationalisation or expropriation of such an investment (‘expropriation’). Expropriation, is a sovereign right of a host state, which can be described actions by the host state where it seeks to deprive a foreign investor, whether wholly or in part, of its rights to exploit or manage a project provided that other conditions are present: (i) it should be for public purposes, (ii) implemented in a non-discriminatory manner and (iii) give rise to payment of prompt and adequate compensation. This is ‘lawful’ expropriation. It becomes ‘unlawful’ when one of these conditions is absent; and the failure to make payment of adequate compensation or recompense to the aggrieved party is generally the most litigious element in state-foreign investor disputes, where the unjust enrichment of a host state arises. ‘Fairness’ is an issue that becomes relevant when attempts are made to negotiate a settlement between the investment parties, before an arbitration authority is called upon to deal with a failure to agree.

Failure to compensate for the seizure of control of foreign investment assets, whether physical or economic, is also viewed as unjustified enrichment of the host state, at the expense of the home nation of a foreign investor; and therefore is an international issue. Economic resources originating in another state will have been transferred to the territory of the host state in order to effect the investment project, then have been wrongfully seized via the investor, as the benefit of that investment. In the context of ‘unjust enrichment’ and expropriation, it may be viewed as the deprivation of another sovereign state by proxy. Expropriation of foreign assets is a rather rich source of litigation. When a foreign investor and their home nation invest money and

281 Agreement between the Government of Sweden and the Government of the United Mexican States Concerning the Promotion and Reciprocal Protection of Investments (Sweden-Mexico BIT) 3 October 2000
282 Chapter 11 Art. 1110 NAFTA (n16)
expertise into a host state, they are looking for a profit rather than pursuing a primarily altruistic aim. The definition of ‘expropriation’ and the risks and methods of limiting its effect need to be considered.

ii) Expropriation and Nationalisation

The concept of ‘nationalisation’ differs in its scope and extent from ‘expropriation’. The latter is commonly utilised to describe measures taken by the host state in individual cases, while the concept of ‘nationalisation’ is a measure of larger change in the economic and social operation of a state. Occasionally, dependent on the extent of the host state action of seizure, the terms are used interchangeably; hence ‘expropriation’ of entire industries or sectors of the economy are described by Newcombe and Paradell as ‘nationalisation’. The Tribunal in the Lauder v Czech Republic case stated that:

In general, expropriation means the coercive appropriation by the State of private property, usually by means of individual administrative measures. Nationalisation involves large-scale taking on the basis of an executive or legislative act for the purpose of transferring property or interest into the public domain.

Many BITs and MITs do not distinguish between the concepts of nationalisation and expropriation, perhaps because for the foreign investor, they may have same practical and legal impact. The term ‘expropriation’, therefore, will be used hereafter to describe actions where state seeks to deprive a foreign investor, wholly or in part, of its rights to exploit or manage a project, as mentioned above.

iii) Types of Expropriation

Chapter 1110 of NAFTA outlines types of state behaviour in the context of expropriation, as the direct or indirect nationalisation or expropriation by the state of


285 Lauder v Czech Republic UNICITRAL Award 3 September 2001 Para 200
an investment made by a foreign investor on its territory, or the taking of measures tantamount to that.

A) Direct Expropriation

This is the action of a responsible, sovereign host state aimed at achieving the forced transfer of property from a private individual to the nation. In the case of LG&E v Argentina, the tribunal dealing with the issue of liability called it ‘the forcible appropriation by the state of the tangible or intangible property of individuals by means of administrative or legislative action’. The transfer of property requirement in the definition has been reaffirmed more recently in the Enron v Argentina case, where ‘the tribunal does not believe there can be a direct form of expropriation if at least some essential components of property rights have not been transferred to a different beneficiary, in particular the State’.

Another example occurred in the dispute between Compania del Desarrollo de Santa Elena, S.A. v Republic of Costa Rica, which arose over the compensation price for expropriation by the state. The claimant company (CDSE) was formed in 1970 to purchase property in Santa Elena, Costa Rica in order to develop a tourist resort and residential community. A majority of CDSE’s shareholders were U.S. citizens. In May 1978, Costa Rica issued an expropriation decree for Santa Elena and proposed to pay CDSE US$1.9 million in compensation, calculated on the basis of an appraisal conducted a month previously by one of its agencies. CDSE did not object to the expropriation but it did contest the amount to be paid in recompense for its lost investment, claiming US$6.5 million, according to the property appraisal three months earlier, carried out by the Chief Appraiser of the Banco de Costa Rica. In 1995, the ICSID arbitral tribunal stated that the compensation and interest together equalled US$ 16 million.

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286 ibid Para 187
287 Enron Corporation Ponderosa Assets, L.P. v Argentina Republic ICSID Case No. ARB/01/3 Award 22 May 2007 Para 243
Direct expropriation may simply be enacted by the issue of a legislative instrument or decree by a host state. This results in the authorities taking enforcement action, seizing and transferring ownership of an investment project’s property. The investment is therefore directly taken over by the host state through such actions.

**B) Indirect Expropriation**

There has been a proliferation of definitions and explanations of indirect expropriation in both international conventions and case law. Given the purpose of this research is to attempt to examine not merely the academic aspects of the law but its practice in dispute resolution, it is proposed to consider pertinent examples of the concept in arbitration. The United Nations Conference on Trade and Development (UNCTAD) defines ‘creeping expropriation’ as:

\[
\text{[T]he use of a series of measures in order to achieve a deprivation of the economic value of the investment. In this case, no individual measure in itself would amount to an expropriation.}^{289}\text{ It is not generally an overt, obvious action of the part of a host state but is comprised of a number of elements, none of which can-separately-constitute the international wrong. These constituent elements include non-payment, non-reimbursement, cancellation, denial of juridical access, actual practice to exclude, non-conforming treatment, inconsistent legal blocks, and so forth. The ‘measure’ at issue is the expropriate itself; it is not merely a sub-component part of expropriation.}^{290}
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Investment dispute arbitration tribunals recognise creeping expropriation as an illegitimate programme conducted by a state to deprive a foreign investor of their property and entitlements. The tribunal in the *Santa Elena v Costa Rica* case emphasises that a range of behaviour used by states to deprive foreign investors is key to understanding how indirect expropriation is operated:

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\text{[T]here is a wide spectrum of measures that a state may take in asserting control over property, extending from limited regulation of its use to a complete and formal deprivation of the owner’s legal title. Likewise, the period of time involved in the process may vary – from an immediate and comprehensive taking to one that only gradually and by small steps reaches a condition in which it can be said that the owner has truly lost all the attributes of ownership. It is clear, however, that a measure or series of measures can}
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still eventually amount to a taking, though the individual steps in the process do not formally purport to amount to a taking or to a transfer of title.\textsuperscript{291}

In all business projects, timing is a major factor in achieving success and profitability, and a host state, by its sovereign conduct, can achieve the aspiration of a visionary through the manipulation of time. In a contract made under the BIT between Italy and Lebanon, the duration of a road construction project in the case of \textit{Toto Costruzioni Generali S.P.A v Republic of Lebanon} was predicted to last some 18 months, but due to the alleged interference by the state of Lebanon, actually took in excess of five years to complete. The claimant from the Italian company argued before the ICSID tribunal:

\begin{quote}
By extending the time for completion, because of acts and measures adopted by theRespondent in addition to changing the institutional framework by decisions adopted by the Respondent through increasing taxes, closing quarries and other similar measures, the Respondent eroded the Claimant’s profit and deprived the investment of economical values which is equivalent to an indirect expropriation.\textsuperscript{292}
\end{quote}

The tribunal disagreed, and made no finding against Lebanon. This was largely because the claimant failed to prove the particular elements and to explain how each of the individual delays could be blamed on the host state. An allegation of ‘creeping’ conduct is thus exceedingly difficult to prove.

In the \textit{CME Czech Republic B.V (The Netherlands) v The Czech Republic} case, the claimant, \textit{CME} argued that an indirect expropriation had been undertaken by the host state under the BIT between the Netherlands and the Czech Republic.\textsuperscript{293} The Czech media regulatory agency (the Media Council) took action that required the foreign investor to restructure its deal with the licence holder. The Council had previously approved an arrangement in which \textit{CNTS}, a company owned by \textit{CME}, would have the right to use the television licence of \textit{CET 21}, a Czech company. \textit{CNTS} was in fact granted certain protections under the Memorandum of Association, related to both its use of the licence and its exclusive service agreement with \textit{CET 21}.\textsuperscript{294}

\begin{footnotes}
\footnote{Compañía del Desarrollo de Santa Elena, S.A. (n288) Para 76}
\footnote{Toto Costruzioni Generali S.P.A v Republic of Lebanon ICSID Case No. ARB/07/12 Award 7 June 2012}
\footnote{CME Czech Republic B.V (The Netherlands) v The Czech Republic UNICITRAL Partial Award 13 September 2001}
\footnote{ibid Paras 1-20}
\end{footnotes}
later the Media Council launched administrative and criminal investigations, which forced CME to surrender some of those protections. Three years after that, in response to a request by CET 21 (the Czech licence holder), the Council issued a letter stating that service agreements could only be undertaken on a non-exclusive basis, thereby causing CET 21 to terminate the agreement and commence operation of the TV station.\textsuperscript{295}

Consequently, the tribunal, in a lengthy judgment, stated that the Media Council caused the failure of CNTS’ operation, leaving it a company with assets (as no direct expropriation had been taken on CNTS’ assets), but without business. The commercial value of CME’s investment in CNTS was nullified by the Media Council’s coercion.\textsuperscript{296} After making all the necessary adjustments, the Tribunal awarded CME damages of US$ 270 million plus simple interest of 10% per annum from the date of the arbitration request up to the date of payment.

There is another case that characterises creeping expropriation. The \textit{Tza Yap Shum v Republic of Peru} case involved allegations of a breach by the state of Peru of a BIT with China.\textsuperscript{297} A Chinese national held a 90% share in TSG del Peru, the coordination and financial arm of a hugely profitable fishmeal export company. In addition to Shum’s financial input, TSG, and therefore the profitability of the company and the host state benefitted directly from the claimants’ personal and business contacts. The Peruvian banks were only used by the company for administration purposes, rather than in a more substantial manner. Nevertheless, the Superintendencia Nacional de Administración Tributaria (SUNAT), the tax authorities of the host state, decided to undertake what they claimed was a routine review of the activities of TSG, relating to the movement of money. They subsequently alleged fiscal misconduct, claiming substantial back taxes and penalties. Furthermore, in a measure reserved for ‘exceptional circumstances’ of concealment and lack of disclosure by a company, TSG’s accounts were frozen, making it extremely difficult to operate the business.

\textsuperscript{295} ibid Para 474  
\textsuperscript{296} ibid Para 591  
\textsuperscript{297} Tza Yap Shum v Republic of Peru, ICSID Case No. ARB/07/6 Award 7 July 2011. The case was in Spanish, the selected summary of award from International Arbitration Case Law by Case Report by Kenneth Juan Figueroa, School of International Arbitration, Queen Mary, University of London
Shum claimed that the action of the host state authorities amounted to the indirect expropriation of the project, after the money had been invested by him, and details regarding his business contacts secured. The ICSID tribunal agreed, finding that SUNAT had directly impacted upon TSG’s ability to function as a business. Both auditors instructed by TSG and those used by the host state in the course of the proceedings, found nothing to support the contentions of the tax authorities. The arbitration tribunal found in favour of the claimant, deeming the state to have acted in an arbitrary manner, indirectly, but effectively expropriating Tza Yap Shum’s investment. This left TSG, which had not acted in bad faith as suggested by the state, without effective recourse to due process. With respect to damages, the adjusted future cash flow of TSG was an inappropriate basis for compensation, and instead, compensation was based upon the adjusted book value of TSG. Thus Tza was awarded US$786,306.24 in compensation, plus interest.

These cases illustrate the coercion that a host state may impose on foreign investors, directly affecting their business. All these actions are known in investment arbitration as creeping expropriation.

C) Assessment of the Terminology of Direct and Indirect Expropriation

Direct expropriation is a relatively overt action by a host state, and as such is simple to identify. It usually involves the seizure of a foreign investor’s assets by a host state; and there is a broad consensus on the effects of such action, given by differently constituted tribunals. However, indirect expropriation is more difficult to define, identify and prove. Even various international treaties and arbitration tribunals responsible for developing and enforcing the principle have problems providing definitive interpretations. Chapter 1110 of NAFTA provides such an example. A tribunal constituted with a particular panel of personnel may conclude on a set of facts in a manner differently from another body of judges, thus leading to a lack of clarity on the details of the term, from allegation to proof. Where the state acts in a manner that interferes with an investor’s ability to operate their business, by creating practical obstacles for an investment project, this may be more suitably considered to be a

298 ibid 3-5
299 ibid
breach of the agreement. Additionally, the efficacy of the continuation of the project will be of significance in the assessment of whether expropriation has occurred.

This was the conclusion reached in the case of *EnCana v Republic of Ecuador*, when the host state defendant reorganised its tax regime, causing loss to the claimant. The tribunal rejected the claimant’s assertion of indirect expropriation, because although there was an adverse effect on company profitability, the tax law, applicable to all commerce on the host state territory, did not prevent its operation:

Although the EnCana subsidiaries suffered financially from denial of VAT and the recovery of VAT refunds wrongly made, they were nonetheless able to continue to function profitably and to engage in the normal range of activity, extracting and exporting the oil (the price of which increased during the period under consideration). There is nothing in the record which suggests that the change in VAT laws or their interpretation brought the companies to a standstill or rendered the value to be deprived from their activities so marginal or unprofitable as effectively to deprive them of their character as investment.

The application of *EnCana* appears to betray a certain expectation of preferential treatment by Ecuador, but ‘in the absence of a specific commitment from the host State, the foreign investor has neither the right nor any legitimate expectations that the tax regime will not change, perhaps its disadvantages, during the period of investment’.

The tribunal further stated that ‘only if tax law is extraordinary, punitive in amount or arbitrary in its incidence would issues of indirect expropriation be raised’. It is entirely conceivable that the facts of the case could have led to a finding of indirect expropriation by a differently constituted panel, given that a national tax regime change can significantly undermine the profitability of an international project, diverting profit to the state that it would not have previously been entitled to. This potential problem is possibly resolvable by negotiation in the BIT or individual investment contract.

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300 *EnCana Corporation v Republic of Ecuador* UNICTRAL Decision London Court of International Arbitration Award 3 February 2006
301 ibid Para 174
302 ibid Para 173
303 ibid Para 177
The implementation of a contract requires cooperation and good faith from each party. Where one party, particularly a host state, obstructs the process and implementation of the agreement, it is usually regarded as a breach of contractual obligation rather than indirect expropriation, and remedial action is therefore required. The extent and effect of obstructive conduct, and whether it amounts to breach of a specific term of the investment contract should be considered. The host state can cause great inconvenience and potential loss for a foreign investor in its sovereign role of management of its economy. In the event of a claim, a tribunal must examine and analyse individual circumstances, in order to ascertain the intention behind changes to the investment environment. Some actions may constitute a breach of contract, and compensation may be awarded on this basis, if proven, rather than on the more nebulous moral principle of conduct ‘in bad faith’. It is appropriate that protections from the effects of state action should be expressly incorporated into the agreement. Negotiation at the signature stage is an essential prerequisite to protect the interests of an astute foreign investor, whilst failures at the formative stage of an agreement should arguably not afford a route to compensation under the guise of indirect expropriation.

iv) Limitations to the State’s Right of Expropriation

International treaties, negotiated between states in order to facilitate the smooth exchange of trade, generally accept foreign investor proprietary rights such as ownership and the exploitation and management of resources in their investment projects, although there is an expectation of respect from the host state for these entitlements. Action taken by a host state to expropriate property belonging to an investor (whether physical, commercial or intellectual), under the principle of sovereignty must therefore be subject to limitation. Treaties incorporate restrictions on the absolutist interpretation of sovereignty in order to facilitate the promotion of world trade, and it is useful to consider the breadth of support for this principle illustrated in various BITs and MITs. Multilateral treaties incorporate remarkably similar specifications for expropriation. Article (4) of the General Assembly Resolution in Permanent Sovereignty Over Natural Resources (1962) declared that:

Nationalisation, expropriation or requisitioning shall be based on grounds or reasons of public utility, security or the national interest, which are recognized
as overriding purely individual or private interests, both domestic and foreign. In such cases the owner shall be paid appropriate compensation.  

Article 3 of the Organisation for Economic Co-operation and Development Draft (1967) (OECD Draft) states that:

No Party shall take any measures depriving, directly or indirectly, of his property a national of another Party unless the following conditions are complied with: (i) The measures are taken in the public interest and under due process of law; (ii) The measures are not discriminatory or contrary to any undertaking which the former Party may have given; and (iii) The measures are accompanied by provisions for the payment of just compensation.

Article 13 of the ECT states that:

[The] Investment of investor of a contracting party in the area of any other contracting party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent no nationalisation or expropriation (hereinafter referred to as “expropriation”) except where such expropriation is: (a) For a purpose which is in the public interest; (b) Not discriminatory; (c) Carried out under due process of law; and (d) Accompanied by the payment of prompt, adequate and effective compensation.

Chapter 1110 of the NAFTA also deals with similar limitations:

No party may directly or indirectly nationalize or expropriate an investment of an investor of another party in its territory or take a measures tantamount to nationalisation or expropriation of such an investment (“expropriation”), except: (a) For a public purpose; (b) On a non-discriminatory basis; (c) In accordance with due process of law and Article 1105(1) [providing for minimum international standards of treatment, including fair and equitable treatment]; and (d) Upon payment of compensation in accordance with paragraph 2 to 6 [which] require compensation at fair market value, to paid without delay, with interest.

BIT clauses, where incorporated, are modelled on the terminology of the multilateral treaties and share significant similarities. Article 6 of the United States Model BIT provides a definitive example, stipulating that:

Neither party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalisation (“expropriation”), except: (a) for a public purpose; (b) in a non-discriminatory manner; (c) on payment of prompt, adequate, and effective

304 Art. 4 UN Resolution on Permanent Sovereignty over Natural Resources (n279)
305 Art. 3 OECD Draft Guidelines for Multinational Enterprises 1976
306 Art. 13 ECT (n53)
307 Chapter 1110 NAFTA (n16)
It is clearly evident that the expropriation of a foreign investment project by a host state is not prohibited per se. As has been illustrated, international law will countenance expropriation on the basis of three limitations upon the potential wilful arbitrariness of the action: (i) it should be for a public purpose; (ii) on a non-discriminatory basis, and (iii) compensation must be paid. Each of these principles has developed its own body of case law.

A) Expropriation for a Public Purpose

Public purpose has numerous manifestations, including public interest, utility and benefit inter alia. They each contain a degree of ambiguity in definition, and indeed, several of the international agreements entered into by the UK tend to narrow its scope of operation. For example, the treaty between the UK and Costa Rica asserts that ‘the public purpose must be related to the internal needs of the host state’.  

International investment tribunals require a state to provide evidence to justify any action claimed to be undertaken for public purpose, and the cogency of that evidence will be closely scrutinised. In the *ADC Management Limited v The Republic of Hungary* case, a host state decree voided the Hungarian government’s agreement with foreign investors for the operation and management of Budapest Airport, and the state assumed control of the airport in 2002, before being privatised in 2005. The claimant investor asserted that Hungary had never articulated a public interest justification for its conduct, other than a general strategic interest. The government counter-argued that its measures were part of harmonisation process to promote the nation’s public benefit, in order to gain admission to the European Union; and thus

\[308\] Art. 6(1) United States Model BIT 2012; Art. 13(1) Canadian BIT Model law; Art. 5 French Model BIT 2006  
\[309\] Newcombe (n284) 370  
\[311\] *ADC Affiliate Limited and ADC & ADMC Management Limited v The Republic of Hungary* ICSID Case No. ARB/03/16 2 October 2006
Hungary’s access to the EU was a strategic interest of the state. The question of the legality of what was a clear case of expropriation stood to be determined.

When considering the public interest standard of the expropriation of the project, the ICSID tribunal examined the ensuing actions of the Hungarian government, and noted that

[The] subsequent privatisation of the airport involving BAA and netting Hungary USD 2.26 billion renders any public interest argument unsustainable. In the opinion of the Tribunal, this is the clearest possible case of expropriation.

The court further commented on the evidential requirements when public interest is claimed:

A treaty requirement for “public interest” requires some genuine interest of the public. If mere reference to “public interest” can magically put such interest into existence and therefore satisfy this requirement. Then this requirement would be rendered meaningless since the Tribunal can imagine no situation where this requirement would not have met.

Continuing the requirement of actual evidence rather than mere pronouncement, the conclusion reached was one of dissatisfaction with Hungary’s contention:

With the claimed “public interest” unproved and the Tribunal’s curiosity thereon unsatisfied, the Tribunal must reject the arguments made by the Respondent in this regard. In any event, as the Tribunal has already remarked, the subsequent privatization and the agreement with BAA renders this whole debate somewhat unnecessary.

It is possible to imagine an alternative reading of the facts, namely that in the actions of the state, ‘public interest’ need not be considered an element of expropriation. It is instead arguably an exercise in state sovereignty entitlement, bringing into play the requirements of recompense to a foreign investor. However, such an interpretation would be a considerable disincentive to foreign investors to expend their money and expertise, particularly if there is no just and reliable framework in place for restitution for any value lost. Given the existence of sovereign rights and the presence of an obligation to act for the benefit and interests of its own nationals, a state should not find a practical difficulty in proving a public utility argument for its actions, despite the ADC decision.

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312 ibid Para 222
313 ibid Para 304
314 ibid Para 432
315 ibid Para 433
The Siemens A.G. v Argentina case involved an agreement between the German corporate investor and the host state to provide immigration and identification services.\textsuperscript{316} The election of a new government in Argentina precipitated the suspension of the operation of the contract in 1999. The state then sought to renegotiate the contract, after it had already received substantial financial and intellectual property investment from Siemens, and thereafter attempted to pursue its own financial agenda, renege on the renegotiated contract and impose terms that effectively deprived Siemens of its investment. The subsequent ICSID tribunal found that the actions of the state amounted to the expropriation of Siemens’ assets and that there was no evidence of a ‘public purpose’ for the series of measures undertaken by that state relating to the concession contract. It was simply an obvious attempt by the Argentinian government to save money by trying to renegotiate terms with the investor. The financial crisis of 2000 was the catalyst for the actions by Argentina, and could therefore amount to a ‘public purpose’ according to the tribunal; but as in the ADC Management Ltd case, the subsequent conduct of the state deprived it of credibility.\textsuperscript{317} Argentina’s argument of fiscal distress as justification was not accepted, particularly given the multiple breaches for which the investor was entitled to be compensated.

It is difficult to identify what benefits accrue to the state following the plea of ‘public purpose’. It has been noted that state sovereignty includes the right of expropriation:

\begin{quote}
Every State has the right to nationalise, expropriate, or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent.\textsuperscript{318}
\end{quote}

It does not appear necessary to justify expropriation by asserting a ‘public purpose’ defence, if the investment is of foreign origin, except in so far as it provides a level of credibility to actions that may be less alienating to prospective investors.

The public purpose expropriation of a project is potentially more palatable to domestic investors, as they have a greater perception of the benefit to their community or state. Domestic investors will still want compensation for their loss;

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\textsuperscript{316} Siemens A.G. v Argumenta Republic ICSID Award Case No. ARB/02/8, 17 January 2007
\textsuperscript{317} ibid Paragraph 273; see Newcombe (n284) 372–373
\textsuperscript{318} The Charter of Economic Rights and Duties of States (n151) (emphasis added)
\end{flushright}
although they will not have access to the processes of international law. A foreign investor is likely to be considerably less interested in the alternative public purpose use of their expropriated project, as they are not a member of the host state community, and their main interest will be compensation for their loss; they may also seek the return of their project via tribunal award, only to discover that the host state has put public purpose on the dispute agenda in order to overcome suggestions of self-interested expropriation, as seen in the *ADC Management Limited v The Republic of Hungary* case discussed above.\(^{319}\)

The *Compañía del Desarrollo de Santa Elena, S.A. v Costa Rica* case involved an investment agreement entered into for land purchase and tourism development, between American nationals and Costa Rica in 1970.\(^{320}\) On the effect of a public purpose argument relating to the host state’s expropriation of the land in 1978, the Tribunal stated that:

> While an expropriation or taking for environmental reasons may be classified as a taking for a public purpose, and thus be legitimate, the fact that the property was taken for this reason does not affect either the nature or the measure of the compensation to be paid for the taking. That is, the purpose of protecting the environment for which the Property was taken does not alter the legal character of the taking for which adequate compensation must be paid. The international source of the obligation to protect the environment makes no difference.\(^{321}\)

Public purpose therefore appears to justify the legality of an action, but not the level of compensation payable. The ICSID tribunal underscored this principle emphatically:

> Expropriatory environmental measures – no matter how laudable and beneficial to society as a whole – are, in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state’s obligation to pay compensation remains.\(^{322}\)

\(^{319}\) *ADC Affiliate Limited and ADC & ADMC Management Limited v The Republic of Hungary* ICSID Case No. ARB/03/16, 2 October 2006, 77

\(^{320}\) *Compañía del Desarrollo de Santa Elena, S.A.* (n288)

\(^{321}\) *ibid* Para 17

\(^{322}\) *ibid* Para 72
B) Expropriation Undertaken on a Non Discriminatory Basis

Non-discrimination in international investments is typically related to its meaning in customary international law. Foighel asserts that:

The rules of international law against discrimination can be considered to be satisfied when foreigners are given formal equality with the nationals of the country in question in respect of protection in similar situation. 323

The intention behind this principle is to prevent a host state from justifying expropriation on the basis of its foreign policy interests. 324

Article 1102(4) of NAFTA warns against discriminatory action by host states, that demand significant involvement or financial interest of its own nationals in a foreign investment project; stipulating that:

No party may: (a) impose on an investor or another party a requirement that a minimum level of equity in an enterprise in the territory of the party be held by its nationals, other than nominal qualifying shares for directors or incorporators of corporations; or (b) require an investor of another party, by reason of its nationality, to sell or otherwise dispose of an investment in the territory of the party. 325

Maniruzzaman further contends that the concept of discrimination requires the consideration of two further elements relating to its perpetration; (i) measures directed against a particular party must be for reasons unrelated to the investor party, whether it be a perceived personal, racial or national characteristic, for example, the home state of the company; and (ii) the avoidance of discrimination requires the foreign party to be treated in an equivalent manner to a national of the host state. 326

International law demands that states refrain from discriminatory treatment in the realm of foreign investment dealings, but it is less clear what in fact constitutes such

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324 For example, Chavez threatened to expropriate Colombian investments in Venezuela in retaliation for a border incident and allegations of his support for rebels the territorial integrity of Colombia. See Reuters, ‘Chavez said could nationalize Colombian firm’, 6 March 2008. <http://uk.reuters.com/article/topNews/idUKN0510446320080306> Accessed 15 August 2013; see Andrew Newcombe (n284) 370
325 Art. 1102(4) NAFTA
326 Maniruzzaman (n323) 59
conduct. The act of biased behaviour from an individual or state can be perpetrated without overt action, and may therefore only be based on the perception held by an aggrieved party. Dolzer and Stevens have attempted to identify how certain behaviour may constitute discrimination forbidden under international law, and suggest two prerequisites for its determination; (i) the measure must result in actual injury to the foreign investor, (ii) the act must be done with the intention to harm the aggrieved foreign investors. If analysed from an alternative perspective, this amounts to an example of a state failing to provide fair and equitable treatment to a foreign investor. This is a broader concept of the regulation of state conduct, which will be subject to greater examination later in this study.

Where expropriation by the state occurs for discriminatory reasons, it marks a failure to provide fair and equitable treatment of a foreign investor. This breach of an integral principle of state sovereign responsibility leaves proof of discrimination redundant in any claim, as there is no broad, far-reaching application of a doctrine to prevent or prohibit discrimination in either conventional or customary international law. In applying the prohibition, a judge or arbitrator must evaluate all the relevant circumstances relating to conduct and context, as there is no formula or list from which to draw guidance on the acceptability of conduct.

The principle of non-discrimination is also problematic in its enforcement, and it is often prudent for a claimant to seek another route to resolve disputes and payment of entitlements. In the case of American Independent Oil Company (Aminoil), the government of Kuwait granted an oil concession for exploitation by the American company in 1946; and over subsequent years, sought to renegotiate the terms of the agreement before deciding to pursue what was effectively expropriation under Decree Law Number 124 of 1977. Aminoil suggested that the act of nationalisation was tainted by discrimination, because another foreign oil company, the more local Arabian Oil Company (AOC), which operated offshore under a joint concession granted by the governments of Kuwait and Saudi Arabia; had not had its operation

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328 Maniruzzaman (n323) 77
nationalised under the Decree. The ad hoc Arbitral Tribunal rejected outright any suggestion of discrimination, stating:

First of all, it has never for a single moment been suggested that it was because of the American nationality of the Company that the Decree Law was applied to the Aminoil’s concession. Next, and above all, there were adequate reasons for not nationalising Arabian Oil. AOC’s high-cost offshore production operations are such as to give it a special position which requires a high decree of expertise. At the same time, it is working within the framework of a concession granted by both Kuwait and Saudi Arabia, so its position is completely different. Any modification of concession must be agreed to by both countries.  

AOC was being cited as a comparison by Aminol, in support of its argument concerning differential, discriminatory treatment; however, it appears to have mistakenly chosen a company with a completely disparate business model and investment agreement arrangements.

C) Expropriation Should be Upon Payment of Compensation

The sovereign right of a host state to expropriate property of a foreign investor is balanced by the protection afforded by international law to an aggrieved party’s right of compensation. The recompense principle is commonly enshrined in both BITs and MITs, in terms similar to that of the United States and the Republic of Uruguay; where ‘neither party may expropriate or nationalise a covered investment either directly or indirectly through measures equivalent to expropriation or nationalisation (“expropriation”), except […](c) on payment of prompt, adequate, and effective compensation’.  

However, while it may not be specifically referred to in some international conventions, this does not reduce its importance. Article 1 of Protocol 1 of the European Convention for the Protection of Human Rights and Fundamental Freedoms 1950, came into effect in September 1953. It does not explicitly state the principle

330 ibid Para 585
331 Art. 6 Treaty between the United States of America and the Oriental Republic of Uruguay concerning the Encouragement and Reciprocal Protection of Investment, with Annexes and Protocol (United States-Uruguay BIT) 4 November 2005
332 European Convention for the Protection of Human Rights and Fundamental Freedoms 1950
of compensation, but strongly implies that the duty to compensate is applicable to the normal regulation of international investment agreements:

Every natural or legal person is entitled to the peaceful enjoyment of its possessions. No one should be deprived of his possessions except in the public interest and subject to the conditions provided for by the law and by the general principles of international law. The proceeding provisions shall not, however, in any way impair the right of a state to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.\footnote{ibid Art. 1 (Protection of Property)}

It is both prudent and wholly logical that an investor should demand an investment agreement the incorporation of a right to compensation in the event of expropriation by the host state party. This is a vital consideration in the decision-making process of an investor, and there appears to be no incentive to sign a contract if such a term was declined by the host. Other aspects of this entitlement to recompense need to be considered, not least the basis of calculation.

v) Appropriate Date of the Valuation of Seized Assets

Valuation of assets and opportunities for the payment of compensation varies according to when it is undertaken; and is therefore a source of dispute that must be addressed in the relevant multilateral and bilateral treaties. In the case of direct expropriation, it is the date of the expropriating legislation or decree by the host state. Chapter 1110 of NAFTA and Article 6(2) of US Model Law refer to it specifically as the “date of expropriation”. Article 13 of the ECT calls it the “Valuation Date” and the French Model BIT 2006 refers to the “date of dispossession”. The date is usually easily ascertainable, as in the case of \textit{LIAMCO v Government of the Libyan Arab Republic}; where the investor’s oil concession was granted in December 1955 and nationalised by the new regime of the host state on 1 September 1973.

However in the \textit{ADC v Hungary} case, where the state took over the operation of Budapest airport, which was built and run by the American investor claimant, the tribunal held that the appropriate date for valuation, in order to meet the standard of full reparation, was not the date of expropriation, but the date of award. Usually, the value of an investment declines after its seizure by the state. The tribunal noted that
this case was “unique”, given the substantial inflationary differentiation in value between when expropriation actually occurred and when it was adjudicated upon; in favour of the investor, to properly reflect the loss incurred.\(^{334}\) This judgement was clearly deemed by the ICSID panel as an exception to the principle.

Where expropriation is indirect or creeping, the appropriate date of valuation will be within the discretionary decision-making power of the tribunal. In the *Santa Elena v Costa Rica* case, the tribunal stated that:

> There is ample authority for the proposition that a property has been expropriated when the effect of the measures taken by the state has been to deprive the owner of title, possession or access to the benefit and economic use of his property […] The expropriated property is to be evaluated as of the date on which the governmental ‘interference’ has deprived the owner of his rights or has made those rights practically useless.\(^{335}\)

This will, in either instance, be difficult to ascertain, which in turn will affect the valuation to be relied upon. The UNCITRAL tribunal in the *CME Czech Republic B.V (The Netherlands) v The Czech Republic* case decided that the valuation for compensation should be calculated from just before the actual breaching by the respondent, in its adjudication on the partial award said:

> The Respondent is obligated to remedy the injury that Claimant suffered as a result of Respondent’s violations of the Treaty by payment of the fair market value of Claimant’s investment as it was before consummation of the Respondent’s breach of Treaty in 1999 in an amount to be determined at a second phase of this arbitration.\(^{336}\)

Determination of the ‘date of governmental interference’ is simply a matter of judgement, based on the view of the tribunal of when the compensable loss was incurred; but does not have the specificity of a decree or law. It can be a progressive series of actions with no definable date, but remains an element of calculation because the value of the property may change from one day to another.\(^{337}\) The author proposed that the most valid mechanism for evaluating property is by ascertaining the date of

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\(^{334}\) *ADC Affiliate Limited and ADC & ADMC Management Limited v The Republic of Hungary* ICSID Case No. ARB/03/16, IIC 1 (2006), Para 496-497  
\(^{335}\) *Compañía del Desarrollo de Santa Elena, S.A.* (n288) Paras 77-78  
\(^{336}\) *CME Czech Republic B.V (The Netherlands) v The Czech Republic* UNCITRAL Partial Award 13 September 2001, Para 624  
\(^{337}\) Stephan Schill, *International Investment Law and Comparative Public Law* (Oxford University Press 2010) 757
the first action carried out by the host state that deprived the foreign investor of their right to manage the investment property. That is for a tribunal to decide on the facts.

4.2.3 State Responsibility for Failure to Protect a Foreign Investment

The obligation of a host state to facilitate and provide protection to a foreign investment property on its territory is a commonly expressed obligation in customary international law, treaties between nations and individual investment. Typical language used is incorporated in Article 10, Part III of the ECT:

Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area [...] Such Investments shall also enjoy the most constant protection and security.  

The ‘most constant protection and security’ provision (also expressed as ‘full protection and security’) is found in most BITs. Article 2(2) of the United Kingdom–Vietnam BIT, for example, reflects this common formulation, stating:

‘investments of nationals or companies of each Contracting Party shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Contracting Party’.  

Such a pronouncement is entirely logical and prudent, given that the failure to so guarantee will alienate potential investment; and yet it is a mainstay of breach claims made to international tribunals. The host state is obliged to actively protect foreign investor interests from actions which threaten them, whether from competitors, critics or other assorted private interests; as well as the state itself. Provision for the protection of property has helped guarantee the legal status and security of the investor, enabling them to pursue their entitlements under the agreement more effectively and presumably thereby benefit the state’s economy. An investor will always give consideration to the treaty terms between their home state and the repository nation of their money and expertise, in order to ensure the inclusion of the principles of responsibility and obligation in anticipation of circumstances where they

338 Art. 10, Part III ECT (n53)
339 Art. 2(2) Agreement Between The Government of The United Kingdom of Great Britain And Northern Ireland And The Government of The Socialist Republic of Vietnam For The Promotion And Protection of Investments (United Kingdom–Vietnam BIT) 1 August 2002
340 Christoph Schreuer, Full Protection and Security (2010) Journal of International Dispute Settlement 1

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will have little control and thus depend heavily on the host. The state’s obligation appears to require the taking of necessary measures to prevent harm, of which it is aware, to the investors’ interests, and to provide any necessary assistance. However, opinions differ about the level of responsibility a state must exercise; and whether there is an absolute liability to provide security and protection, or whether due diligence will suffice. ‘Due diligence’ broadly means the detailed examination and assessment of risk carried out by a host, with a reasonable standard of care; in order to avoid harm being caused to others. It is the objective standard required of a state in the protection of an investor used in several international treaties, for example, Article 10 of the Harvard Law School Draft proclaims that a ‘state is responsible if an injury to an alien results from its failure to exercise due diligence to prevent the injury’; while Article 1 of the OECD Draft Convention on the Protection of Foreign Property states that:

most constant protection and security must be accorded in the territory of each Party to the property of nationals of the other Parties […] the rule indicates the obligation of each Party to exercise due diligence as regards actions by public authorities as well as others in relation to such property."

The standard of due diligence assumes a pre-existing responsibility for protection of, and prevention of damage to an investor’s interests; it will include circumstances where the state has the opportunity to act, but fails to do so. The ICSID arbitration tribunal in Biwater Gauff (Tanzania) Ltd v Tanzania case referred to the definition by Brownlie in ‘Principles of International Law’; who postulated that a ‘substantive failure to take reasonable, precautionary and preventive action is sufficient to engage the international responsibility of a State for damage to public and private property in that area’.

Arbitral tribunals have also sought to enforce the obligation of due diligence in the assessment of the levels of protection expected of a host state. The Biwater Gauff

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341 Art. 10 Harvard Law School Draft (n225) 131
344 Biwater Gauff (Tanzania) Ltd v Tanzania. ICSID Case No. ARB/05/22, 24th July 2008; Brownlie (n 146) 453
(Tanzania) Ltd v Tanzania, an ICSID case, was a dispute under the auspices of the UK-Tanzania BIT, involving a lease contract to supply water and sewerage services, which encompassed numerous complaints of expropriation and inadequate performance.\textsuperscript{345} The ‘full protection and security’ standard was held to imply due diligence in risk assessments and management, thus requiring state representatives to liaise with parties on the precautionary measures taken to protect investments in its territory; the principle here was preservation of not just physical protection, but also commercial and legal stability.

In the \textit{Asian Agricultural Products Ltd (AAPL) v Sri Lanka} case, the claimant, a Hong Kong private company, established a seafood company in the host state, and in 1987, during a military operation conducted by the security forces of Sri Lanka against an installation reported to be used by local rebels (the Tamil Tigers), one of their farms was attacked and destroyed.\textsuperscript{346} The ICSID tribunal found that malice or even negligence need not be established to support the claim of lack of protection, but ‘the mere lack or want of diligence’ would be sufficient. It went on to state that due diligence “is nothing more nor less than the reasonable measures of prevention which a well-administered government could be expected to exercise under similar circumstances”.\textsuperscript{347} In another case involving domestic unrest in the host state; the \textit{American Manufacturing and Trading Inc. (AMT) v Zaire} case, the tribunal found that Zaire (now known as the Democratic Republic of the Congo), had taken no action whatsoever to protect the claimant’s property during riots in the capital of Kinshasa.\textsuperscript{348} The tribunal found that it was of little or no consequence whether a member of the Zairian armed forces or a common burglar had committed the illegal acts, Zaire had an ‘obligation of vigilance’ and responsibility was established for the failure to provide full protection and security, and for losses owing to the riots or acts of violence.\textsuperscript{349}

In a study by the UNCTAD, the cases outlined above were commented upon as follows:

\textsuperscript{345} ibid \textit{Biwater Gauff (Tanzania) Ltd} Paras 724-725
\textsuperscript{346} \textit{AAPL v Sri Lanka}, ICSID Case No. ARB/87/3, 27\textsuperscript{th} June 1990 Para 18
\textsuperscript{347} ibid Para 18
\textsuperscript{348} \textit{AMT v Zaire} ICSID Case No. ARB/93/1, Final Award 1997
\textsuperscript{349} ibid Para 6.05
While not an obligation of result, an obligation of good faith efforts to protect the foreign-owned property has been established by these recent cases, without special regard for the resources available to do so. This has been referred to as a standard of ‘due diligence’ on the part of the host country. As a result, this standard should be understood as being very much a ‘living’ one. It places a clear premium on political stability, and the obligation of host countries to ensure that any instability does not have negative effects on foreign investors, even above the ability to protect domestic investors.\textsuperscript{350}

A clear correlation is drawn between the need for political stability to attract foreign investment, and subsequent obligations upon the state to facilitate their retention and protection.

4.2.3.1 Protection of Tangible and Intangible Investment Assets

The assets of foreign investors often go beyond the physical, such as land, machinery or products, and include expertise, intellectual property, commercial contacts and trademarks, to name but a few. This gives rise to questions about the extent of state responsibility in the levels of protection afforded to the range of physical, intangible, legal and commercial assets of those who bring commerce into their territory.

A) Tangible Assets

The obligation to protect tangible assets is relatively simple to implement since physical items can be easily seen and assessed. In the Rumeli v Kazakhstan case, the Tribunal noted ‘that the full protection and security standard […] obliges the State to provide a certain level of protection to foreign investment from physical damage’.\textsuperscript{351}

International treaties and arbitration tribunals have embraced enforcement of the obligation to protect investments on a host territory at times of civil instability. Article 5 of the U.S. BIT Model Law states that ‘full protection and security requires each Party to provide the level of police protection required under customary international law’.\textsuperscript{352} This obligation is obviously concerned with the preservation of physical,

\textsuperscript{350} UNCTAD Investor-State Disputes (n289) 40-41
\textsuperscript{351} Rumeli Telekom A.S. and Telsim Mobil Telekomikasyon Hizmetleri A.S., v Kazakhstan, ICSID Case No. ARB/05/16 Award 29 July 2008, Para 668
\textsuperscript{352} Art. 5(2)(b) U.S. BIT Model Law
tangible assets; and is particularly important in the event of an attack on investment property during times of civil unrest or vandalism. The tribunal in the case of *Eastern Sugar v Czech Republic*, gave consideration to what level of protection should be expected by an investor where a third party seeks to inflict violent harm on the host state territory:

As the Tribunal understands it, the criterion in Art. 3(2) of the [Czech-Netherlands] BIT concerns the obligation of the host state to protect the investor from third parties, in the cases cited by the Parties, mobs, insurgents, rented thugs and others engaged in physical violence against the investor in violation of the state monopoly of physical force. Thus, where a host state fails to grant full protection and security, it fails to act to prevent actions by third parties that it is required to prevent.\(^{353}\)

Prevention of damage to the interests of a foreign investor, not merely the reaction to a definite threat, is incumbent in the obligation to protect. The claimant in *Pantechniki v Albania* argued that proactive, precautionary steps should have been undertaken by the defendant in anticipation of the riots and looting that led to considerable damage and loss to its project in 1997.\(^{354}\) The investment treaty between Albania and Greece specifically provided for ‘full protection and security to the other contracting party’ but the tribunal decided that the requirement was dependent on the availability of state resources; and therefore the extent of the civil disturbance was something the state could not manage for all citizens, never mind specifically protecting the foreign project.\(^{355}\)

It is worthy of note that whilst various international tribunals have sought to enforce state obligations in volatile, internal crises, they have also extended their operation to include the actions of parties associated with the state. In the *Siag v Egypt* case, the Italy-Egypt BIT specifically incorporated a clause for ‘full protection in the territory of the other contracting party’; this not only meant practical police safeguards, but also legal protection.\(^{356}\) The investment agreement involved the development and operation of a tourism project; however, force was used by Egypt in the expropriation of the investment; which was authorised by executive resolutions that had no legal

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\(^{353}\) *Eastern Sugar v Czech Republic* SCC No. 088/2004 Partial Award 27 March 2007 Para 203

\(^{354}\) *Pantechniki v Albania* ICSID Case No. ARB/07/21 Award 30 July 2009

\(^{355}\) ibid Para 71-84

\(^{356}\) Waguih Elie George Siag And Clorinda Vecchi (Siag) v The Arab Republic Of Egypt ICSID No. ARB/05/15 Award 1 June 2009
foundation or authority in domestic law. The police declined to act to protect the project, despite repeated requests. The ICSID tribunal declared that it was:

Of the view that the conduct of Egypt fell well below the standard of protection that the Claimants could reasonably have expected, both in allowing the expropriation to occur and in subsequently failing to take steps to return the investment to Claimants following repeated rulings of Egypt’s own courts that the expropriation was illegal.\(^{357}\)

**B) Intangible Assets**

The resources that a foreign investor introduces to a host state via its investment are described by the OECD as rights to use industrial assets, such as patents, trademarks, trade names, designs or models. It also includes literary and artistic property rights, and intellectual property such as know-how and trade secrets. These intangibles are assets of considerable import even though they may have no book value in the balance sheet of a company.\(^{358}\) Intangible assets can potentially carry considerable legal risks, in contract law, product liability or environmental consequences and must also receive the benefit of a ‘protection and security’ standard that exceeds the physical manifestations of an investment and applies to the stability of the investment environment itself, whether legal or commercial, giving rise to host state obligations and reparations in the event of failure.

International tribunals have utilised the concept of ‘devaluation of an investor’s interest’ as a broad term to encompass the range of intangible knowledge and expertise a foreign investor may bring to a project, and gives rise to a cause of action and legitimate claim for compensation. In the *CME v The Czech Republic* case, where the claimants’ media project was expropriated, the tribunal asserted that:

The Media Council’s actions in 1996 and its actions and inactions in 1999 were targeted to remove the security and legal protection of the Claimant’s investment in the Czech Republic […] The host State is obligated to ensure that neither by amendment of its laws nor by actions of its administrative bodies is the agreed and approved security and protection of the foreign investor’s investment withdrawn or devalued. This is not the case. The Respondent therefore is in breach of this obligation.\(^{359}\)

\(^{357}\) ibid Para 448  
\(^{358}\) OECD, Special Considerations for Intangible Property 1996, Chapter 4, VI-1  
\(^{359}\) *CME v The Czech Republic* (n336) Para 613
The adequate protection and security of an investment is a positive attraction to entrepreneurial individuals and companies, who bring their expertise, specialist, knowledge and skills to a country, and these require protection as much as money and land do. In such circumstances, consideration must be given to the decisions made by international tribunals in their adjudication of host state accountability for any breach. There may even be a breach in the absence of physical damage or forceful expropriation, as seen in the Azurix v Argentina case, where

Full protection and security was understood to go beyond protection and security ensured by the police. It is not only a matter of physical security; the stability afforded by a secure investment environment is [just] as important from an investor’s point of view. The Tribunal is aware that in recent free trade agreements signed by the United States, for instance, with Uruguay, full protection and security is understood to be limited to the level of police protection required under customary international law. However, when the terms ‘protection and security’ are qualified by ‘full’ and no other adjective or explanation, they extend, in their ordinary meaning, the content of this standard beyond physical security.\footnote{Azurix Corp. (n61) Para 408}

In the Biwater Gauff v Tanzania case, the Tribunal asserted

[W]hen the terms “protection” and “security” are qualified by “full”, the content of the standard may extend to matters other than physical security. It implies a State’s guarantee of stability in a secure environment, both physical, commercial and legal. It would in the Arbitral Tribunal’s view be unduly artificial to confine the notion of “full security” only to one aspect of security, particularly in light of the use of this term in a BIT, directed at the protection of commercial and financial investments.\footnote{Biwater Gauff (Tanzania) Ltd v Tanzania, ICSID Case No. ARB/05/22 Award 24 July 2008, Para 729}

This case law is indicative of the importance of intangible security to foreign investor assets. The concept of “full” protection must go beyond the physical assets themselves, protecting the commercial and legal interests of the investor if it is agreed by the host state to do so in the agreement.

**4.2.4 Failure to Provide “Fair and Equitable Treatment” to Foreign Investors**

The term ‘fair and equitable treatment’ is vague, and often relies upon individual or state judgement and sense of propriety; just as people have different perspectives on morality, states have different standards of behaviour. Although there have been
attempts to provide judicial meaning for the term, it has never been defined within regional, multilateral or bilateral treaties, and it is therefore a further point to be resolved in the discretionary processes of an arbitration tribunal.

In the *Suez and others v The Argentine Republic* case, the ICSID tribunal noted that, on the interpretation of ‘treatment’ in the context of the investment treaties between the host state, and Spain and France;

The word “treatment” is not defined in the treaty text. However, the ordinary meaning of that term within the context of investment includes the rights and privileges granted and the obligations and burdens imposed by a Contracting State on investments made by investors covered by the treaty.

ThePermanent Court of Arbitration tribunal ruling on the *Saluka Investments BV v The Czech Republic* case postulated that:

The ‘fair and equitable treatment’ standard in Article 3.1 of the Treaty is an autonomous Treaty standard and must be interpreted, in light of the object and purpose of the Treaty […] The Czech Republic, without undermining its legitimate right to take measures for the protection of the public interest, has therefore assumed an obligation to treat a foreign investor’s investment in a way that does not frustrate the investor’s underlying legitimate and reasonable expectations. A foreign investor whose interests are protected under the Treaty is entitled to expect that the Czech Republic will not act in a way that is manifestly inconsistent, non-transparent, unreasonable (i.e. unrelated to some rational policy), or discriminatory (i.e. based on unjustifiable distinctions). In applying this standard, the Tribunal will have due regard to all relevant circumstances.

This adjudication draws various elements into the expectation of fair treatment, from protection of the investment and expectations therefrom, to avoidance of frustration of purpose and discrimination. In essence, the investment project is not to be undermined by the state, at least not without justification or recompense for sovereign interference.

States develop their own norms and levels of what they determine to be ‘fair and equitable’ in accordance with their philosophies, and act accordingly. These are then

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362 Salacuse (n145) 218; Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, 2007) 635; *CMS Gas Transmission Company v The Argentine Republic* ICSID Case No. ARB/01/8, Award 2005 Para 273
363 *Suez, Sociedad General de Aguas de Barcelona S.A., and InterAguas Servicios Integrales del Agua S.A. v The Argentina Republic*, ICSID Case No. ARB/03/17 Decision on Jurisdiction, Para 55
364 *Saluka Investments BV* (n275) Para 309
objectively assessed under the reasonableness principle, which is judged in the context of case law precedent and customary international law. The *ADF Group Inc. v United States of America* case involved a Canadian based company that specialised in the design, engineering and manufacture of structural steel products; initiating proceedings under the ICSID Arbitration (Additional Facility) Rules for damages allegedly arising from the Federal Surface Transportation Act (1982). New regulations were introduced by the US Department of Transportation, mandating the use of locally produced steel for highway projects that were federally funded. *ADF* claimed that this mandate breached the national treatment requirement set out in Article 1102; the minimum standard of treatment requirement in Article 1105(1); and the prohibition against performance requirements contained in Article 1106. *ADF’s* claims, however, were dismissed in their entirety, echoing the decision of the *Mondev International* construction dispute. The ICSID tribunal stated that:

> Any general requirement to accord ‘fair and equitable treatment’ […] must be disciplined by being based upon State practice and judicial or arbitral case law or other sources of customary or general international law.\(^{366}\)

The standard of behaviour expected of host states is thus a mix of domestic practice and international legal norms.

Two problems may arise in ascertaining the efficacy of claims of breach of the fair treatment duty. The first is the violation of legitimate expectations of the investor.\(^{367}\) This can be based on the investment legislation and legal framework of the host nation in general, as illustrated by the ICSID Tribunal in the *CMS Gas Transmission Company v The Argentine Republic* case, which was a consequence of the host state’s programme of privatisation, prompted by a profound financial collapse. The case highlights the basic duties that an investor is entitled to rely upon: ‘the principal objective of the protection envisaged is that fair and equitable treatment is desirable ‘to maintain a stable framework for investments and maximum effective use of

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\(^{365}\) *ADF Group Inc. v United States of America* ICSID Case No. ARB (AF)/00/1 Award 9 January 2003, 280 Para 184

\(^{366}\) ibid Para 184

economic resources.’ There can be no doubt, therefore, that a stable legal and business environment is an essential element of fair and equitable treatment’.

It is clear that the principle of fair treatment is a pre-requisite of stability, and therefore is essential to make investment attractive. Sudden or fundamental change to the law by a host state should not be expected to form part of an investor’s risk analysis prior to any investment. This is particularly the case where an agreement is made under the laws of a host state, which subsequently and fundamentally changes after the investment structure is in place, as such action is an irrational and unjustifiable alteration to the legal framework and of detriment to the investor, as well as making the country distinctly unattractive to future potential investors.

However, this does not mean that a host state cannot change its laws. It has, of course, a sovereign right to do so. Chapter II of the Charter of Rights and Duties of States enshrines the inalienable right to change laws, political and social systems in order to conform to its economic aims and policies. Nevertheless, such change should not cause unjustified harm to a foreign investor. Article 18(4) of ECT, for example, asserts that:

The Contracting Parties undertake to facilitate access to energy resources, inter alia, by allocating in a non-discriminatory manner on the basis of published criteria authorizations, licences, concessions and contracts to prospect and explore for or to exploit or extract energy resources.

Put simply, standards must be maintained or compensation paid.

A second element of investor concern is the need to be protected from discrimination and arbitrary decision-making by a host state, based upon basic expectations of ‘fair and equitable treatment’. The Waste Management, Inc. v United Mexican States case involved a claim by the American investor company, which experienced the unilateral imposition of changes to its concession by the state. Amongst other types of state

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368 CMS Gas Transmission Company (n362) Para 274
369 Christoph Herrmann, Markus Krajewski and Jörg Philipp Terhechte, European Yearbook of International Economic Law (EYIEL) (Vol. 3 Springer Publishing 2012) 359
370 ibid 360
371 Art.18(4) ECT (n53)
372 Waste Management, Inc. v United Mexican States ICSID Case No. ARB(AF)/00/3 Award 30 April 3 2004
misconduct, officials began to refuse to issue a permit to begin the contracted work, for no apparent reason. The ICSID tribunal stated that:

The minimum standard of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety - as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process. In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.\(^{373}\)

This type of activity can be differentiated from that of the Czech Republic, as seen in the *CME* case. This case involved the legislature enacting radical statutory change, which was to the detriment of the investor. In *Waste Management Inc.* the arbitrary and discriminatory conduct of the state’s executive forms the basis of the complaint. Although there existed a relatively stable legal framework, the officials of the host state behaved in a manner that was arbitrary or discriminatory against a foreign investor. This kind of discriminatory behaviour may be based on any number of premises; racism, envy, misuse of authority, or simply malevolence. It is a breach of Article 2(2) of the UK Model BIT that contains a prohibition on the use of unreasonable measures that may ‘impair the management, maintenance, use, enjoyment or disposal of investments’.\(^{374}\) It is not ‘fair and equitable treatment’ if the host state makes representations regarding protection of the investment, which are relied upon, and then ignored. ‘Fairness’ in this judgement is closely linked to the transparency of justice, stability of the legal process, and freedom from the risk or fear of discriminatory practices.

There is also a requirement to treat foreign investors on similar terms as resident nationals of a host state, which the OECD terms ‘national treatment’. Two issues should also be clarified. The first is that ‘fair and equitable treatment’ principles generally do not apply under the National Treatment provisions for foreign investors, if there is no specific stipulation contained in the investment contract referring to such treatment. Sovereign entitlement also permits the treatment of domestic investors however the state sees fit. Foreign investors expect ‘fair and equitable treatment’ in

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\(^{373}\) ibid Para 98  
\(^{374}\) Art. 2(2) UK Model BIT
the same minimum standards in international law as other investors in the same sphere of activity.

An important rationale is that domestic investors should be protected from unfair competition by foreign rivals, especially those more experienced and financially able to operate major projects, due to their access to finance, equipment, labour and knowledge. Whilst a host state may have to secure foreign investment in order to ensure it obtains the best possible resources for the country, this should not be at the expense of its own domestic resources. A perennial problem, however, is that the domestic expertise, skills and finance which all provide a similar quality of project often cannot be sourced internally, leading to a stipulation from states that foreign investors use of a proportion of the domestic workforce and provide training and development opportunities. There remain sensitive areas such as security installations and government operations, where a foreign investor should not be permitted to have an investment interest. ‘Most-Favoured-Nation’ status, where foreign investors share similar rights and advantages as state nationals in state projects, should only be conferred as a result of a bilateral agreement with states that provide an official measure of reciprocity.

A) The Development of the Concept of Fair and Equitable Treatment In International Treaties: A Historical Review

The first reference to ‘just and equitable treatment’ is found in Article 11(2) of the Havana Charter for an International Trade Organisation (1948), which was drafted to promote treaty provisions based on fairness and equity in the protection of transferable technology, knowledge and skills, as well as more tangible property moved from one nation to another in the pursuit of trade and investment.\(^\text{375}\) The intention was to provide investors with guarantees, and to encourage the International Trade Organisation (ITO) to devise detailed recommendations for the operation of the principle of fair treatment.\(^\text{376}\) These aims were achievable, even in the circumstances where members could stipulate their own terms for the type of investor or project that

\(^{376}\) ibid
they would permit on their territory. The intention was to ensure that just terms were implemented regarding ownership of the investment, and to lay down other reasonable requirements for both existing and future investments. The provisions of the Charter were so comprehensive in the effect on national strategy that a number of major countries refused to ratify it. This brought the first multi-state attempt to define accepted parameters of investment and trade practices to a rather ignominious conclusion.377

In 1948, the Ninth International Conference of American States ratified the Bogota Economic Agreement, which dealt with, amongst other measures, the protection and safeguarding of foreign investor interests; with the stipulation under Article 22 that:

Foreign capital shall receive equitable treatment.378 The States therefore agree not to take unjustified, unreasonable or discriminatory measures that would impair the legally acquired rights or interests of nationals of other countries in the enterprises, capital, skills, arts or technology they have supplied.379

This too failed to come into force, due to lack of support and disputes about the proposed obligations, on the basis of individual national interests.

The growth in trade following World War II increased the need for protection of investors and attempts to codify principles for state-foreign investor deals increased. In 1959, the Draft Convention on Investments Abroad, was drawn up under the auspices of Herman Abs, Director-General of the Deutsche Bank, and Lord Shawcross; the UK Attorney General. Article 1 stipulated that ‘each Party shall at all times ensure fair and equitable treatment to the property of the nationals of the other Parties’.380 As a result of these discussions, a proposal was made by Germany to the OECD that it provides for the establishment of a convention on the international protection of private property.

Intensive negotiation resulted in the adoption of the Draft Convention on the Protection of Foreign Property by the OECD Council in October 1967. On the

377 ibid
378 Art. 22 Economic Agreement of Bogotá 1984
379 Art. 22 Ninth International Conference of American States adopted the Economic Agreement of Bogotá, 1984
380 Art. 1 Draft Convention on Investments Abroad 1959
treatment of foreign property on the territory of another state, arising from investment contracts, Article 1(a) stipulated that ‘each Party shall at all times ensure fair and equitable treatment to the property of the nationals of the other Parties’. In view of the extent of opportunities at stake, the Draft Convention represented the policies of OECD nations on foreign investment issues and influenced the course of deliberations on foreign investment during that period; although it was never signed. On the issue of seeking to ‘ensure fair and equitable treatment’, the Draft Convention placed greater significance on the standard of behaviour required from host states than earlier instruments and numerous future conventions and agreements adopted this standard in their specifications.

B) Fair and Equitable Treatment in International Minimum Standards

States owe foreign investors and their property a minimum level of fair and equitable treatment under international law: regardless of the way they treat their own nationals; the failure to meet this standard invokes liability for any resultant loss. The Official Commentary of Article 1 of the OECD Draft Convention on the Protection of Foreign Property expressly states that:

The phrase “fair and equitable treatment”, customary in relevant bilateral agreement, indicates the standard set by international law for the treatment due to each State with regard to the property of foreign nationals […] The standard requires conforms in effect to the ‘minimum international standards’ which forms part of customary international law.

In the S.D. Myers Inc. v Canada case, the American claimant, Myers, operated a chemical waste remediation facility under an agreement with the Canadian
government, which subsequently prohibited the export of a particular chemical to America.\textsuperscript{386} As a result, a claim was made under Article 1105 of the UNCITRAL Rules of Arbitration, citing a breach of international law principles regarding non-discrimination and fairness. The tribunal adjudicated that:

Unfair and equitable must be considered within the context of treatment according to the expectations of international law stating that ‘[t]he minimum standard of treatment provision of the NAFTA is similar to clauses contained in BITs. The inclusion of a “minimum standard” provision is necessary to avoid what might otherwise be a gap. A government might treat an investor in a harsh, injurious and unjust manner, but do so in a way that is no different than the treatment inflicted on its own nationals […] the ‘minimum standard’ is a floor below which treatment of foreign investors must not fall, even if a government were not acting in a discriminatory manner.\textsuperscript{387}

The concept of an ‘international minimum standard’, specifically incorporated in the Mexico and United Kingdom investment treaty, reflects the understanding that such standards are not interpreted too widely by arbitral tribunals. However, in light of the ruling of the arbitral tribunal in the \textit{Biwater Gauff Ltd v Tanzania} case, ‘the actual content of the treaty standard of fair and equitable treatment is not materially different from the content of the minimum standard of treatment in customary international law’.\textsuperscript{388}

4.3 Conclusion

This Chapter has shown that host states bear a considerable responsibility in the use of their sovereign power under customary international law, especially where it could cause harm to the interests, both current and future, of foreign investors. It is also clear that the failure to use such authority appropriately will incur penalties where the rights and interested of foreign have been unduly harmed. Still, the right of investors to compensation for provable loss places a burden upon states, some of whom show a reluctance to acknowledge. Sovereignty remains prima facie intact, but there are consequences if it is used in a manner which causes harm; and the case law used in this chapter shows that there are many ways a state can wreak havoc on an investment project, if they so choose.

\textsuperscript{386} \textit{S.D. Myers, Inc. v Canada} UNCITRAL Partial Award 13 November 2000  
\textsuperscript{387} ibid Para 259  
\textsuperscript{388} ibid Para 592
A prudent foreign investor has to protect their investment from the offset and should do so during contract negotiations. Investors should also undertake an appropriate risk assessment before entering into any international investment contract. Such prudence will reduce their need to rely on international law tribunals to resolve any future disputes. However, this may not always be possible, and host states can act in unexpected ways in their exercise of sovereign rights, in these situations the entitlement to recompense under customary international law will be a vital tool to foreign investors. There are a plethora of apparently protective measures, including bilateral and regional agreements, such as NAFTA and OECD; multilateral treaties such as ECT and ICSID Conventions; tribunal decisions and municipal laws. However, these tools have not established an authoritative base upon which the standard of compensation due to an expropriated investment can accurately be assessed.\(^{389}\) The amount of compensation should be adequate and fair, and therefore there are many methods of evaluation. It can be surmised that the varied methods and levels of expropriation, reasons propounded for the action and modes of compensatory assessment reveal the complexity of the issue in international law. The problem lies not with the concept itself, but with the amount of compensation available to an injured foreign investor and its affordability to a recalcitrant state.\(^{390}\) Moreover, it is important to note that perceptions held by the parties are important and what an adjudication tribunal deems to be ‘adequate and fair’ may appear punitive to a host state, yet appropriate to a foreign investor or vice versa.

A foreign investor must consider such non-commercial risks when dealing with sovereign states. As part of the initial risk assessment, the investor, whether an individual or a company, must ascertain how the investment can be protected and its value returned in the event of unanticipated act by the host state. The question must be “what is the best alternative to a negotiated agreement (BATNA), the course of action available to a party should their preferred negotiation position fail and an


\(^{390}\) Art. (IV) World Bank Guidelines on the Treatment of Foreign Direct Investment 1992; Art. 1110(2) NAFTA; Art. 13 ECT (n53)
agreement cannot be reached?" The answer is not particularly troublesome if addressed early, and should be guided by whether an inter-state treaty route is chosen, where an appropriate international arbitration clause is incorporated, or via a claim in the contract, which should contain the remedial procedures available as it will be assessed further in Chapter five.

Chapter Five

State Sovereignty in Bilateral Investment Treaties and Investment Contracts and the Role of Investor-State Arbitration

5.1 Introduction

When operating in the international investment environment, a foreign investor needs to be protected from uncertainty, particularly in circumstances where a host state seeks to utilise its sovereign powers to affect either the investment project or the foreign investor. Uncertainty may include the compromising or breach of the provisions of the contractual relationship; or obstruction of the investment process, as a result of the actions of the state in pursuit of its own interests. Countries that lack a stable, entrenched system of Law, and effective regulation of the separation of powers (Legislative, executive and judicial) present such risks. The result is a disproportionate representation in BIT and contract-based claims.\(^\text{392}\) The interaction between a host state and an investor arising from an international financial venture creates considerable potential for conflict, especially when a host state’s administration lacks a stable legal system incorporating robust principles of ‘transparency, efficacy, accessibility and equality’.\(^\text{393}\)

Investor-state arbitration has therefore become a vital mechanism of resolution for foreign investors in the settlement of disputes with host states, facilitating the recovery of resultant losses.\(^\text{394}\) It is particularly complex in its operation, proving a hybrid of classic commercial, contract and public international law.\(^\text{395}\) Guidance and regulations are derived from the general principles of international law and specific application of concepts in arbitral awards in the quest to clarify meanings, utility and


\(^{393}\) Ibid 323

\(^{394}\) Zeynep Akgul, *The Development of International Arbitration on Bilateral Investment Treaties: Disputes Between States and Investor, ICSID Cases Against Turkey Regarding Energy Sector* (Universal Publishers 2008) 15

boundaries of the common key terms used for the resolution of disagreements. International investment arbitration therefore must be considered through examination of its defining elements. The context of this consideration is the protection of the foreign investor from host state misconduct, with the investor more likely to choose the international arbitration option, due to the practical benefits that can be derived from the process, which distinguishes it from other methods of settlement, for example, expert adjudication and international mediation.

5.2 Overview of Investor-State Arbitration

Arbitration is generally considered a binding process, in which two or more parties in dispute submit the resolution of their differences to a third party. The impartial arbitrator assesses the relative strength of the evidence provided by the litigant parties, and decides, in the context of the applicable law, how the matter in dispute should be adjudged. Investor-State arbitration is more specific, seeking to resolve disputes arising between a foreign investor and a host state. It has as its central tenet the financial investment principle enshrined in Article 25(1) ICSID:

The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.

This highlights the international manifestation of the binding nature of its jurisdiction, where there is consent from the parties that submit to its judgment.

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397 s.1(a) Arbitration Act 1996 c23 (UK) states ‘the object of arbitration is to obtain the fair resolution of disputes by an impartial tribunal without unnecessary delay or expense’
398 Art. 25(1) ICSID Washington Convention (n3)
5.2.1 Fundamental Features of Investor-State Arbitration


The inherently problematic feature of a domestic court system is that it is an integral part of a host state’s apparatus. Whilst the principle of judicial independence may be entrenched, the system remains representative of the authority of the state and is therefore bound to apply the rules, law and procedures of the state; as judges owe an allegiance to the administration that implicitly limits and may even prohibit the exercise of discretion in the application of legislation.

In the investor-state arbitration arena, all parties, including the foreign investor, have considerable latitude in the determination of the conduct of proceedings, subject to the minimum safeguards of due process. This fundamental principle of autonomy provides opportunities for the litigants to adapt procedures according to their particular requirements and circumstances of the dispute, and their commercial needs. Those who adjudicate are independent of host state laws, with their mandate embodied in the arbitration agreement between the parties. Their only allegiance is therefore to the procedure agreed by the parties, rather than to a particular piece of legislation enacted by the host state.399

B) Investor-State Arbitration and Alternative Dispute Resolution (ADR)

Although the authority of the arbitration tribunal derives from the contractual agreement between the parties, they do have the authority to make an award that will necessarily be contrary to the interests of one of the litigants. Parties are therefore expected to accept the obligation to be bound by the final adjudication in the

It is useful to note that such awards are enforceable in a similar manner to national court judgments, a factor that distinguishes investor arbitration from other forms of ADR. In contrast, in the process of mediation and conciliation, for example, the independent mediator is integral to seeking a resolution to the dispute between parties, but has no power to impose a final decision, and they effectively work with the parties to reach an agreement resulting in a settlement rather than presenting a binding decision that carries with it an enforceable award.

C) Investment Arbitration and the Commercial Arbitration Process

Investor-state arbitration proceedings are identified by the status of the parties, namely a foreign investor (who is normally the claimant), and a host state. The purpose of the proceedings is to enable the potentially weaker foreign party in a transactional dispute to seek redress against the more powerful sovereign host, who has control over the legislative, regulatory and policy authorities of its own territory. There is a contrast herein arising from the status of the parties in a purely commercial dispute. Business merchants or entities, whether individuals or companies, who transact trade contracts between themselves, are expected to have the capacity to protect their own interests, on a presumption of equality in the protection of the principle of freedom of trade. Internationally based investor-state arbitration operates in a context of presumed inequality between the parties, involving the implementation of conventions of investor protection provisions in inter-state BITs and MITs. The prime embodiment of such special protections is contained in the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (Washington or ICSID Convention 1965); which established the International Centre for Settlement of Investment Disputes (ICSID), and therefore provided recognition of and an authoritative method of enforcement to foreign arbitration awards.

However, the ICSID Convention limited how far the authority of domestic judicial systems of host states in determining regulatory disputes would be supplanted by international arbitrators; limiting it to the types of conflict that result from the exercise

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401 ibid
of host state sovereign authority within its territory that adversely affects the interests of a foreign investor. The opportunity to engage in international arbitration is a valuable medium for investors seeking to resist unilateral changes in state regulation engendered by their host, and to seek recompense for losses that compromise their interests.\textsuperscript{402} The jurist Thomas W Wälde, succinctly states the purpose of the process:

Investment arbitration is not international commercial arbitration. It is essentially a form of international judicial review of governmental (regulatory, administrative and at times fiscal) action, though using the forms of commercial arbitration. This is not always appreciated by lawyers used in the traditions of commercial arbitration.\textsuperscript{403}

5.3 Host State and Investor-State Arbitration

Investment dispute arbitration is a principle purpose of inter-state BITs, and usually operates in conjunction with a properly drafted, investment specific contract. It provides a foreign investor the opportunity to achieve redress for loss of rights and entitlements, as a result of host state sovereign and non-sovereign action.

States are varies to accept the arbitration clause in their dealing with the foreign investors, however, it has an important effect on both of them. That’s the reason for the states to abide or not abide themselves by such clause by decree a proper legislation as a declaration for the foreign investors to invest in its territory.

5.3.1 Host State Legislation and Investor-State Arbitration

It is prudent for an investor to consider whether or not the host state will refer to a resolution process for disputes in its own national investment law or code. Whilst an arbitration process is subject to implied or express consent, this traditionally emanates from a pre-existing agreement between the parties. This framework is often provided via an existing inter-state treaty, binding the financially interested states as well as providing incorporation into the specific investment contract. The stipulation of a


mechanism of resolution into the particular national law regulating foreign investments does not however involve a foreign investor, or indeed any other interested state. It is simply a means of the host state regulating its own national investment law.\textsuperscript{404} As the tribunal of \textit{IBM World Trade Corporation} case, it stated that state determines ‘by means of a unilateral commitment […] set forth in its legislation’ to ‘propose […] to submit the differences, arisen from any investment or any kind of investment, to the ICSID jurisdiction’.\textsuperscript{405}

National investment law tends to differentiate between patterns of dispute resolution, particularly in the issue of consent to arbitration. There are also different levels of state commitment to the process, which take much of the decision making out of its direct control. In reality, the domestic law of a host state may not incorporate any mechanism for resolving investment problems, choosing to virtually ignore the intervention of international arbitration in disputes. This may be termed the ‘no-arbitration’ or ‘opt-out arbitration’ pattern, and is a feature of Mauritian investment law.\textsuperscript{406}

The second option is an ‘opt-in arbitration pattern’, whereby national investment legislation requires foreign investment disputes be resolved by the domestic courts of the host state.\textsuperscript{407} In such circumstances, only explicit declarations of intent in an inter-state investment treaty such as a BIT (or indeed the particular investment project contract), may permit international investment arbitration to supplant a domestic court settlement as the appropriate means of redress. Consent to a choice of arbitration is not an issue in such circumstances, as somewhat ironically, a state’s ‘opt-in’ law to international investment arbitration can be indicative of a rather unfavourable view of its own domestic judicature. The Mongolian Foreign Investment Law requires an opting in to arbitration of disputes before its national courts, where there is no alternative international treaty in effect. According to Article 25:

\textsuperscript{405} IBM World Trade Corporation v Republic of Ecuador ICSID Case No. ARB/02/10 Decision on Jurisdiction 22 December 2003 Para 24 and see Ceskoslovenska Obchodni Banka AS. v The Slovak Republic ICSID Case No. ARB/97/4 Decision on Jurisdiction 24 May 1999 Para 45
\textsuperscript{407} ibid (Mbengue) 109
Disputes between foreign investors and Mongolian investors as well as between foreign investors and Mongolian legal or natural persons on the matters relating to foreign investment and the operations of the foreign invested business entity shall be resolved in the Courts of Mongolia unless provided otherwise by international treaties to which Mongolia is a party or by any contract between the parties.408

The third mechanism can be termed the ‘optional arbitration pattern’. This involves a state enacting foreign investment legislation that facilitates the choice of national or international venue, and thus obviates the need for consent to arbitration. The law simply stipulates an international arbitration option to settle foreign investment disputes, in addition to its domestic jurisdiction. It would normally articulate the issue as a reflection of choice, whereby disputes ‘may’ be resolved in a process of arbitration, which ‘may’ be agreed between parties.409 The Investment Code of the Seychelles (2005) utilises the ‘optional arbitration pattern’, providing the legislative choice of domestic or international venue for resolution. Article 13.2 reads:

Disputes which cannot be resolved by the parties themselves may be settled: a) by an arbitration procedure whether local or international that is based on a previous agreement between the parties; or b) by legal proceedings in accordance with the Law of Seychelles.410

5.3.2 State Sovereignty and Investor-State Arbitration Between Bilateral Investment Treaties and Contracts

It has been noted that a BIT aims to establish the relationship of basic trade standards between two sovereign states, aiming to attract foreign investment through the limiting of behavioural irregularity, or the arbitrary actions of a host recipient. International investment agreements, or investment contracts, are the result of such action, leading to a specific investment project between a host state and a foreign entrepreneur. Any dispute arising from the operation of the enterprise may therefore constitute a breach of either the investment treaty or the investment contract.

For the next section, a try will be made to clarify the impact of BIT arbitration on host state sovereignty.

408 Art. 25 Foreign Investment Law of Mongolia
409 ibid
410 Art. 13(2) Seychelles Investment Code
5.3.2.1 State Sovereignty and Investment Arbitration – the Bilateral Investment Treaty Perspective

Treaties between states must encompass principles and expectations much broader than the money making potential of a specific investment project. Mutually supportive trade relationships are promoted by such agreements, and tend to stimulate a greater sense of accord between participant nations. The 2003 BIT between Korea and Chile expounds a broader range of social and developmental goals than the specific treaty provisions, including the principle that

[The agreement] should be implemented with a view toward raising the standard of living, creating new work opportunities, and promoting sustainable development in a manner consistent with environmental protection and conservation.

The creation of a BIT also establishes a foothold of one signatory in the domestic market of another, and such deals have mutual trade benefits. BITs tend to be utilised by more developed countries, such as the United States and the UK, to seek advantage using their strong bargaining position and financial superiority. This facilitates the attainment of economic advantage and a more favourable environment for the benefit of their nationals; with the stronger state wielding a model BIT in a ‘take it or leave it’ manner. It is a particularly advantageous negotiating technique where new technology is needed by a developing host, which can only be accessed through foreign investment. Equality is therefore not an abiding principle of BIT discussions between sovereign nations.

Prior to the more widespread adoption of BITs, foreign investors faced considerably more difficulty in resolving their grievances and subsequent pursuit of claims against the governments of host states. It has been noted that the traditional principles of international law tend to shield recalcitrant national authorities from the litigious attention of both individual and corporate investors, as the doctrine of sovereignty

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412 Chile-Korea BIT 2003
414 Ibid
meant foreign investors effectively required the consent of a host government in order to seek redress.\(^\text{415}\) This generally required a triumph of hope over reality, and investors claiming infringement of their interests had to rely on their domicile states to protect their investment by diplomatic means, or even force. The effect of such inefficient and potentially dangerous methods led to many smaller transgressions being simply put down to experience.\(^\text{416}\)

As a sovereign authority, a host state has the indisputable jurisdiction to establish, legislate for and regulate all investment projects on its territory. The advent of the BIT system limits such unfettered control, ceding entitlements to international investors negotiated by their home states.\(^\text{417}\) The result is a requirement that host states actually relinquish some of their economic sovereignty, in order to acquire investment from foreign businesses.\(^\text{418}\) The necessity to achieve a balance between investors and a host state in the adjudication of disputes was the rationale behind the formation of the ICJ in 1945.\(^\text{419}\)

**i) Bilateral Investment Treaties and Their Impact on State Sovereignty**

The acceptance of international agreements made with other nations necessarily limits the omnipotent scope of sovereignty and control over the territorial jurisdiction of a host state. The customary expectation that a foreign investor will accept the compromise of their interests to the sovereign whim of a host state government or its legal system is curbed by the presence of the investment treaty. Jurisdiction over disputes and the balance of competing interests becomes, under the BIT, subject to international analysis and arbitration.\(^\text{420}\) Foreign investment protection requires recompense from a host state for the impact that its regulatory actions may have on a project.\(^\text{421}\) As a consequence, it alters the relationship between those who undertake

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\(^{416}\) Garcia (n392) 310  
\(^{417}\) ibid  
\(^{418}\) Chung (n413) 963  
\(^{419}\) ibid  
\(^{420}\) Dolzer (n30) 956  
business on its territory and the signatory state, potentially reducing the scope of sovereignty on matters of investment regulation. This in turn has an impact on wider public policy regulation, allowing for the potential challenge of a host state via the treaty dispute settlement mechanism where it has an effect on the interests of a foreign investor.\footnote{Eric Neumayer and Laura Spess, \textit{Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?} (10/2005) 33(10) World Development 1567-1585} Some 63 per cent of cases that fall under the jurisdiction of the ICSID arise from actions taken as a result of BITs.\footnote{The ICSID Caseload- Statistic (Issue 2012-2) 10}

The United Kingdom demonstrates an interesting historical anomaly regarding the implementation process of a treaty in both international and national law. Constitutional theory dictates that the treaty becomes effective in international law when it is ratified by the Queen, or her representative. However, it has no authority in national law until the elected legislature gives it legitimacy through an Act of Parliament.\footnote{Peter Malanczuk, \textit{Akehurst’s Modern Introduction to International Law} (7th Edition Routledge 1997) 66} Although the role of a monarch in a modern democracy is largely symbolic, the House of Lords was still postulating this principle until 1989. Lord Oliver of Aylmerton asserted in the \textit{International Tin} case, which involved the Commonwealth state of Australia:

As a matter of constitutional law of the United Kingdom, the Royal Prerogative, whilst it embraces the making of treaties, does not extend to altering the law or conferring rights upon individuals or depriving individuals of rights which they enjoy in domestic law without the intervention of Parliament. They do not come into effect themselves, in the mere expression of their terms of intent, so do not form part of English law unless and until they have been incorporated into the law by legislation.\footnote{Australia & New Zealand Banking Group Ltd et al. v Australia et al. [1990] ILM 29 671, 694; HL 26 October 1990; On the interpretation of treaties see R. Gardiner, \textit{Treaty Interpretation in the English Courts Since Fothergill v Monarch Airlines (1980)} (1995) 44(3) International Comparative Law Quarterly 620}

Outside of such Commonwealth anomalies, it is generally the elected legislature or that ratifies a treaty in a democracy. It is a legislative act, and therefore the treaty becomes enforceable in international and domestic law simultaneously.\footnote{Malanczuk (n424) 66} When the treaty satisfies the legal and constitutional procedures of a host state, it becomes an enforceable law, and in the context of international agreements it is inappropriate to legislate contrary to such commitments.
Controversy as a result of such obligations arises when considering how far state sovereignty should be limited by investment treaties, especially where a balance must be struck between the exercise of regulatory authority in return for the benefit of investment. This inevitably leads to scrutiny of how much control host state exercises over a foreign investment project on its territory, through the enactment of appropriate regulation.

A) Balancing the Rights of Investors and the Power of the State to Regulate

A host state, in pursuit of economic advancement, should resist the temptation of short-term gain to enact law or make administrative decisions that affect, whether directly or indirectly, foreign business investment. To do otherwise would alienate potential investors and deprive the state of valuable benefits.

Actions of the state may be prompted by the need for more effective management of its affairs, but liability to compensate may arise under investment treaties, where such actions interfere with or compromise a foreign investor’s interests. The onset of an economic crisis, for example, need not automatically lead to any liability of a host state to protect an investor, but measures taken to deal with such upheaval, which directly and adversely affect their rights and interests can make a state accountable in international law.427 The tribunal in the Parkerings-Compagniet v Lithuania case stated that:

> It is each State’s undeniable right and privilege to exercise its sovereign legislative power. A State has the right to enact, modify or cancel a law at its own discretion. Save for the existence of an agreement, in the form of a stabilisation clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment. As a matter of fact, any businessman or investor knows that laws will evolve over time. What is prohibited however is for a State to act unfairly, unreasonably or inequitably in the exercise of its legislative power.428

427 Brower and Schill (n421) 483
428 Parkerings-Compagniet AS v Republic of Lithuania, ICSID Arbitration Case No. ARB/05/8 (2007) Para 332
Concepts of fairness and reasonability become closely allied with investor treaty protections, and culpability in the event of their compromise.

A state is not immune from the tendency to make unrealistic promises in an attempt to portray an attractive, engaging environment to elicit investment. Liability will follow if such assurances fail to materialise or pledges are reneged upon. Such issues where raised in the *Methanex Corporation v United States Of America* case, where the tribunal asserted that commitments must be adhered to:

> As a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alia, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.429

Therefore, the dispute resolution provisions incorporated in investment treaties arguably constitute some of the strongest investor protections.430

**B) Regulation of Domestic Affairs**

*ADC Affiliate Ltd and others v Hungary* highlights problems inherent in regulatory measures that can deprive a foreign investor of revenue.431 The tribunal acknowledged the traditional rights of sovereignty, but recognised treaty limitations imposed thereon. It averred:

> It is [our] understanding of the basic international law principles that while a sovereign state possesses the inherent right to regulate its domestic affairs, the exercise of such right is not unlimited and must have its boundaries. As rightly pointed out by the claimants, the rule of law […] includes obligations [and] provides such boundaries. Therefore, when a state enters into a bilateral investment treaty like the one in this case, it becomes bound by it and the investment-protection obligations it undertook therein must be honoured rather that be ignored by a later argument of the state right to regulate.432

429 *Methanex Corporation v United States of America*, NAFTA, Award 3 Aug 2005 Part IV Chapter D Para 7
431 *ADC Affiliate Limited and ADC & ADMC Management Limited v The Republic of Hungary* ICSID Case No. ARB/03/16. 2 October 2006
432 *ibid* Para 423
In summary, international obligations that are freely entered into must be observed. National legislation must not breach international treaties, although some very limited latitude is given on sensitive domestic matters. Gambling is generally accepted as an issue of contention, and is therefore subject to regulation. In the case of International Thunderbird Gaming Corp v Mexico, sovereign authority was considered:

Governments have a particularly wide scope of regulation reflecting national views on public morals. Mexico can permit or prohibit any forms of gambling as far as NAFTA is concerned. It can change its regulatory policy and it has a wide discretion with respect to how it carries out such policies by regulation and administrative conduct. The international law disciplines of article 1102, 1105 and 1110 in particular only assess whether Mexican regulatory and administrative conduct breach these specific disciplines. The perspective is of an international law obligation examining national conduct as a ‘fact’.\

In the context of this specific project agreement, it could be argued that morality should have played a larger role in the negotiations.

5.3.2.2 State Sovereignty and Investor-State Arbitration from the Investment Contract Perspective

The Latin maxim Pacta sunt servanda broadly means that an agreement must be kept, alternatively referring to the ‘sanctity of contract’, where parties are free to negotiate that which will bind them in terms of their obligations and rights. It is a concept much respected in national legislation, as a freedom of contract, but is applied differently in the context of disputes emanating from investment contracts that relate to projects and services involving the state as a party.

In civil jurisdictions, where law is broadly codified in statute, contracts are deemed administrative exercises of the executive, where they relate to public services and the business of government. This extrapolation allows a state to weaken the pacta sunt servanda principle, where the agreement conflicts with the perceived public interest. In contrast, judicially framed common law jurisdictions interpret such agreements as public decision making, allowing a lower level of discretion to the executive.

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However, this differentiation does not mean that, in either type of jurisdiction, a host state cannot exercise its sovereign powers in investment contracts that do not relate to public services or the operation of government. The exercise of legislative authority by a contracting host state remains for measures that affect private property and the contract rights of a foreign investor.\footnote{Thomas W. Wälde, *The Energy Charter Treaty: An East-West Gateway for Investment and Trade* (Kluwer Law International Ltd Publications 1996) 350.} Legal impropriety of state conduct in the context of an investment contract is merely compounded by an inability to call upon a public interest argument, and therefore the need for investor protection is increased.

**(i) State Sovereignty and the Administrative Investment Contract**

In conjunction with its sovereignty status, administrative investment agreements are signed by a host state (or one of its constituent departments or representatives), in order to provide a public service, whether it be the addressing of a public need or the advancement of a national interest. Sovereign prerogatives are invoked to impose state authority on other contracting parties and their interests.\footnote{Sornarajah (n60) 86} The undertaking of activity that produces such an outcome, without providing effective investor recourse to the courts, may culminate in the state acting in a proprietary manner, without proper acknowledgement of international or contractual obligations. The role of a national court in assessing the legitimacy of executive actions in a claim for recompense can be undermined in the face of such imperiousness. The Principle of Legitimacy in Administrative Law requires the observation of current national and international laws and regulations when decisions are made by the state that affect individuals; a failure to comply will enable the court to annul decisions and order the administration to compensate the other party where appropriate.

Administrative law jurists, such as el Tamawi (a prominent Egyptian jurist), suggest that it is unreasonable that a contract should prove a barrier to achieving public goals and advancing the public interest,\footnote{These prerogatives could be based on national legislation, the tendering special/public book or by the investment contract itself. See Suleiman El Tamawi, *The Administrative Contracts: Comparative Study* (Ain Shams University Publications 1984) 141} arguing that such executive decisions should not be considered an excessive use of authority or maladministration. However such decisions can result in a contracting foreign investor losing a substantial part of their
investment return, as a result of unfettered sovereignty excused by the public interest. It is necessary for an investor to know what a host state believes its authority to be when acting in the public good context, its limitations, and their entitlements in any subsequent dispute. Internationally based investor-state arbitration becomes of key importance when the state refuses to redress the claimant contracting party for the exercise of its authority.

Therefore, a host state may impose their sovereign powers in administrative contracts. Such contracts have been created and practiced by the French legislator and administrative court and are followed by many countries that have the same approach to civil law countries, particularly in Egypt. These sovereign powers can be summarised as the power to control and monitor, impose sanctions on the contracting party, amend the terms of the contract and ultimately, to terminate the contract.438

A) The Power to Control and Monitor

The authority and responsibility of the state carries with it the power to monitor, supervise and regulate any investment project on its territory; and their use is expected to be in the promotion of the public interest. The prerogative is expressed in specific terms incorporated in the administrative part of any investment contract.439 The exercise of such authority will vary between agreements, depending on the technical provisions of the project; for example, the standards in Public Private Partnership (PPP) contracts may stipulate assessment of the work of contractors with agreed specifications. A result of administrative failure by an investor may include sanctions, or even termination of the contract, and may lead to state justification for its actions on the basis of alleged breach of contract by an investor.

B) The Power to Impose Sanctions on a Contracting Party

Sanctions may be imposed on a financial investor by the state, or indeed any other duly authorised public body, in the event of the failure to fulfil appropriate

438 Mohamed A M Ismail, Globalization and New International Public Works Agreements in Developing Countries (Ashgate Publishing Ltd. 2011) 25
commitments. This can effectively be considered a use of sovereign powers without recourse to the court, particularly when based solely on a state’s assessment of the progress and compliance of a project. Financial sanctions can result in a sum of money being forfeited by the contractor to the state in the manner of a fine if contractor commitments are said to have been breached.\textsuperscript{440}

Sanctions may not only be based on financial forfeiture. They may constitute a state taking guardianship of a project via a concession contract. Care and control by a public body need not necessarily constitute an allegation of misconduct on the part of the investor-contractor; in the case of force majeure, the state may legitimately argue necessity for protection of the public interest.\textsuperscript{441} Alternatively, a cause may arise whereby a public works contract may be seized by virtue of a unilateral decision of state at a time of domestic urgency. A public body, or another contractor, perhaps at the expense of the supplanted party, may then operate the project.\textsuperscript{442} Finally, where a project has been slow to produce the agreed result, a state authority may, at the expense of the contractor, purchase the necessary operating materials and expertise, particularly in a supply agreement. In each of these instances, an investor will suffer considerable loss where the assessment of fault is entirely at the remit of the host.

C) The Power to Amend the Terms of a Contract

A major component of the \textit{pacta sunt servanda} maxim is that parties in a contract cannot unilaterally change its terms once the agreement is made. However, this is subject to challenge by a public authority in administrative contracts, dependent on circumstances. International investment contracts are entered into by investors acting as merchants seeking to promote their business interests. Whilst this may also form part of the motivation for a host state, they must also protect the wider public interests of their subjects; arguing that this outweighs the private interest of a foreign investor, or at least requires the establishment of a balance between them.\textsuperscript{443} The French supreme Administrative Court, the \textit{Conseil d'État Français} for example, approved the

\begin{itemize}
\item \textsuperscript{440} El Tamawi (n437) 145
\item \textsuperscript{441} ibid 147
\item \textsuperscript{442} ibid 149
\item \textsuperscript{443} Georges Langrod, \textit{Administrative Contracts: A Comparative Study}, (1995) The American Journal of Comparative Law 326
\end{itemize}
power of the public authority to amend the terms of the contract cited in *Compagnie Nouvelle du Gaz de Deville-lès-Rouen* (1902) and in the case of *Compagnie Générale Française des Tramways* (1910). 444 Unilaterally granted rights may only be modified where sufficient public interest is apparent, and only then upon payment of full compensation.

El Tamawi argues that intervention by a public authority requires, and is limited to four conditions: the modification of any agreement should be connected to the enhancement of the public utility; should be reserved for the development of significant circumstances unforeseen by either party, and that only arise after the contract has been concluded; there has to be a continuing commitment to the original contract, that is that the measures must not make such radical changes that they supersede the original contract and unilaterally impose a new set of obligations; and finally the public authority should respect the rules of legitimacy.445

D) The Power to Terminate the Contract

In the context of an administrative contract, largely in the power of the executive, a host state may terminate the contract completely by unilateral decision without any requirement of error or misconduct on the part of the other contracting party. This robust entitlement is generally acknowledged and supported by the *Council d’Etat* in France; and means that the state executive enjoys an inherent legal power to terminate any agreement that it is a party to, whenever the administrative contract no longer meets the public interest.446 The Egyptian Administrative Court also considered the differentiation between administrative and civil jurisdictions:

The administrative contract has its own features that distinguish them from the civil contracts; that feature is that the administrative contracts are connected directly to the needs of the public utilities which targeted by this kind of


445 El Tamawi (n437) 152

contracts. These [administrative] contracts seek to give the priority to the public interest rather than private one. According to that feature, the public authority has the right to terminate the contract if it sees that the public interest should be applied. The compensation is the only right to the other party.  

The government may therefore bring an end to an applicable agreement by administration directive, but must also fully indemnify the aggrieved contracting party.  

(ii) The Act of State Doctrine - *La théorie du fait du prince*  

‘The act of the prince’, in French administrative law, is an arbitrary but legal action of the executive. The doctrine refers to a legitimate act of the state, undertaken by the government or public authority, to reduce the financial return in an investor-contractor party without actually breaching the contract. A common example may be the modification of commodity prices, or raw materials necessary for a contractor to undertake a project. Where a state seeks utility of powers, it is vital to the protection of those who will potentially be disadvantaged that conditions apply; and therefore, the act should arise from the public authority that entered into the agreement with the contractor; where it adversely affects the contractor this must have been unforeseeable when the contract was written; and the contract between the contractor and the public authority should be administrative in nature.  

If these conditions are satisfied, the contractual party affected by the action of the state, or its associated public authority, is entitled to full compensation, in addition to their inherent right to terminate the contract where a state imposes an excessive increase in obligations on the investor.  

A host state has considerable authority to exercise its duty in the promotion of the public interest of its subjects, and this can significantly affect (usually adversely), the financial interests of foreign investors. Investment arbitration therefore has to limit and assess the legitimacy of the principle in the use of these powers; and a foreign

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447 The Supreme Administrative Court (Egyptian Council d’Etat) decision No. 1227 (Translated)  
448 Bermann and Picard (n438) 89  
Investor must take steps early in the negotiation process to ensure the inclusion of the appropriate arbitration clause within the resultant investment contract. Host state national administrative courts tend to oversee and adjudicate on the deeds of the state administration according to the existing legislative framework. However, upon assessment of compliance of domestic legal requirements, their authority rarely extends to interference with the effects that occur. National courts may be bound by, and therefore have to enforce, legislation that is unfair or inequitable to a foreign investor. The domestic judicial system is part of the state, and in the absence of effective checks and balances on its authority, the executive administration has carte blanche to act according to arbitrary will.

In this context, the forum clause of arbitration becomes vital to the protection of a foreign investor’s interests. In the event of a dispute, there is, subject to the inclusion of the option in the agreement, the entitlement to choose the venue for the resolution of the dispute. This option may emanate from the inter-state BIT, or be incorporated into the specific investment contract, and it is certainly easier to administer when included in both. However, whilst the issue of international venue may be incorporated in the BIT, the investment contract may specify use of the host state national courts instead. Such disparity can be resolved through the use of the ‘umbrella clause’.

5.3.3 State Sovereignty and the ‘Umbrella Clause’

The umbrella clause is a treaty provision; often incorporated in a BIT, that requires each contracting state to comply with all obligations contractually undertaken with investors from other treaty states. The purpose is to facilitate resolution of an investment contract breach, subject to the scope of the BIT in an international forum. Article 2(2) of the British Model BIT (1999), for example, states the basic principle of contract law and makes it an international treaty duty issue: ‘Each

452 ibid 145
Contracting Party shall observe any obligation it may have entered into with regard to investments of nationals or companies of the other Contracting Party’.\(^{453}\)

In that event, when there is a breach of a specific state-investor contractual obligation, it effectively may become an inter-state treaty breach, where one has been entered into by the investor domicile and the host state.\(^ {454}\) The principle governing a host state’s international obligations and responsibilities, and the all-encompassing nature of dispute settlement procedures withdraws contracts from unilateral influence and regulation by a host state into the international arena. The United States model BIT purports to expand the jurisdiction of the arbitral tribunal to three legal spheres for a host state cause of action: a dispute arising out of or relating to ‘a (BIT) obligation’, an investment authorisation, or an investment agreement’.\(^ {455}\)

In the \textit{SGS Société Générale de Surveillance S.A v Philippines} case, the umbrella clause incorporated in the BIT between Switzerland and the Philippines stated that ‘each Contracting Party shall observe any obligation it has assumed with regard with specific investments in its territory by investor of the other Contracting Party’.\(^ {456}\)

The tribunal decided this ‘makes it a breach of the BIT for the host State to fail to observe binding commitments, including contractual commitments, which it has assumed with regard to specific investment’.\(^ {457}\) This analysis effectively makes a breach of any investment contract obligation an issue that can prompt an intervention under international law, potentially increasing the burden of time and expense on a host state, and indeed the investor who makes such a choice; as all investment agreements can become subject to international assessment and scrutiny, which will have an overwhelmingly adverse effect on the conduct of business.\(^ {458}\)

\(^{453}\) Art. 2(2) UK Model BIT 1999  
\(^{454}\) Dolzer (n30) 965; Margaret L. Moses, \textit{The Principles And Practice Of International Commercial Arbitration} (Cambridge University Press 2008) 234  
\(^{455}\) Art. 24(1) U.S. Model BIT; Mariel Dimsey, \textit{The Resolution of International Investment Disputes: Challenges And Solutions} (Volume 1 Eleven International Publishing 2008) 77; Moses (n454) 241  
\(^{456}\) \textit{SGS Société Générale de Surveillance S.A v Republic of the Philippines}, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction on 29 January 2004 Para 115 (Hereinafter “ \textit{SGS v Philippines}”)  
\(^{457}\) Ibid Para 128  
\(^{458}\) Chung (n413) 961
Within the operation of the umbrella clause is the possibility of ‘double jeopardy’, the potential for simultaneous operation of both national and international dispute resolution proceedings. The principle of state sovereignty is undermined by the supplanting of domestic authority by the automatic application of international treaty jurisdiction, and therefore the method of interpretation of such a clause is of considerable importance to a state’s autonomy in decision-making within its own territory.

A) The Restrictive Interpretation of the Umbrella Clause

The examination of case studies and tribunal decisions provides a useful insight into the resolution of conflicting contractual and treaty provisions when containing an umbrella clause. Jurisdictional issues often form a preliminary matter to be addressed before proceeding with the hearing of disputes between states and investors.

The ICSID Tribunal in the *SGS Société Générale de Surveillance S.A. v Pakistan* case endorsed a narrow and restrictive interpretation of the umbrella clause, thus partially preserving some semblance of state territorial autonomy.\(^{459}\) The case involved a pre-shipment inspection agreement (PSIA). The Swiss claimant had contracted with Pakistan to perform specified services for imports entering the host state territory, and any dispute arising under the investment contract was to be settled via arbitration under Pakistani law.\(^{460}\) The investor claimed breach of the agreement, and sought to take the dispute to the ICSID Convention. Pakistan argued *pacta sunt servanda*, and the tribunal therefore did not have jurisdiction; and the forum designated for resolution of disputes negotiated in the formation of the original investment contract was the appropriate venue.\(^{461}\) *SGS* argued that the umbrella clause contained in Article 11 of the BIT between Switzerland and Pakistan raised the status of breach of contract matters to inter-state treaty violations, and ‘each time you violate a provision of the contract [...] you also violate norms of international law, [and] you violate the treaty by the same token’.\(^{462}\) The forum selection clause in the PSI agreement was

\(^{459}\) *SGS Société Générale de Surveillance S.A. v Islamic Rep. of Pakistan*, ICSID Case No. ARB/01/13, Objections to Jurisdiction on 6 August 2003 (Hereinafter “*SGS v Pakistan*”)

\(^{460}\) ibid Para 15

\(^{461}\) ibid Para 48, 51-52

\(^{462}\) ibid Para 99
deemed valid and enforceable ‘so far as concerns the Claimant’s contract claims which do not also amount to BIT claims’. However, if breaches in the investment contract did not prompt the need for a higher level of treaty protection, the claimant would not be able to seek restitution before an international tribunal. As there was no ‘special agreement’ outside of the contractual parameters between the parties in this case, SGS had to take its complaint to the Pakistan national courts as per the original contract and not to the ICSID.

A similar case emerged in the mid 2000s, when Argentina was in the grip of a financial crisis. In an attempt to stabilise its economy, the national government enacted measures that affected the commercial interests of foreign investors. The *El Paso Energy International Co. v Argentina* case concerned the removal of fundamental contractual entitlements and protections by the state in order to bolster its own domestic energy sector, contrary to the interests of the foreign investor, and a claim was made under creeping violation of the fair and equal treatment standards. The United States and the Argentinian inter-state BIT incorporated an umbrella clause which was utilised in order to balance the protection of both state and investor interests, given the economic circumstances in Argentina. Umbrella clauses do not alter the nature of a claim under contract to one which qualifies for inter-state treaty protection, as otherwise this would transform the most minor of issues into treaty claims, thus completely undermining any control the state may have in dealings on its territory and in the context of its own needs.

In its broad review of the international law on jurisdictional issues and the entitlement under an umbrella clause to choose a venue, the *El Paso Energy* tribunal examined similar points of potential controversy. It reiterated that there must be a clear distinction drawn between the character of the state acting as a commercial merchant, and acting in accord with its sovereign rights and duties. When the state exercises its sovereign authority, the imbalance of power requires that a foreign investor must

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463 ibid Para 161
464 ibid Para 161
465 *El Paso Energy Int’l Co. v Argentine Rep.*, ICSID Case No. ARB/03/15 Decision on Jurisdiction on April 27, 2006, Para 23
466 ibid Para 70
467 ibid Para 82; *SGS v Pakistan* (n458) 166
468 ibid Para 79
receive the protection of international adjudication. However, when a state acts in a purely commercial capacity, as any other business may do, the presumption of freedom of trade and equality in bargaining will not activate protections unless specific treaty terms are incorporated. The umbrella clause did not ‘extend the Treaty protections to breaches of an ordinary commercial contract entered into by the State or a State-owned entity’; rather, it would ‘cover additional investment protections contractually agreed by the State as a sovereign [...] inserted in an investment agreement’. The decision that an umbrella clause will not of itself establish a liability in international law goes far beyond the standards and duties imposed by a treaty in the safeguarding of a foreign investment, and concern was expressed that an investor could circumvent the host state judicature ‘if the ICSID tribunals offer them unexpected remedies’. Therefore, limitations should be imposed on the operation of umbrella clauses, to prevent the natural inclination to seek unjustified advantage in largely commercial disputes.

B) Wider Interpretations of the Umbrella Clause

A wider interpretation of the effect of an umbrella clause is likely to place a foreign investor at an advantage over a host state, with the choice of the international as opposed to the domestic arena. The leading case advocating a broader interpretation of the clause is Société Générale de Surveillance S.A. (SGS) v Philippines, involving a claim for unsatisfied payments under an investment contract, for contractual provision of pre-shipment inspections by SGS to the Philippines, decided the year after the claimant’s action against Pakistan. The government argued for the restriction of the application of the umbrella clause to circumstances where actions of the state sought exclusion of state duties in specialised state-investor agreements. The tribunal took an alternative perspective on the effect of the clause, and the contention by the

469 ibid Para 80–81; Impregilo S.P.A. v Islamic Republic of Pakistan, ICSID Case No. ARB/03/3, Decision on Jurisdiction on April 22, 2005, Para 260. (Only the State in the exercise of its sovereign authority (‘puissance publique’), and not as a contracting party, may breach the obligations assumed under the BIT)
470 El Paso Energy (n459) Para 81; CMS Gas Transmission Co. (n362) Para 299: “Purely commercial aspects of a contract might not be protected by the treaty in some situations, but the protection is likely to be available when there is significant interference by governments or public agencies with the rights of the investor.”
471 El Paso Energy (n465) Para 82
472 SGS v Philippine (n455) Para 518 and SGS v Pakistan Case No. ARB/01/13 Objections to Jurisdiction on 6 August 2003, 8 ICSID Rep. 2005, Para 406
Philippines that such a term should be more narrowly applied to the discharge of commitments imposed by other international law apparatus and principles, not including those incorporated only in the investment contract, was rejected; as if that was the intention, the tribunal concluded, it could easily have been expressed as such in the BIT.\textsuperscript{473}

In a revision to its predecessor’s assessment of the operation of an umbrella clause in \textit{SGS v Pakistan}; the tribunal rejected the view that a wider interpretation could be ‘susceptible of almost indefinite expansion’, but noted the greater clarity and expression of intent in the drafting of the jurisdictional issues in the Philippines BIT. The rather prosaically expressed

\begin{quote}
Commitments [...] entered into with respect to the investments’ terminology which was previously rejected as capable of activating international jurisdiction was replaced herein by ‘any obligation [...] assumed with regard to specific investments.\textsuperscript{474}
\end{quote}

The use of the word ‘obligation’ was clear in its effect: parties had to comply with each obligation it entered into under the contract and the law, as well as each obligation it would assume in the course of its operation. Hence the option of international arbitration was apparent.

The decision in the \textit{SGS v Pakistan} case led to further criticism for its failure to make clear the operation of the jurisdiction clause in the applicable BIT, coupled with a somewhat controversial description of the effects of an umbrella clause. It was not accurate that a wider interpretation would cause a major upheaval in the international adjudication eligibility of domestic contractual disputes, with an investment agreement transforming itself into a treaty with the investor. It did not change the jurisdictional nature of

(i) Non-binding domestic blandishments into binding international obligations, (ii) questions of contract law into questions of treaty law, and (iii) [did] not change the proper law of [contract] from the law of the Philippines to international law.\textsuperscript{475}

\begin{flushright}
\textsuperscript{473} ibid Para 118
\textsuperscript{474} ibid Para 119
\textsuperscript{475} ibid Para 126
\end{flushright}
The broader view of the operation of an umbrella clause was only to be presumed on specific investments, on a case by case basis, rather than creating a general legal obligation; and international law was now prepared to accept where appropriate, a choice of jurisdiction. The placement of the clause, considered decisive in the Pakistan BIT was rendered insignificant as a relevant factor.

This extensive review of the operation of an umbrella clause in a pertinent BIT concluded that the entitlement of a foreign investor to seek international arbitration for contract breaches was not based upon the range of obligations in an investment contract, but on their performance. An assurance to investors was an appropriate purpose of international law for ‘[securing] the rule of law in relation to investment protection’. The extent of specific obligations would still be governed by the investment contract, and only determined by reference to the contract’s terms. A breach would subsequently arise if the government failed to observe binding obligations. However the umbrella clause would not ‘convert the issue of the extent or content of such obligations into an issue of international law’.

Despite such criticism and re-evaluation of precedent, in the case of SGS v Philippines the tribunal decided that it would not accept jurisdiction on the alleged contract breaches therein. It also decided that that a broad interpretation of the jurisdictional rights of the foreign investor enabled abrogation in cases where there was a dispute settlement clause that had been freely and properly negotiated and incorporated into the obligations. The contract before the tribunal incorporated such a freely negotiated term on specific jurisdictional issues regarding contractual discord, and the commitment of the parties to deal with those at the national arbitration level would be honoured. General provisions contained within the BIT should not displace arrangements in the project specific investment contract contracts without a clear expression from the parties that it may do so.

Wong asserts that the umbrella clause will ‘only have effect in one of two scenarios: (a) where the contract’s forum selection clause designates the same forum as the BIT;
and (b) where the contract does not contain a forum selection clause’.\textsuperscript{479} Here, priority of enforcement lay with the obligation to respect and utilise the specific, investor-negotiated contract term and avoid the tactical tendency to ‘approbate and reprobate in respect of the same contract’.\textsuperscript{480}

However, there remain circumstances where commercial aspects of an investment contract may invoke the protection of international adjudication under the BIT; such as when host state actions cause ‘significant interference’ with an investment project. In the \textit{CMS Gas Transmission Co. v Argentina} case, another arising as a result of Argentina’s economic crisis, a dispute arose regarding regulatory acts of the state that compromised the interests of CMS, a privatised company. The claimant investor alleged new enactments breached contractual agreements, and they sought ICSID jurisdiction under the inter-state Argentina-USA BIT.\textsuperscript{481} The host state contested the appropriateness of international arbitration, arguing that the alleged breaches were not of specified treaty rights and obligations that should trigger BIT protection; arguing instead that, as the dispute was purely commercial, arbitration should be conducted in its national jurisdiction.\textsuperscript{482}

However, specific contractual terms were incorporated in the investment contract requiring the government to refrain from unilaterally altering the terms of the contract, in particular the existing tariff regime under which the energy project would operate. This happened, not with the aim of harming investor interests, but in order to manage the economic crisis. The tribunal found that it was the acts of the state executive that were called into question, not the commercially related claims; and thus state conduct was not compliant with international standards of protection. This activated the BIT umbrella clause and thus the investor’s choice of venue: ‘legal and contractual obligations pertinent to the investment (had) been breached and resulted in the violation of the standards of protection under the Treaty’.\textsuperscript{483}

\textsuperscript{479} Wong (n451) 166
\textsuperscript{480} SGS v Philippine (n456) Para 155
\textsuperscript{481} CMS Gas Transmission Co. (n362)
\textsuperscript{482} ibid Para 299
\textsuperscript{483} ibid Para 303
The *Noble Ventures, Inc. v Romania* case involved a dispute regarding the state privatisation of a steel mill established as the result of an international investment contract between the American claimant and the respondent; and *Noble Ventures* sought international arbitration under the treaty between the two countries, rather than the investment contract national procedure.\(^{484}\) Romania argued that umbrella clauses in the contract and treaty did not elevate contract breaches into treaty claims; and instead that they were simply designed to prevent state interference in the contractual obligations relating to foreign investment. However, the tribunal recognised that the umbrella clause appeared both in the BIT and the contract provision containing the primary obligations of the parties, thereby indicating an intention in the project’s contract that obligations existed beyond the treaty, not least because of the significance of its location in the agreement.\(^{485}\) The umbrella clause in the BIT read:

‘Each Party shall observe any obligation it may have entered into with regard to investments’,\(^{486}\) and as a result referred to the investment contracts but failed to deal with international treaties on investments, and thus the pacta sunt servanda, ‘agreements must be kept’ principle applied. The umbrella clause and subsequent choice of jurisdiction did not arise from actions solely relating to the exercise of sovereign powers.

### 5.3.4 State Sovereignty and Forum Selection Clauses

There are a number of other issues that affect how international law and state-foreign investor relations interact, not least whether international investment treaty arbitration can be initiated based on the presence of a treaty umbrella clause when there exists, in a specific investment contract, a forum selection clause providing for the national judiciary of a state to arbitrate in disputes.\(^{487}\) It may be presumed that an investment contract will provide for disputes being resolved in the courts of a contracting host state rather than international arbitration. The inter-state treaty, however, may alternatively provide for international arbitration under ICSID.\(^{488}\)

\(^{484}\) Noble Ventures, Inc. *v* Romania ICSID Case No. ARB/01/11 Award 2005 Para 2
\(^{485}\) ibid Para 51; *BIVAC B.V v Republic of Paraguay*, ICSID Case No. ARB/07/9, Objections to Jurisdiction on 29 May 2009 Para 141
\(^{486}\) ibid Noble Ventures Para 32
\(^{488}\) Moses (n454) 244
International tribunals have supported foreign investors in their choice of jurisdiction under treaty umbrella clauses, and in the event of a host state breach of contract, will permit a choice of arbitration forum. International adjudication is normally the preference of an investor seeking enhanced protections, even if there remains an agreed forum clause in the specific investment contract for national court jurisdiction, usually the preferred choice of a state. In cases where a foreign investor implements an umbrella clause to take their dispute to the international arena, they effectively challenge the sovereignty of the host state in the conduct of its national judicial system, particularly where state legislation requires submission to the domestic jurisdiction to ensure commitment to local law. It is beyond the scope of this thesis to discuss the issue of perceived superiority of international or national law and the respective decision making propriety, instead the thesis will try to consider the perspectives of international law and states and their attitude towards sovereignty while using case law to demonstrate prevailing practices.

5.3.4.1 Domestic Courts Versus International Arbitration Tribunals

It is useful to examine the respective roles and duties of international arbitration tribunals and the domestic courts of a host state, particularly when an operative umbrella clause gives rise to the duplication of proceedings. Any resolution process requires the communication and exchange of information, and in the absence of an agreement on a primary issue of jurisdiction, there has to be a clear set of legal and judicial principles to govern a single, logical arbitration procedure. A preliminary step is to ascertain whether a dispute and claim is more akin to a contract or a treaty breach. This applies even with the broader view now taken by tribunals of operative umbrella clause, which recognise all contract breaches as potential BIT violations.

A treaty provision is expected to set a standard distinct from that of independently negotiated contracts, and not merely reflect the view that an umbrella clause becomes operative when defining a BIT violation as any breach of the contract.\textsuperscript{489} The investment contract in the \textit{Holiday Inns v Morocco} case involved an agreement for the

\textsuperscript{489} Wong (n451) 170-171
establishment and operation of hotels in Morocco by a foreign investor.\textsuperscript{490} Loan contracts related to the operation of the investment were kept contractually separate from the main purpose and operation of the agreement, and incorporated forum clauses specifying the host state’s courts as the jurisdiction for disputes. Morocco failed to make the necessary payments, and \textit{Holiday Inns} complained to the ICSID under the U.S. - Morocco BIT jurisdiction clause. The argument by the host state was simple; the dispute about money related to separate transactions from the main investment project, and involved different parties, for which domestic dispute settlement procedures had been agreed in the international investment agreement, and the treaty option for international arbitration was reserved for the hotel business. The ICSID disagreed, supporting the contention that any breach may amount to a treaty infraction and choice of arbitration venue. The explanation was one of unity in the operation of the investment between loan arrangements and hotel building, allowing one to follow the other into the international arena under the investment agreement and BIT umbrella clauses.

It seems reasonable, as a result of the \textit{Holiday Inns} case, to interpret the effect of a BIT umbrella clause as being applicable to obligations arising under an independent investor and state investment contract, permitting an international tribunal to exercise jurisdiction over breach of contract claims. This appears to be the case even when the independent project contract contains an exclusive forum selection clause; if it can be shown to form part of a wider agreement.\textsuperscript{491} Nevertheless, considerable problems may occur in this particular interpretation of the function of the umbrella clause, with regard to the intentions of the parties on jurisdiction issues, effectively nullifying an otherwise valid forum clause.

The tribunal in the \textit{SGS v Philippine} case veered away from the application of BIT provisions to circumvent the independent decision making process inherent in contract negotiations, particularly regarding forum selection clauses. This approach appears more in keeping with the principles of freedom of contract, on the basis that a


\textsuperscript{491} Wong (n451) 175
general treaty provision which forms a backdrop to discussions should not then be
presumed to take precedence over a specific term in a directly negotiated contract.492
Primacy lies with the forum selection clause negotiated at the time of contract,
asserting that ‘the basic principle [...] that a binding exclusive jurisdiction clause in a
contract should be respected, unless overridden by another valid provision’. 493
Accordingly the tribunal found that

The BIT did not purport to override the exclusive jurisdiction clause in the
[investor-state contract], or to give SGS an alternative route for the resolution
of contractual claims which it was bound to submit to the Philippine courts
under that agreement.494

Given the somewhat conflicting opinions on the operation of a jurisdiction umbrella
clause, the standard accepted legal principle need to be examined.

A) The Distinction Between Sovereign Acts (jure imperii) and Commercial Acts
(jure gestionis)

When considering the appropriate venue for hearing a dispute, it is necessary to
distinguish between a public act of state, which is only possible by a sovereign
authority, and a private act undertaken by the state, which could also be undertaken
by a commercial entity such as an investor or business.495 In the I Congreso del
Partido case (a shipping dispute), Lord Wilberforce relied on an assessment of the
nature of state acts rather than their purpose, as a basis for defining the scope of
sovereign immunity from suit, citing the German Federal Constitutional Court:

As a means for determining the distinction between acts jure imperii and jure
gestionis one should rather refer to the nature of the state transaction or the
resulting legal relationships, and not to the motive or purpose of the state
activity. It thus depends upon whether the foreign state has acted in exercise of
its sovereign authority, that is in public law, or like a private person, that is in
private law.496

492 SGS v Philippine (n456) Para 141
493 Ibid Para 138
494 Ibid Para 143
495 Gus Van Harten, The Public-Private Distinction in the International Arbitration of Individual
Claims Against the State (2007) 56(2) International and Comparative Corporate Law Quarterly 371
496 I Congreso del Partido, [1983] 1 AC 244, 267 (HL), citing claim against the Empire of Iran (1963)
It is argued that public sovereign measures, not available to business organisations, require the international scrutiny of complaints made by the weaker investor party; while disputes of a commercial nature, which could conceivably be carried out by the investor are more suitably dealt with in the national courts in the normal manner, as they represent a business matter with no exercise of exceptional sovereign powers.

Article 11 of the Harvard Draft Convention is clear on states’ international liability for their actions:

A State may be made a respondent in a proceeding in a court of another State when, in the territory of such other State, it engages in an industrial, commercial, financial, or other business enterprise in which private persons may there engage.497

Therefore, a recalcitrant state cannot be immune from suit in the courts of another state if it has acted in a commercial capacity in that state, much in the same manner as a private company. It is argued that commercial acts should be adjudicated upon under the specific investment contract if that act is a breach of the contract; while in contrast, sovereign actions, which only fall within the remit of the state, require examination in the context of the international BIT where a breach is alleged. This comes back to the contentious assessment and determination of the nature of the state act, whether sovereign or commercial, which is all the more difficult to resolve in the context of assertions of denial of justice, unjust enrichment, failure to physically and legally protect the investment, and breach of fair and equitable treatment provisions; which prima facie represent BIT breaches, requiring international scrutiny.

The Vivendi annulment decision helps to form an, albeit incomplete, basis of differentiation between sovereign and commercial state actions. It deals with the breach of a concession contract between CGE, a French company with an Argentinian affiliate; and Tucuman, a province of Argentina and therefore a public body, concerning a project operating a water and sewage system.498 The claimant alleged before the ICSID that a number of actions had been undertaken by the provisional government, which undermined the operation of the project, claiming such actions

498 Compañía de Aguas del Aconquija S.A. v Argentine Rep., ICSID Case No. ARB/97/3, Annulment 3 July 2002 41 International Law Materials 1135
violated the BIT between Argentina and France. The case relied on the provisions of the umbrella clause in the BIT to pursue international jurisdiction, although Article 16.4 of the project concession contract stated that

For purposes of interpretation and application of this contract the parties submit themselves to the exclusive jurisdiction of the Continues Administrative Tribunals of Tucuman.

Argentina therefore challenged the jurisdiction on the basis of the forum selection specific to the investment contract.

In their analysis of the relationship between the specific investment contract and the BIT, the tribunal noted that the agreement that established the project contained a national court forum selection clause, but without an umbrella clause giving the international arbitration option, whilst the BIT did incorporate the latter. The claimant investor therefore had to justify its action by contending pursuit of both contractual and treaty-based claims in a single international proceeding. If this argument failed, the international tribunal would be enabled, in order to send the case to the national court for adjudication; arguing that the ‘state may breach a treaty without breaching a contract, and vice versa’, effectively leaving the foreign investor to prove their loss and the state to resolve issues of principle.

Article 3 of the ILC Articles on State Responsibility assert that state action characterised as wrongful in international law is governed by international jurisdiction, and that such an assessment is not affected by the view of internal, national law of the same act. The tribunal stated that the particular claims made by CGE would be adjudicated upon in accordance with the legal provisions which applied to each individually, BIT breaches by the international tribunal; investment contract infractions by the municipal national law designated by the contract. Logically, where the breach is essentially one of the agreement, the tribunal will honour and effect a valid contractual forum clause (which may in fact be international arbitration); while breach of the inter-state BIT, which ‘[lays] down an independent

499 ibid Para 27
500 ibid
501 ibid Para 95
503 Compañía de Aguas (n498) Para 96-98
standard by which the conduct of the parties is to be judged, the existence of an exclusive jurisdiction clause in a contract [...] cannot operate as a bar to the application of the treaty standard’.

The ruling of the Vivendi committee ultimately fails to determine whether the actions of Argentina involved the use of sovereign powers or were commercial acts; and yet in the context of determining the proper forum for arbitrating on a breach, such a finding must be explicit, and determine whether it forms a treaty or contract violation. This differentiation is crucial, given that some acts of the host state may be investment contract breaches involving the use of sovereign powers. However, in Vivendi there contains only an implicit reference: ‘it is one thing to exercise contractual jurisdiction [...] and another to take into account the terms of a contract in determining whether there has been a breach of a distinct standard of international law, such as that reflected in Article 3 of the BIT’.

Several implications may occur from a single act of the state executive, for example, the failure to meet payment obligations to the foreign investor, which may breach both treaty and contract. This commercial issue, leading to an application for redress, may find the judicial system influenced by the executive to deprive a foreign investor of their right to payment; the domestic courts may order the host state to pay, compliance subsequently be denied, and the court may be unable to institute enforcement measures. These are sovereignty matters, and a foreign investor may seek arbitration to assert their rights under the BIT. According to the Vivendi Committee, a ‘state cannot rely on an exclusive jurisdiction clause in a contract to avoid the characterisation of its conduct as internationally unlawful under a treaty’. Where the breach results in state responsibility under the international law or treaty, the treaty forum clause will be activated, bringing forth international arbitration scrutiny and adjudication.

B) The Forum Clause in Investment Contracts

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504 ibid Para 101  
505 ibid Para 105  
506 Compañía de Aguas (n498) 105
Contract law generally requires enforcement proceedings and claims to be brought before the domestic courts where parties to an investment contract have negotiated and incorporated a forum clause into the agreement. Where an umbrella clause is incorporated in a treaty, this does not predestine the jurisdiction agreement in the original investment contract. In the Sempra Energy v Argentina case, the tribunal fully and concisely asserted that it:

Fully shares the view that ordinary commercial breaches of a contract are not the same as Treaty breaches, as was well explained by the tribunal in SGS v Philippines when distinguishing a contractual dispute over payment from a Treaty dispute. So too, the Tribunal can only agree with the view adopted in SGS v Pakistan that such a distinction is necessary so as to avoid an indefinite and unjustified extension of the umbrella clause. The decisions dealing with the issue of the umbrella clause and the role of contracts in a Treaty context have all distinguished breaches of contract from Treaty breaches on the basis of whether the breach has arisen from the conduct of an ordinary contract party, or rather involves a kind of conduct that only a sovereign State function or power could effect.

Evidently, the expression of jurisdiction preference agreed by the parties to an investment contract in a freely negotiated forum clause deserves respect as the primary rule determining the venue of arbitration. Therefore, breach of agreement terms by a host state does not automatically mean that a foreign investor is entitled to pursue redress to an international tribunal under a treaty umbrella clause. It is certainly possible that a BIT umbrella clause will expressly provide for such a breach to amount to a treaty issue, but the protraction of litigation arising from what would otherwise be a simple contract breach is expensive and contrary to the principle of closure; as ‘justice too long delayed is justice denied’. A foreign investor must therefore seek justice from the national system to which they aligned their money and expertise, and a properly constituted and independent local court will usually provide swift and just enforcement of commercial rights. Doing so avoids the potential for a clash of judgements, where the complainant seeks advantage and commences actions in both national and international jurisdictions; as such a possibility cannot bring

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507 SGS v Philippine (n456) Para 138
508 Sempra Energy International v Argentine Republic, ICSID Case No. ARB/02/16 Award of the Tribunal 28 September 2007, Para 310
credit to either justice system. An investor always has international recourse if the national jurisdiction fails on standards of fairness and equity.

A review of the legal principles governing interpretation facilitates understanding of the application of the jurisdiction clauses.

_Pacta sunt servanda_, agreements must be kept. Parties to the contract, that has been freely negotiated, are expected to accept adherence to its specific terms, including those that stipulate the mode of dispute resolution. The tribunal in the _Noble Ventures, Inc. v Romania_ case rejected the argument before it from the recalcitrant state; Romania had claimed the umbrella clause was only applicable to some investments covered by international treaties, which did not form a part of this action. The tribunal judged that there was a choice of international venue available on broadly commercial disputes, and that where there was an expressly framed contractual umbrella clause, did not only apply to state sovereign action.\(^{510}\) In the _SGS v Pakistan_ case, the incorporation in the investment contract of a valid forum selection clause ‘so far as concerns the Claimant’s contract claims which do not also amount to BIT claim’ would be sufficient to activate entitlement to international arbitration, the tribunal noting further that it had no jurisdiction where breaches of an international investment agreement ‘did not also constitute breaches of the substantive standards of the BIT’.\(^{511}\)

_Lex specialis_, whereby the law that answers the specific issue in question takes precedence over that which deals with the more general principles thereof. The specific investment contract governs the investment project; and its terms and clauses are more detailed and specifically relevant to the problems that arise in its operation rather than the general principles of the inter-state BIT obligations. Schreuer asserts that a ‘document containing a dispute settlement clause which is more specific in relation to the parties and to the dispute should be given precedence over a document of more general application’.\(^{512}\)

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\(^{510}\) _Noble Ventures Inc._ (n484) Para 51

\(^{511}\) ibid Para 162

\(^{512}\) Schreuer and others (n15) 362; James Crawford, Karen Lee and Elihu Lauterpacht, _ICSID Reports_ (Cambridge University Press 2005) 558; _SGS v Philippines_ (n456) Para 141
Lis alibi pendens, the filing of notice of pending proceedings regarding property, in the context of an investment contract dispute, applies where one party, normally the foreign investor, institutes international proceedings for redress under the BIT umbrella clause, whilst the other party, on the same facts, seeks national court adjudication via the investment contract forum clause in the same contract.513

Contradictory judgements, and a consequent a lack of clarity, risks the undermining of both legal systems. This may be avoided by preventing new proceedings continuing whilst those elsewhere are in progress; or by one jurisdiction (normally the national courts), declaring an action before it improper, as judgement is pending elsewhere. Oellers-Frahm highlights the necessity of mechanisms for the avoidance of a ‘multiplicity of jurisdictions’ that give rise to confusion, a lack of unity and cogency of justice.514 In such circumstances, where an investment contract contains a freely negotiated and specific forum clause governing disputes under the agreement, and giving exclusive jurisdiction to the local courts of a host state, the international tribunal should stay any proceedings before it based on the same facts, until the local court has made its decision. Exceptions apply if there is also a breach of the relevant BIT, or in the event of a denial of justice, although that may only be capable of determination after the judgement of the host state judiciary.

The Brussels Convention (1968) reflected the recognition by signatory states of the problems of parallel litigation, and developed a framework for its resolution and avoidance.515 In the utility of the lis alibi pendens principle, Article 21 states that: ‘Where the jurisdiction of the court first seized is established, any court other than the court first seized shall decline jurisdiction in favour of that court’.516 However, in Article 1 thereof, it expressly excluded various types of dispute and the resolution method of arbitration, which, ironically, is the prevalent practice in international law. Nevertheless, this solution appears applicable to the analysis of similar problems of

513 Dimsey (n455) 90
516 Art. 21 Brussels Convention 1968
jurisdiction in international investment contract disputes, although the international tribunal may be first seized, but potentially be the wrong jurisdiction given the context of the nature of the allegations. The local courts of the host state may in fact be apposite if there exists a forum clause jurisdiction in the investment contract. In the *SGS v Philippine* case, the tribunal stayed the international arbitration proceedings before it, given as the exclusive jurisdiction of the local courts to decide the contract claims had not been overridden by the BIT or the ICSID Convention.

*ne bis in idem* propounds that the same act should not be tried twice; a potential consequence of parallel litigation. A purpose of litigation is to bring just closure to a problem, not to provide a variety of methods and procedures in order to secure a result suitable to one or the other parties. Where the facts of the dispute are the same, a single, fair and just adjudication, based on established legal standards, should suffice for all those involved.\(^5\)*17 The existence of a contractual forum clause, agreed independently by the parties for their specific project, and giving national courts jurisdiction in disputes does not necessarily prevent a foreign investor from utilising the inter-state BIT umbrella clause, and initiating an international tribunal claim; and this may be based on the same facts in an action taken at the same time. This convoluted process risks securing differing national and international judgments, on the same facts, which then damage the credibility of both jurisdictions. Sovereignty and treaty obligations, with their respective jurisdictional effects, must have an established framework in which to be decided.

**C) The Fork in the Road Clause, the Umbrella Clause and the Forum Clause in Investment Contracts**

In the context of an investment agreement, the ‘fork in the road’ clause allows an investor to choose between international arbitration and the domestic processes of the host state. If they choose the domestic court, they cannot thereafter submit a claim to international arbitration, and the choice of international proceedings precludes a claim to the host state jurisdiction.\(^5\)*18 This decision should be freely taken, without pressure,

\(\text{\footnote{\text{*5\textsuperscript{17} SGS v Pakistan (n459) Para 182}}} \)
\(\text{\footnote{\text{*5\textsuperscript{18} Lucy Reed, Jan Paulsson, Nigel Rawding and Nigel Blackaby, \textit{Guide to ICSID Arbitration} (Kluwer Law International 2011) 100}}} \)
and the bar should not absolve the state of treaty obligations. Parallel litigation consequences are therefore avoidable where there is an operative umbrella clause, but under principles of contract law, may still arise where there is a selection clause in the investment agreement.

In recognition of this anomaly, a number of international treaty agreements seek to provide guidance. Article 26(2) of the US BIT Model (2004), states:

No claim may be submitted to arbitration under this Section unless: [...] (b) the notice of arbitration is accompanied, [...] (ii) for claims submitted to arbitration under Article 24(1)(b), by the claimant’s and the enterprise’s written waivers any right to initiate or continue before any administrative tribunal or court under the law of either Party, or other dispute settlement procedures, any proceeding with respect to any measure alleged to constitute a breach referred to in Article 24.  

Furthermore, Article 1121(1) of NAFTA asserts:

A disputing investor may submit a claim under Article 1116 to arbitration only if: [...] (b) the investor and, where the claim is for loss or damage to an interest in an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, the enterprise, waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures.

The Toto Construzioni v Lebanon case, a road construction contract dispute, found the host state claiming that the action by the foreign investor under the Italy-Lebanon BIT was premature, because the national court route agreed in the investment contract had not been exhausted. The ICSID tribunal commented:

Lebanon argues that the Tribunal lacks jurisdiction over the claims already submitted to the Conseil d'Etat because Article 7.2 of the Treaty gives the Claimant the option of submitting claims either to the host State's domestic courts (in casu Conseil d'Etat) or to international arbitration (ICSID), but not to both. Even assuming arguendo that these claims amount to Treaty claims (which Lebanon firmly rejects, considering them to be purely contractual in nature), the fork-in-the-road clause would bar Toto from submitting these Treaty claims to ICSID.

Therefore, a choice of jurisdiction had to be made by the claimant or dictated by the contract.

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519 Art. 26 (2) US Model BIT 2004
520 Art. 1121(1) NAFTA (n16)
521 Toto Costrzioni Generali S.P.A. v Republic of Lebanon, ICSID Case No. ARB/07/12, Decision on Jurisdiction on 11 September 2009
522 Ibid Para 205
5.4 Conclusion

Investment arbitration is linked to the nature of the responsibility of the state, whether commercial (*jure gestionis*), sovereign (*jure imperii*) or both. However, it should be noted that sovereign acts of state that may consequently injure a foreign investor’s interests can in fact be lawful. Whilst investor-state arbitration has an important role to play against states and their sovereign decisions, sometimes state sovereign immunity can abort the arbitration process. State sovereign immunity is generally protected, because all signatories to treaties have their own vested interest for doing so. The UK State Immunity Act (1978) incorporates a regulatory regime that protects the assets of other nations on its soil. The implications for foreign investors should be assessed, as well as consideration given to restrict, under UK legislation, the opportunity for other states to evade their responsibilities.

Indeed investment contracts and BITs are considered as protective methods available to foreign investments. Particular investment contracts and treaties between states should already incorporate an arbitration clause. When a dispute is settled in the national court of a host state may face problems in its outcome, particularly in the implementation of the national law of host state, perceived to have sovereign bias whilst asserting the protection of the foreign investor. A potential problem of ADR is enforcement against the host state. Customary international law is available to protect the investor from inequitable actions of the state; as a statement of principles however, enforcement is problematic, and requires the wrong-doer to adhere to said ideals. It is however a sound basis of claim under a BIT, if included therein. Without question, the investor-state arbitration has an important role to play against sovereign states and their sovereign decisions, but sometimes the state sovereign immunity can abort all the arbitration process by claiming its sovereign immunity. The implications for foreign investors need to be assessed, as well as considerations being given to restrict, under UK legislation, the opportunities for other states to evade their responsibilities.
There must be an examination and clarification, therefore, of state sovereign immunity and how it affects the arbitral award as will be explained in the next chapter.
Chapter Six

State Sovereign Immunity and the Challenges to Investor-State Arbitration

6.1 Introduction

Conflict and controversy do not arise only when state sovereignty is claimed for actions against the interests of foreign investors, but is also often manifested during the dispute resolution process, when an award/decision has been made and while it is awaiting implementation. Whilst the concept of state immunity attracts much analysis from academics, examination of its utility in resistance to dispute resolution appears rather sparse. However, as a litigation tactic, the immunity claim is a valuable tool of state, if only to cause substantial expense to a foreign investor, which provides a considerable disincentive to the pursuit of a legitimate claim. State immunity is a body of internationally acknowledged rules of law and principle, which enable a state to claim entitlement to determine its own internal affairs without interference from a foreign state, authority or jurisdiction, including, in the framework of international investment disputes, that of the ‘forum state’ in which a resolution is sought.

Therefore, it is necessary to understand the value and effect of sovereign state immunity in the arbitration process, focusing in particular on how sovereign power impinges on the rights and entitlements of a foreign investor. The international principle is that a host state has the privilege of autonomy over what occurs and how it acts on its own territory, and thus has considerably more power than a foreign investor in negotiations and any subsequent dispute. This superiority may be exercised in the claim of immunity from actual jurisdiction of an arbitral tribunal, or from the execution of an arbitration award. McNamara asserts that the recent wave

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523 See for example, Dhisadee Chamlongrasdr, *Foreign State Immunity and Arbitration* (Cameron May 2007); Pieter Sanders, *Quo Vadis Arbitration?: Sixty Years of Arbitration Practice*: a Comparative Study (Kluwer Law International 1999).
526 Martin Dixon, Robert McCorquodale and Sarah Williams, *Cases and Materials on International Law* (Oxford University Press 2003) 331
of economic interventions by various states will almost certainly raise many issues regarding the application of state sovereign immunity in international investment litigation. Sovereign immunity is a broad principle encompassing all potential executive and legislative action on a host territory, and therefore the examination of its influence will be limited to the context of investment arbitration with foreign businesses to see to what extent states can use its immunity to deprive the foreign investors from their rewards and what is the best mechanism to the latter to evade it.

6.2 Legal Theories on State Immunity

Protections are afforded to states in disputes that involve the questioning and adjudicating upon actions for which sovereign entitlement is claimed. The nature and extent of immunity dictates its utility to the state in its investment dealings with foreign investors, and must be considered in the context of the jurisdiction chosen to hear and decide on claims, and on matters relating to the execution of any subsequent awards.

6.2.1 Absolute Immunity of the State

Both international law and territorial jurisdiction bring sovereign privileges of freedom to govern, and the entitlement to act in accordance with unfettered discretion, free from intervention or suit from other nations; sovereign prerogative prevents a foreign government suffering the indignity of acquiring ‘defendant’ status in the courts of another, at least without its consent. Absolute immunity exempts the state from liability in other jurisdictions, protecting its property from seizure or attachment, its vessels from arrest and suit, or the taxation of its assets in any other country. In the global economic environment of foreign trade such absolutist principles of immunity are becoming increasingly anachronistic, and in recent years restrictions have been placed on its effect.

529 ibid 52
6.2.2 Restrictive Immunity of the State

As nations have become increasingly active in global business enterprises and international commerce, whether independently, through quasi-governmental bodies or in private enterprise partnerships, the economic value of absolute sovereignty has been undermined and the supremacy of the state over its territory requires the effective abdication of at least part of its authority, in order to derive the financial benefits of the modern trade environment.\textsuperscript{531} A new formula to define sovereignty is required to facilitate the attraction of investment in its territory. Therefore, a state is deemed to be immune from the exercise of judicial jurisdiction by another state where the claims emanate from jure imperii, that is, actions of the state specifically attributable to the exercise of sovereign authority, as opposed to jure gestionis, an act in the course of business or commerce where claims arise from behaviour of a kind that can also be indulged in by private individuals or companies.\textsuperscript{532} Under the modern principle of restricted state immunity, immunity will not apply to actions of a commercial nature.\textsuperscript{533}

Pursuit of jure imperii economic and public interest raises questions regarding the strength of the public purpose argument in order to justify state acts and any subsequent immunity from suit. International investment law has developed so that, in principle, immunity will not follow where states undertake an act considered to be an exercise of dominion contrary to a foreign investor’s interests or terms of the agreement. Nevertheless, where a host state acts in a sovereign capacity, particularly when it promotes its public interest and domestic security; and claims immunity entitlement, such motivation should be considered legitimate. As previously discussed, much litigation arose from the measures taken by Argentina in an attempt to deal with its financial crisis between 1999 and 2002. The bondholders and investors affected took proceedings in a range of different jurisdictions, depending on their state of origin. Italian investors found their domestic courts lacked the inclination to accept jurisdiction, accepting Argentina’s plea of sovereign immunity

\textsuperscript{531} Joyner (n528) 52
\textsuperscript{533} Bishop and others (n170) 1616
under international law, approved by the Court of Cassation, in plenary session on 27 May 2005, citing the ‘public purpose [...] of protecting the primary need of economic survival of the population in a historical context of very serious national emergency’.534

The UK courts have adopted the principle of more restricted state immunity, as evidenced by their decision in the Philippine Admiral v William Shipping (Hong Kong) case, regarding a ship owned by a government agency, the Philippine Reparation Commission, as a result of the Japanese reparation settlement following the Second World War.535 The vessel was operated under charter by the Liberation Steamship Company (LBS) for the purposes of carrying freight, until 1972. It was subsequently docked in Hong Kong for repairs, but a dispute then arose involving the payment of costs between LBS, and a brokerage firm and shipping agents, leading to the issue of ‘writs in rem’ against the ship for recovery of the expense of the repair, and it was ‘arrested’. The Philippine state, somewhat surprisingly, failed to take any action for the return of the vessel, until the Hong Kong Supreme Court ordered its sale and for the proceeds to be paid into court.536 The Philippine state then decided to object, and claim sovereign immunity from such legal action. The Chief Justice made an interim order setting aside the writs on that basis, but the full court then reversed the order, leading to an appeal by the Philippines, which was also dismissed by the Judicial Committee of the Privy Council. Their adjudication was that this was a purely commercial matter, and thus did not attract the immunity that may follow the exercise of sovereign powers in international law.537 Whilst the court recognised that immunity from adverse adjudication and enforcement may follow from the state’s exercise of its authority for purposes of its government function, it did not apply where the action arose from the course of a business transaction that was not exclusive to the state.

Immunity only attaches to sovereign decisions of the state, and will not protect those from suit who are acting, without choice, on the instructions of the sovereign power.

534 Decision No. 11225, reproduced in Rivista di diritto internazionale privato e processuale (2005) Para 1094 cited from Francioni (n226) 745
535 Philippine Admiral v William Shipping (Hong Kong) Ltd and another [1976] 2 W.L.R. 214
536 ibid Para 228
537 ibid
In the *Trendtex Trading Corporation v Central Bank of Nigeria* case, the defendant bank, which, despite its name, was a separate legal entity from the government; issued a letter of credit in favour of *Trendtex*, a Swiss company, to pay for cement ordered by the Nigerian Ministry of Defence for military purposes.\(^{538}\) After the overthrow of the government, which was involved in negotiating and approving the investment agreement, the new executive ordered that the Central Bank not pay for the cement. *Trendtex* subsequently sued the bank, and demanded the payment. The Court of Appeal accepted that the bank was a separate legal entity from the state, and thus, despite acting on orders of the government, was not immune from suit.\(^{539}\) Although this approach could promote liability avoidance, these decisions represent a development in the way international law restricts the availability of immunity claims from states which could harm foreign investors. This practice of restriction is developed in the concept of a denial of immunity, albeit qualified and subject to exceptions.

### 6.2.3 Denial of Immunity of the State

Sir Hersch Lauterpacht, in the 1950s, baldly asserted that a foreign sovereign is not entitled to immunity from legal processes in the territory of another sovereign.\(^{540}\) The Learned Jurist did however limit this theory, suggesting that immunity would continue to apply to legislative, executive and administrative acts (with associated measures), of a foreign state within its own territory, transactions where there is a *lex fori* conflict of private international laws where the national courts have no jurisdiction, and acts of state contrary to accepted principles of diplomatic immunity in international law. The practical difference between the denial of immunity and the operation of restrictive immunity is minor if the *jure gestionis* business transaction is considered by its nature, rather than purpose.\(^{541}\) In such circumstances, denial of immunity effectively constitutes restrictive immunity, particularly when the exceptions to the principle of absolute denial are considered in greater detail.

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\(^{538}\) *Trendtex Trading Corporation v Central Bank of Nigeria* [1977] 64 International Law Reports 134-135 CA

\(^{539}\) ibid


\(^{541}\) ibid 239-240
The practical effect of restricted or denied sovereign immunity theories depend to a great extent on the interpretation of international law, but have little impact on the way the global investment community resolves its disputes. Lauterpacht suggests that an exception to when immunity will be denied to a sovereign state occurs when the executive or legislature implements regulations or other such actions that will adversely affect the interests of a foreign investor. However, in the realm of international investment law, principles of the prohibition of denial of justice, expropriation without just compensation, and unfair and inequitable treatment will protect a foreign investor and thus effectively restrict, or deny, sovereign entitlement. The state has a positive obligation to provide security and protection for the investment and cannot claim immunity, even where its actions are considered sovereign. Lauterpacht further asserts that the executive and administrative acts of a host state are protected by sovereign immunity as an exception to his denial of sovereignty theory, but not where they are contrary to the investment agreement or directed against a foreign investor. 542

A host state, as part of the negotiation of an investment agreement, may waive its sovereign immunity, dependent on the value of the project to its economic strategy. Where there is no such express or implied waiver, immunity is a powerful tool available to a sovereign state in order to halt litigation prior to its inception; whether as a practical defence or indeed a litigation tactic, the potential cost to a foreign investor can appear prohibitive. The utility of foresight should therefore lead an investor to negotiate an immunity waiver with the host party prior to the implementation of the project.

6.3 Waiver of Immunity

A sovereign state, or its properly authorised representative, may waive its immunity from international jurisdiction over disputes in an investment contract or BIT provision, by the incorporation of an arbitration clause with another party. 543 This express waiver simplifies adjudication on the issue should it subsequently arise. The

542 ibid
waiver of immunity by a host sovereign state may also be implicit, through the engagement in a commercial transaction with a foreign investor, or the choice of arbitration as a method of dispute resolution; as it would be anomalous to claim sovereign immunity from suit where the state has previously opted for a particular arbitration service. This implicit waiver is recognised in customary international law, forming part of the practice of states in negotiated provision to regulate disputes under international conventions to which they are a signatory.

The next section will discuss the state sovereign immunity in its commercial activities and its impact on the host state.

6.3.1 State Sovereign Immunity in the Context of State Commercial Activities: *Acta jure gestionis*

Chamlongrasdr asserts that a state may not claim entitlement to immunity from jurisdiction or execution where property that is subject to the dispute is used for commercial purposes or where the claim arises out of a commercial transaction. The U.S. Foreign Sovereign Immunities Act (FSIA) defines ‘commercial activity’ as ‘an activity [that] shall be determined by reference to the nature of the course of conduct or particular transaction or act, rather than by reference to its purpose’.

The denial of sovereign immunity in the context of business investment arrangements is recognised and supported by international law via multinational Conventions: for example, Article 10 of the Convention on Jurisdictional Immunities of States and their Property (2004) avers:

If a State engages in a commercial transaction with a foreign natural or juridical person and, by virtue of the applicable rules of private international law, differences relating to the commercial transaction fall within the jurisdiction of a court of another State, the State cannot invoke immunity from that jurisdiction in a proceeding arising out of that commercial transaction.

While Article 7 of the European Convention on State Immunity (1972) appears somewhat more forthright in its assertion that

544 Dhisadee Chamlongrasdr, *Foreign State Immunity and Arbitration* (Cameron May Ltd. 2007) 103
545 Foreign Sovereign Immunities Act 1976, 28 U.S. Code 1603(d)
546 Art. 10 Convention on Jurisdictional Immunities of States and Their Property 2004
A contracting state cannot claim immunity from the jurisdiction of a court of another contracting state if it has on the territory of the state of the forum an office, agency or other establishment through which it engages, in the same manner as a private person, in an industrial, commercial or financial activity, and the proceedings relate to that activity of the office, agency or establishment.\footnote{Art. 7 European Convention on State Immunity 1972}

The FSIA Act seeks to identify what constitutes a commercial activity by referring to its nature, for example, business related dealings, rather than its purpose; which is usually advancement of a state aim or policy. However, this does not resolve questions about the status of government or sovereign, bonds, issued to raise money for the promotion of the financial strategy of a state; prima facie this appears both a commercial and sovereign act of state. In the Republic Of Argentina v Weltover, Inc case, the Argentine government issued bonds in order to make funds available to businesses engaged in foreign transactions at a time of profound domestic economic instability, particularly in relation to the devaluation of its currency.\footnote{Republic of Argentina v Weltover Inc. United States Supreme Court, 504 U.S. 607 (1992) Para 607-608.} In 1981, a Foreign Exchange Insurance Contract (FEIC) between the Argentine state and its national bank provided that risks of further currency depreciation in international transactions and contracts would be borne by the government.\footnote{Ibid Para 609} This method of encouraging investment was to be achieved through the selling of loans to Argentine borrowers at a fixed local rate, linked to the American dollar; and ultimately this effectively linked repayment on maturity to a more stable currency.

The outstanding contracts and loans became due in 1982, but by then Argentina could not satisfy its contractual obligations, due to its lack of U.S. dollars. It thus attempted to re-finance its debts through the issuing of government bonds to the foreign creditors of Argentine businesses. As a result of this intervention, it was hoped that the state would owe the money, rather than individual companies, and that foreign creditors, such as the American company Weltover Inc; would benefit from achieving security for their investments by remaining in a commercial relationship with their Argentine counterparts, with the government acting as guarantor. This was an imaginative solution, designed to prevent the haemorrhaging of foreign capital investment, with the hope that the currency situation would improve by the new date
of bond maturity, 1986; however, by then, Argentina still lacked the dollar funds required to satisfy its obligations. In order to seek circumvention of this problem, the government decided, unilaterally and without creditor approval, to extend the time it had to pay the bond debt; and in return, it offered bondholders substitute instruments to reschedule the debts.\(^\text{550}\)

The interests of Weltover Inc. were likely to suffer as a consequence of this plan, and it insisted, in the New York Federal District Court, on full repayment following default, claiming Foreign Sovereign Immunity Act (FSIA) (1976) jurisdiction, on the basis that it was a commercial transaction. Argentina claimed sovereign immunity and therefore lack of jurisdiction on the subject matter, and even additionally suggested that New York posed logistical problems for its defence under the *forum non conveniens* doctrine.\(^\text{551}\) In its findings, the tribunal adopted the restrictive theory of foreign sovereign immunity, permitting a suit that dealt with commercial, market-based matters where the role of the state is analogous to a common business activity.\(^\text{552}\) The tribunal declared that raising money was a commercial activity; even where its purpose was to support government plans. As a result, the issue of Argentine sovereign immunity was redundant, and the international tribunal could accept jurisdiction of the dispute.

The English courts and legislature support this point of view. Section 3 of the State Immunity Act (1978) asserts that:

(1) A State is not immune as respects proceedings relating to (a) a commercial transaction entered into by the State; (b) an obligation of the State which by virtue of a contract (whether a commercial transaction or not) falls to be performed wholly or partly in the United Kingdom.\(^\text{553}\)

The definition of a commercial transaction undertaken by the state is wide ranging, and may be in the form of the supply of goods and services, loans, financing, guarantees and indemnities and anything which is of ‘a commercial, industrial,
financial, professional or other similar character [...] otherwise than in the exercise of sovereign authority’. 554

This attitude was also evident in the NML Capital Limited v Republic of Argentina case, where another dispute arising from the unfortunate run of ill fortune faced by South American countries in the 1990s and 2000s, and was eventually adjudicated on by the UK Supreme Court in 2011. 555 The basis of the claim was the rather disastrous bond issue scheme implemented by the Argentine government in an attempt to stabilise its economy and to secure foreign investment; similar in nature to the Weltover case. NML Capital was a New York-based hedge fund group that gambled on the distressed bonds, which it purchased at a considerable discount with the expectation that state guarantees would more than double the investment return on maturity.

NML asserted that Argentina defaulted on the bonds in November 2003. It sought the principal value of the bonds, with interest, from Argentina in the New York courts, largely because state law governed the operation of the bonds; and in May 2006, obtained summary judgment. Enforcement action was then taken before the Commercial Division of the UK’s High Court, which found in favour of the Claimant. The Court of Appeal disagreed however, finding that Argentina was protected under SIA (1978) by state sovereign immunity. 556 NML then successfully appealed to the Supreme Court. Lord Phillips stated, ‘I differ from the Court of Appeal. My conclusion is that the present proceedings are ‘proceedings relating to a commercial transaction’ within the meaning of Section 3 of the 1978 Act’. 557 The cases illustrate that immunity is a privilege of sovereignty, but that both national and international law imposes limitations where the activities of the state are commercial in the sense that the state is acting as a common merchant in such circumstances, and thus logic dictates that the bargaining positions are to be considered more even, and thus there is no special treatment.

554 s.3(3)(c) Sovereign Immunity Act 1978
556 ibid Para 1
557 ibid Para 41
6.3.2 State Sovereign Immunity Versus Arbitration Agreements

A state that enters into an arbitration agreement with a foreign investor will effectively find itself being treated like any other private party, required to comply with agreement obligations, and without the special status of sovereign and the privileges it confers. In giving effect to such terms as part of the initial negotiation process, it is expected that a state will accede to the submission of disputes to the appropriate tribunal, and comply with, if not accept its findings and awards. Contractual agreements are presumed to have been freely negotiated between parties, and the ICJ in the Anglo-Iranian Oil Case (1952) asserted that the refusal of a state to honour its previously accepted arbitration is “a grave violation of international law”. This is a generally accepted principle; to the extent that refusal is considered ‘a denial of justice’. Moreover, a claim that the relevant contract is itself void ab initio is no defence in such cases.

Immunity is clearly a litigation tactic of value to states seeking to avoid their contractual obligations to arbitrate, leaving an investor facing considerable additional demands in terms of time and expense, in pursuit of a legitimate claim under contract; and is ultimately devoid of remedy. Implicit therefore in the contractual acceptance of an arbitration process is a waiver of the immunity claim in international law. This is now an established principle of international law, and is reflected in Article 12 of the European Convention on State Immunity (1972) (ECSI):

Where a contracting state has agreed in writing to submit to arbitration a dispute which has arisen or may arise out of a civil or commercial matter, that State may not claim immunity from the jurisdiction of a court of another Contracting State on the territory or according to the law of which the arbitration has taken or will take place in respect of any proceedings relating to: (a) the validity or interpretation of the arbitration agreement; (b) the

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559 *Anglo-Iranian Oil* (1952) I.C.J. Rep. 93 Para 165
560 (1983) 8 Y.C.A. 108. For other cases supporting the point under discussion, Schwebel, *Some Aspects of International Law in Arbitration between States and Aliens in Private Investors Abroad - Problems and Solutions in International Business in 1986* (Janice R. Moss, ed., Matthew Bender, 1986), chapter 12, s.12.06
562 Chamlongrasdr (n544) 79
arbitration procedure; (c) the setting aside of the award, unless the arbitration agreement otherwise provides.\textsuperscript{563}

This is reiterated in Article 17 of the UN Convention (2004) which provides that where a state agrees in writing to arbitration in a commercial dispute, it cannot subsequently invoke immunity before the judicature of another competent state regarding the validity of the contract, the process of arbitration or a dispute regarding the award enforcement; unless the agreement states otherwise.

On the issue of the waiver of immunity by the acceptance of an arbitration procedure, international law appears clear. However, some international agreements limit the extent of the waiver to contracts concerning arbitration acceptance in commercial activity disputes; and legislative provisions that expand the interpretation of how acceptance of international arbitration can be implied. The FSIA, as interpreted by the tribunal in the \textit{Libyan American Oil Company (LIAMCO) v Socialist People’s Libyan Arab Jamahiriya} case, indicates that the agreement of a state to arbitrate can be determined by a waiver of immunity from the jurisdiction of the U.S. courts.\textsuperscript{564} Section 1605(a)(6) of the FSIA states that the enforcement of an award will be activated in three circumstances: where the arbitration occurs in the US; where there is an applicable treaty or international agreement concerning recognition and enforcement of the award; or if the underlying claim could have been brought in the US but for the presence of the arbitration agreement. Libya’s assertion of sovereign immunity from the jurisdiction of the domestic court of the foreign investor was rejected, that defence having been waived by its express agreement to specific provisions of arbitration and choice of law clauses in the original contract.\textsuperscript{565}

In the UK, Section 9 of the SIA (1978) does not associate the implied waiver of immunity by a state’s acceptance of arbitration on disputes relating to purely commercial activity. It states that

\[
\text{Where a state has agreed in writing to submit a dispute which has arisen, or may arise, to arbitration, the state is not immune as respects proceedings in the courts of the United Kingdom which relate to arbitration.}\textsuperscript{566}
\]

\begin{itemize}
\item \textsuperscript{563} Art.12 European Convention on State Immunity (ECSI) 1972
\item \textsuperscript{564} \textit{Libyan American Oil Company (LIAMCO) (n173) Para 1175}
\item \textsuperscript{565} ibid Para 1177
\item \textsuperscript{566} s.9 Sovereign Immunity Act 1978
\end{itemize}
International law establishes a framework for the restriction of state immunity in the arbitration process. International and multilateral treaties, such as the ECT and NAFTA, promote dispute resolution by arbitration enabling foreign investors to utilise signatory states prior to acceptance of the procedure, in order to protect themselves from immunity arguments in disputes. The effective removal of much of the sovereignty barrier to claims has resulted in a significant increase in actions brought under inter-state BITs. The exponential growth of international trade has ensured that associated investment treaties, where properly negotiated, will incorporate arbitration mechanisms. Investors will then have the opportunity, in both public and private law and under international treaties, to choose the international forum to pursue its private law entitlements against states, for losses that result from the exercise of its public law powers.\textsuperscript{567}

Under general BIT arbitration clauses, private parties can ‘seek compensation for the costs that flow from the exercise of public authority’.\textsuperscript{568} The disparity of power and authority between the parties in investor-state agreement has always been an obstacle, but the restriction of the sovereign immunity privilege by the state’s signature to an arbitration clause has eased the means of investors seeking restitution before a neutral international tribunal.\textsuperscript{569} The limitation of sovereign immunity, where commercial decisions cause the dispute is now widely accepted; and it is further espoused that a state invoking immunity for \textit{acta jure imperii}, act of dominion, should only do so with no malign motive, and where it does not violate international law.\textsuperscript{570}

The differentiation issue, regarding whether the conduct of a state amounts to \textit{acta jure imperii}, an exercise of sovereign authority over its territorial affairs, or the \textit{acta jure gestionis} of commercial transactions, may also be resolved by a sovereign state agreeing to an arbitration process at the inception of an agreement.

\textsuperscript{567} Alexis Blane, \textit{Sovereign Immunity as a Bar to the Execution of International Arbitral Awards} (2009) 41 International Law And Politics 454, 480
\textsuperscript{568} Van Harten and Loughlin (n402) 124
\textsuperscript{569} Blane (n567) 504
\textsuperscript{570} Ignaz Seidl-Hohenvardern, \textit{International Economic Law, General Course on Public International Law}, (1987) 198 Collected Courses of the Hague Academy of International Law, Hague Academy of International Law 144
In the *Soleh Boneh Intl Ltd (Israel) and Water Resource Development Intl (Israel) v The Republic of Uganda and National Housing and Construction Corp of Uganda* case, a dispute occurred in the operation of the contract of the foreign consortium undertake building works in Uganda, guaranteed by the host state government.\(^{571}\) Proceedings to arbitrate on the dispute took place in Sweden, and the decisions of the adjudication hearings effectively favoured the foreign investor’s claims. Uganda then sought to set aside the prior rulings, on the basis that not only were those decisions themselves invalid, but so was the arbitration panel itself. Their defence was sovereign immunity, claimed for their actions. Uganda was found to have waivered immunity by the prior agreement to accept an arbitration process, and that there was therefore no need to determine whether its actions in breach of the contract were sovereign or commercial.\(^{572}\) This provides an assertive opinion that appears to deprive the sovereignty principle of any value or purpose in transactions with foreign commercial enterprises, where the state accepts a suitable process for resolving any problems, even where its actions are in the pursuit of the national good.

In any litigation process, the parties, whatever their status, will seek to press their advantage and attempt to avoid liability and the consequences for their actions that may constitute a breach. The state may call upon laws enacted by its legislature, which prohibit submission by the executive or its representative to an external arbitration procedure, in an attempt to exclude proceedings by a foreign investor under an agreement that the state claims it was not entitled to sign. Indeed, depending on the nature and purpose of the investment project, domestic law may prohibit international arbitration, and an arbitration clause thus will purposely not be incorporated into the contract. Submission to a contractual arbitration procedure, and subsequent loss of sovereignty, may depend on who actually signs document, their authority and status. It is expected that international agreements will be negotiated by an appropriately qualified officer of the state, such as a Minister or duly qualified civil servant. It is important to ensure their agreement to terms is not ‘*ultra vires*’ beyond

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\(^{571}\) *Soleh Boneh International Ltd v Government of the Republic of Uganda and National Housing Corporation*, ICC Award No. 2321 4 July 1974 (1976) 1 Yearbook of Commercial Arbitration; and see Chamlongrasdr (n544) 84

\(^{572}\) ibid *Soleh Boneh International Ltd* Para 135
their authority; as failure to do so risks a claim of voidability from a recalcitrant state executive. 573

An investment contract may not incorporate an arbitration clause, particularly if the project lacked the formality of a negotiated written contract. However, in this case, the inter-state BIT would generally be expected to incorporate such a clause, enabling an investor to make a claim to the foreign tribunal and thereby overcome the sovereign immunity issue. This form of project development appears to lack the protection of properly negotiated individual contractual terms, arising to meet the internal needs of a state and its commercial aims. This type of investment often leads to disputes, especially where it involves policy, administrative or regulatory changes, implemented by the host. 574 Perhaps inevitably states, feeling denuded of their sovereignty will seek to reassert their claim to immunity when challenged about their conduct before a tribunal, regardless of how the investment disputes arises.

6.4 Key Issues in State Immunity from Jurisdiction

National legislation, over which a state has sovereign control, usually without external intervention, has been utilised by the state acting as litigant to seek to repudiate prior consent to international arbitration, where its sovereignty is considerably more restricted. A state may change its laws and regulations to suit its national aims and policies, including those that govern entry into foreign treaties and contracts, and over who has the designated authority to commit the country to international agreements, and national legislation may act retrospectively in order to seek to unilaterally invalidate previous arbitration agreements. This exercise of sovereignty will inevitably raise concerns regarding issues of immunity, thought to have been resolved in international law.

573 Art. 306 Moroccan Civil Law stated expressly “The Arbitration agreement is void on issues related to public policy especially in disputes regarding contracts or money subject to a system governed by the administrative law”. This provision has now been amended and is no longer enforceable.
574 Schill (n487) 41; Fedax N.V v The Republic of Venezuela (n9) Para 29
6.4.1 Host State as a Third Party to the Arbitration Clause

The task of attracting foreign investment is made easier if a host state agrees to an arbitration clause and the signature of its duly authorised representative is on the contract. This form of third party state involvement is particularly valuable to those involved in the venture, especially the foreign investor, as it confers guarantees, security and legitimacy that can overcome other unknown elements such as the success of the project and the reputation of its contractual partners, thus increasing investor confidence. The investment venture contract will usually incorporate an arbitration clause designed to resolve disputes between the parties, but this, in a simple scenario, will not impact upon the state, despite carrying the signature of its authorised representative. In this example, the state is not a party, acting instead in a quasi-supervisory capacity; and does not therefore waive its sovereign rights or immunities; which may prove somewhat frustrating for an ill-advised foreign investor.

The Southern Pacific Properties (Middle East) Limited (SPP) v Arab Republic of Egypt case, involved an agreement between the Hong Kong based claimant and the Egyptian General Organisation for Tourism and Hotels (EGOTH); a private company that had previously been in public ownership. Known as the ‘Pyramid Case’, two contracts were negotiated for the construction of a tourist complex near in Guizeh. The duly authorised Minister of Tourism appended his signature of approval of the deal to the first agreement, but not in a part of the document that suggested the state was a party to the contract. This document neglected to include an arbitration clause in the event of a dispute, but this omission was rectified in the ‘Supplemental Agreement’, signed by EGOTH. On a separate page of that second document, the Minister appended the phrase ‘approved, agreed and ratified’, before adding his

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signature.577 The subsequent cancellation of the project caused considerable loss to SPP, which sought restitution by arbitration against EGO\textsc{th} and the host state.

The legal status and consequent liability of the state was examined. It was argued that the manner of signing and approving the agreement by the representative Minister did not make it a party to the contract or subject to obligations thereunder. It was decided that the arbitration clause incorporated into the supplementary document was not an implied waiver of sovereign immunity from suit, and therefore there was no legal standing for the tribunal to hear the complaint against it. The first ICC Arbitration Tribunal, which heard the claim in 1983 disagreed; stating that arbitration was an accepted method in Egyptian law to settle disputes, and that the two agreements, including the first which neglected to include arbitration constituted a ‘unified contractual whole’, and therefore incorporation in the Supplemental Agreement was evidence that the state of Egypt agreed to arbitration for dispute resolution, with the signature of the Minister on the last page of the Supplemental Agreement effectively binding the nation to the contract as a party.578 Jurisdiction was established and immunity was not an issue, and thus the State of Egypt was ordered to pay substantial recompense to SPP. This finding appears to extend the concept of privity of contract and subsequent assumption of obligations thereunder somewhat wider than the traditional common law view.

The following year, on appeal by Egypt, the Paris Court of Appeal decided that the signature and comments appended to the last page of the supplemental agreement, which contained the arbitration clause, were only an expression of the fact that a state has supervisory authority of what occurs on its territory. It was found that the Minister did not intend to join the state to the agreement or undertake any of its obligations, and that there was certainly no intention to surrender sovereign immunity in what was a private contractual arrangement. It was not an intention to become an obligated party to the second contract and particularly the arbitration clause therein; and thus the award was annulled. The Cour de Cassation, in hearing an appeal from SPP in January 1987, agreed that there was no evidence of intended state participation.579

577 Southern Pacific Properties (Middle East) Limited (n575) Para 52
578 ibid Para 68
579 ibid Para 71
Therefore the assessment of the ICC in reaching its conclusion was judged incorrect according to the adjudication of the superior courts in France. The proper interpretation of the actions of the Egyptian Minister reflected the interaction of a dual capacity of the state in international agreements; where the state may be an actual party to an agreement or merely exercise a supervisory role. It is therefore necessary to differentiate between these roles, using the individual facts of the case, in order to determine if there is a waiver of immunity. Questions regarding the apparent consent to arbitration by a state are usually resolved in favour of the weaker, investor party. However, where the state asserts that supervision marks the extent of its involvement in a contract, this will not result in a consequent loss of sovereignty, and potential problems with immunity claims, and more protracted litigation argument, may arise for the investor.

6.4.2 State Sovereign Immunity and the Domestic Law of a Host State

It is entirely to be expected that a host state involved in a dispute will act in the manner of any other litigant and seek to utilise its strongest tactics to defend its position. In the case of a sovereign party, this is the claim to immunity from suit at its inception. National law may be called upon where it purports to restrict or prevent the executive from making an agreement to supersede the domestic judicial process with international arbitration. There are also likely to be laws regulating the authority of persons eligible to represent the state in international transactions, including commitments by negotiation and the signing of international investment agreements with foreign businesses, especially where consent to an arbitration procedure will limit sovereignty.

A) Sovereign Immunity and Attempts to Invoke Domestic Law in an Investment Dispute

Signing an agreement to arbitration may be a prudent part of the negotiation process of a contract at its inception, but where a dispute arises it can be problematic, given the limitations placed on sovereignty, particularly in relation to immunity. The obvious temptation, where such a provision exists, is to call upon national legal prohibitions to the agreement of terms contained in international contracts that limit
sovereignty, before advancing the argument, in international investment disputes, that any consent to arbitration is void in domestic law. In the context of global international trade, such tactics damage trust and stability on the part of an investor, and thus domestic prohibitions tend not to be acknowledged as enforceable.\(^{580}\)

Article 139 of the Constitutional Law of the Islamic Republic of Iran asserts that

> The settlement, of claims relating to public and state property or the referral thereof to arbitration is in every case dependent on the approval of the Council of Ministers, and the Assembly must be informed of these matters. In cases where one party to the dispute is a foreigner, as well as in important cases that are purely domestic, the approval of the Assembly must also be obtained. Law will specify the important cases intended here.\(^{581}\)

In the *Elf Aquitaine Iran (France) v National Iranian Oil Company (NIOC)* case, NIOC claimed that the contract for exploration and production of oil by Elf was rendered void *ab initio* in 1980, as a result of Article 139 and a subsequent declaration by the Islamic Republic Revolution Council in January 1980. A Special Committee was established on the premise that

> All the Oil Agreements considered by a special commission appointed by the Ministry of Oil to be contrary to the Nationalisation of the Iranian Oil Industry act shall be *considered null and void* and claims arising from conclusion and execution of such agreements shall be settled by the said commission. The representative of the Ministry of Foreign Affairs shall participate in the said commission.\(^{582}\)

As a result, Iran argued that in matters of significant state interest, the presence of these domestic law provisions forbade the entering into agreements with foreign parties without special parliamentary approval,\(^{583}\) and that the government was therefore not bound to comply with the arbitration clause, and sovereignty in its decision making was preserved. This claim was rejected, and the argument that the contract as a whole was void was found not to prevent the operation of the arbitration

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\(^{581}\) Art. 139 Constitutional Law of the Islamic Republic of Iran


\(^{583}\) *Elf Aquitaine Iran (France) v National Iranian Oil Company* Ad Hoc-Award 14 January 1982 Yearbook XI Yearbook Commercial Arbitration 1986
clause therein.\textsuperscript{584} It is apparent that arbitration obligations remain, even where domestic law purports to restrict the legal capacity to agree to its inclusion. Judge Keba Mbaye asserted ‘that a state must not be allowed to cite the provisions of its law in order to escape from an arbitration that it has already accepted’.\textsuperscript{585} This does not mean it has no value as a litigation tactic in an attempt to avoid responsibility and arbitration, for its mere assertion causes delay and increases expense for the investor claimant. However, when considering the BIT, Article 27 Vienna Convention (1969) prohibits states from ‘invok[ing] the provision of its internal law as justification for its failure to perform a treaty’. It is clear therefore that where a BIT includes an arbitration clause; it is then the state is obligated by the treaty.

\textbf{B) Ultra Vires Act of Host State Officials}

Legislation that delegates powers from central government to other bodies, organisations or state representatives limits the extent of that authority and exercises rights of supervision over its use. State officials are governed by their national laws and are subject to the limitations imposed, and this is no different in the context of negotiations and acceptance of international investment agreements, which ostensibly have the capacity to bind the state. This is particularly pertinent when commitments to international arbitration, and consequent loss of immunity, are entered into by either the state or its representative; the issue is whether they are acting in accordance with their delegated authority, or \textit{ultra vires}, beyond it, and thus committing the state to more than it intended. This is an extension of the principle of whether the state or its representative body has the legal capacity to agree to arbitrate, when actually their own national law purports to prohibit such an action.\textsuperscript{586}

A foreign investor may be inhibited in their quest for the international arbitration of disputes, where a host state asserts that its representative was acting beyond their

\textsuperscript{584} ibid 102
\textsuperscript{585} Judge Keba Mbaye is the former Vice-President of the International Court of Justice and former First President of the Supreme Court of Senegal See ICC, \textit{60 Years of ICC Arbitration: A Look at the Future} (ICC Publications No. 412 1986) 296
\textsuperscript{586} Resolution of Institute of International Law On Arbitration Between States, State Enterprises And State Entities, session of Santiago de Compostela 1989 Art. 5: ‘State, a state enterprise, or a state entity cannot invoke incapacity to arbitrate in order to resist arbitration to which it has agreed’; Michael McIlwrath and John Savage, \textit{International Arbitration and Mediation: A Practical Guide}, Kluwer Law International 2010) 336
authority in committing the nation to arbitration, or to the contract per se. Nevertheless, the *ultra vires* argument does not find favour in international law on issues of arbitration jurisdiction and the limitation of sovereignty; with the act of a duly authorised official, even if it is beyond their delegated power, is considered an act of state, and responsibility for any mistake made lies with the state. Article 7 ILC Draft Article on State Responsibility addressed the issue thus:

The conduct of an organ of a State or of a person or entity empowered to exercise elements of the governmental authority shall be considered an act of the State under international law if the organ, person or entity acts in that capacity, even if it exceeds its authority or contravenes instructions.\(^{587}\)

This avoids several potential problems when dealing with a recalcitrant or uncooperative state that may seek to evade the consequences of its legally unacceptable behaviour towards a foreign investor. With foresight, a state may utilise officials with limited authority to complete the final stages of a negotiation, and then in the advent of problems, disavow the contract. This tactic falls foul of the doctrine of separability, where the legitimacy of a contract as a whole is differentiated from the operation of the arbitration agreement.

C) ‘Separability’ of Arbitration Clauses from the Investment Contract

It is sensible to include the agreement to arbitration in the investment contract. However, it is treated as an autonomous and severable clause, capable of standing alone, without the terms it proposes to enforce or rectify in the breach thereof; and does not derive validity from the contract as a whole, but of its agreement. The necessity of this principle is clear, providing a presumption that the dispute resolution contemplated by the clause will include questions of the general validity of the contract that incorporates it.\(^{588}\) Article 16(1) of the UNCITRAL Model Law in Article 16(1) endorses the separability principle:

An arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract. A decision by the arbitral tribunal that the contract is null and void shall not entail ipso jure the invalidity of the arbitration clause.\(^{589}\)

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\(^{587}\) Art. 7 Draft Articles: Wrongful Acts 2001 (n62)


\(^{589}\) Art. 16(1) UNCITRAL Model Law 1985
Furthermore, in the UK, Section 7 of Arbitration Act (1996), provides:

Unless otherwise agreed by the parties, an arbitration agreement which forms or was intended to form part of another agreement (whether or not in writing) shall not be regarded as invalid, non-existent or ineffective because that other agreement is invalid, or did come into existence or has become ineffective, and it shall for that purpose be treated as a distinct agreement.\(^{590}\)

The *Premium Nafta Products Ltd. v Fili Shipping Co. Ltd* case dealt with circumstances where bribery induced the principle contract.\(^{591}\) The House of Lords considered whether this rendered the main agreement void and consequently, if this affected the operation of the arbitration clause, finding that it did not. The principle of ‘separability’ meant that any objection to the validity of the arbitration agreement had to relate to the specific clause itself, and was thus not affected by the probity of the main agreement that contained it.\(^{592}\)

A dispute, usually relating to financial loss, may develop as a result of behaviour that is deemed contrary to the general terms of the investment contract, and one of the parties, usually the host state, may find value in propounding tactical arguments for the suggested invalidity or unlawfulness of the agreement per se. If an arbitration clause is simply treated as part of, and dependent on, a potentially invalid contract, an international tribunal may find that it has no jurisdiction to adjudicate on the merits of claims and thus deprive the aggrieved investor party of just resolution; therefore, to deny separability undermines the integrity of an agreement to arbitrate.\(^{593}\) Academics, including McNeill and Juratowitch, go further and suggest that it is not merely on an issue of the validity and lawfulness of the main contract that the arbitration clause remains valid on separability but is a principle of general application.\(^{594}\) However, this view contains the practical difficulty of attempting to determine the jurisdiction of the arbitral tribunal if the parties do not provide consent by affirmation of the original agreement.

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\(^{590}\) s.7 Arbitration Act 1996  
\(^{591}\) [2007] UKHL 40 HL *Nafta Products Ltd. v Fili Shipping Co Ltd*  
\(^{592}\) ibid Para 46. For further reading, see Mark McNeill and Ben Juratowitch, *The Doctrine of Separability and Consent to Arbitrate* (2008) 24(3) Arbitration International 475  
\(^{594}\) McNeill and Juratowitch (n592) 475
6.5 State Sovereign Immunity from Execution in Investor-State Arbitration

While a state’s claim for jurisdictional immunity may fail, there remains the potential for a plea of immunity from the execution of any subsequent award. The claimant foreign investor may overcome problems of jurisdiction, and the stresses of proceedings akin to a trial, only to find that the arbitration award cannot be executed against the host state opponent. However, this immunity is not absolute, and is considered waived, where a state has either agreed to arbitration, where the transaction is commercial, or both.

The *Svenska Petroleum Exploration AB v Lithuania* case involved a joint venture agreement for the exploration and extraction of oil. The agreement provided that Svenska would undertake an economic feasibility study in relation to two other oilfields lying within the area covered by the agreement, and would develop the same with its local partner *EB Geonafta* under a separate agreement. Svenska expected priority treatment in the concession deal, and complained that it was denied the opportunities to which it was entitled regarding the exploitation of other oil fields. The arbitration tribunal agreed that Lithuania had breached the agreement and made an award in favour of the claimant. The government of Lithuania subsequently rejected enforcement of the award, and applied for it to be set aside, citing entitlement to immunity from any enforcement process under the SIA (1978). However, the Lithuanian government appeared to have neglected to recall that Article 35 of the contract signed by it at the inception of the project provided that “the government and EPG hereby irrevocably waive all rights to sovereign immunity” and the appeal was dismissed. Therefore, sovereign entitlement still requires the consent of a state to the waiver of immunity from execution in order to facilitate the enforcement of an award.

Article 19 of the UN Convention on Jurisdictional Immunities of States and their Properties (2004) states that no enforcement measures, including constraint,
attachment, arrest or execution, may be taken in connection with a judgement of a court in another country against the property of a state except to the extent that

(a) The state against which the judgement has been made has expressly consented to the taking of such measures by international agreement, an arbitration agreement or in a written contract or a declaration before the court or by a written communication after a dispute between the parties has arisen; or (b) that state has allocated or earmarked property for the satisfaction of the claim which is the object of that proceeding; or (c) it has been established that the property is specifically in use or intended for use by that state for other than government non-commercial purposes and is in the territory of the country where the judgement has been made, provided that post-judgment measures of constraint are only taken against property that has a connection with the entity against which the proceeding was directed. 598

The Convention particularises and restricts execution measures to those ‘against property that has a connection with the entity’, meaning the state against which judgement has been entered. Therefore, in a dispute between a foreign investor and a particular body, organisation or entity representative of a state, execution of an award is restricted to the commercial assets of that particular representative agency in the dispute. This is perhaps rather unfortunate for a successful claimant investor, whose preference would be for enforcement of the state as a single embodiment of its constituent parts and all of its propriety interests ‘in use or intended for use’ in commercial activities.

National statutes and international conventions tend to provide for immunity from the range of available enforcement measures without express or implied consent. However, in the USA, Section 1610 of FSIA (1976) specifically excludes attachment applications relating to foreign state property on its territory from immunity, where it has been used for commercial activity and the arbitration proceedings have been conducted in America unless the foreign state has waived its immunity from attachment in aid of execution or from execution either explicitly or by implication, notwithstanding any withdrawal of the waiver the foreign state may purport to effect except in accordance with the terms of the waiver; or the property is or was used for the commercial activity upon which the claim is based; the execution relates to a judgment establishing rights in property that has been taken in violation of international law or which has been exchanged for property taken in violation of

598 Art. 19 UN Convention on Jurisdictional Immunities of States and their Properties 2004
international law; or the execution relates to a judgment establishing rights in property.\textsuperscript{599} In the USA, therefore, a plea of immunity from execution will not be granted where the property of a foreign state on American territory is used for commercial purposes.

However, the FSIA (1976) does not clarify what is meant by the ‘implicit waiver of immunity’ and questions therefore arise as to what is meant by the phrase ‘used for commercial activity’ under subsection (2). This issue is particularly pertinent when property is no longer employed for commercial activity but is instead utilised in the sovereign activity of a respondent state. The tribunal will undoubtedly be alert to any steps taken by a respondent state to change the designation of use of property from commercial to sovereign either before, during or after proceedings. The UK Sovereign Immunity Act (1978), at Section 13(4) attempts to provide a solution to the problem of definition by broadening the description of commercial property to that ‘for the time being in use or intended for use for commercial purposes’.\textsuperscript{600} Property that has been used for commercial purposes in the past does not change its availability for enforcement solely by re-designation to non-commercial, whether tactically or in practice.\textsuperscript{601}

In the \textit{SerVaas Incorporated v Rafidain Bank and others} case, the American claimant-appellant had entered into a commercial agreement for the supply of equipment and machinery with the Iraqi Ministry of Industry in 1988.\textsuperscript{602} Two years later, Iraq invaded Kuwait and the assets of the state controlled \textit{Rafidain Bank} were frozen in the UK; in accordance with UN Security Council sanctions. As a result, \textit{SerVaas} terminated their agreement and commenced proceedings in the Paris Commercial Court to recover monies due; obtained judgement in default against the Ministry of Industry, and then took enforcement proceedings in London against the \textit{Rafidain Bank} and its frozen assets.\textsuperscript{603} The money in question was the proceeds of commercial transactions and dealings, and under reassignment to the state under Iraqi government order, was destined for the restructuring of national debt, with the funds to be directed

\textsuperscript{599} Section 1610 US Foreign Sovereign Immunities Act (FSIA) 1976
\textsuperscript{600} s.13(4) Sovereign Immunity Act 1978
\textsuperscript{601} ibid s.13(2)(b)
\textsuperscript{602} [2012] UKSC 40 \textit{SerVaas Incorporated v Rafidain Bank and Others} Award 17 August 2012 on appeal from [2011] ECWA Civ 1256
\textsuperscript{603} ibid Para 2
via the UN Development Fund for Iraq (DFI). SerVaas’ application for a third party payment order (Garnishee Order) to satisfy the judgement debt, sought the payment of sums held by the bank that would otherwise have been payable to Iraq; the question was whether the money deposited with Rafidain was used or intended for use for commercial or sovereign purposes as part of its restructuring of national debt.

An Ambassador Certificate issued under Section 13(5) of the SIA (1978), and signed by the Iraqi Embassy in London, asserted that the funds were dividends intended to support the sovereign scheme of debt management, and were not intended for or being used for commercial purposes. The signature of such a declaration raised the presumption of fact of the content therein, which both the High Court and the Court of Appeal recognised that SerVaas had no realistic prospect of rebutting, and so dismissed their claim for execution of the Paris judgement. The origin of the funds was not important, consideration of the commercial or sovereign status of the property was based on its present and future use. Whilst the money served no purpose whilst it was frozen in the bank, the accepted intended use was via the UN regulated Development Fund for Iraq, and this was sovereign in nature, and not commercial, and therefore not available to satisfy the award.604

6.5.1 UK State Immunity Act (1978) and Immunity from Execution of Central Bank Accounts

Assessment of the application of immunity from execution is most effectively considered through the decisions of courts and tribunals that have put the concept and its associated effects into practice.

In AIG Capital Partners Inc. & CJSC Tema Real Estate Company Limited v Kazakhstan and others 605, a BIT signed by the US and the Republic of Kazakhstan in 1992 provided the basic framework for trade between the two nations. Article 4 dealt with the resolution procedure for disputes, which were to be submitted to the ICSID for adjudication. In 1999, AIG contracted with the defendant state to build the Crystal

604 ibid Para 31
605 AIG Capital Partners Inc v Kazakhstan Case No: 2004/536 Queen’s Bench Division (Commercial Court) 20th October 2005
Village housing development with a Kazakhstan company, *LLP Tema*. The resultant joint venture was called the *CJSC Tema Real Estate Company*. After much preparation, construction began, only for the Kazakhstan government to announce that it wanted to create a national arboretum instead, cancelling the contract and expropriating the land; with no compensation forthcoming. This was officially expropriation, as decided by the ICSID tribunal, and substantial recompense was ordered to be paid by Kazakhstan to the claimants; however, it failed to do so.

The state controlled National Banks of Kazakhstan (*NBK*) held substantial cash and securities on behalf of the state via a third party, in London, *ABN AMRO Mellon Global Securities (AAMGS)*. Consequently, the claimants took enforcement action against the same, obtaining interim orders for their preservation.606 *NBK* sought discharge of the interim orders, claiming that the cash and securities held by *AAMGS* belonged to *NBK*, and therefore the Republic of Kazakhstan, and thus were immune from enforcement under Sections 13(2)(b) and 14(4) of the State Immunity Act (1978). The court accepted this argument, and discharged the orders.607

States operate as an amalgamation of many constituent parts, each integrated to facilitate the working of the other. As a consequence, it can be difficult to separate the concepts of sovereign and commercial activity when considering a central bank. Section (14)(4) of the SIA (1978) effectively protects the state from loss of control over its central bank assets, even though they may also be used for commercial purposes, by stipulating that execution should not be effected on a State’s central bank or any similar monetary authority.608 This appears contrary to the principles of international law covering the protection of foreign investors, and places commercial assets that can potentially be protected and seized to satisfy a judgement against a state, beyond the reach of the courts. Mr Justice Aikens acknowledges this, and explains the thinking behind the immunity protection; his elucidation of the issue is persuasive, and noted in full:

606 ibid Para 8
607 ibid Para 96
608 s.14(4) SIA 1978 states: ‘Property of a State’s central bank or other monetary authority shall not be regarded for the purposes of subsection (4) of section 13 above as in use or intended for use for commercial purposes; and where any such bank or authority is a separate entity subsections (1) to (3) of that section shall apply to it as if references to a State were references to the bank or authority’
One can only speculate on why a separate subsection was introduced by amendment to deal with the position of property of central banks and other monetary authorities with regard to the enforcement process in UK courts. But one can note, first, that generally speaking, when a central bank or a State's monetary authority is performing its key functions of acting as guardian and regulator of the State's monetary system, it will be exercising governmental or sovereign authority; it will not be acting for commercial purposes. Secondly, it is likely that the most obvious ‘property’ of a central bank, a State's reserves, will be held and used for governmental, or sovereign purposes and not for commercial purposes. It may be that it was recognised by the draftsmen of the Act that it would be difficult, if not impossible, to determine whether a particular asset of a central bank or monetary authority was, at a relevant time, being used or intended for use for sovereign purposes or for commercial purposes. The assets of a State's central bank (or monetary authority) would be an obvious target for the enforcement process in relation to judgments against the State or its central bank (etc). This might lead to unwelcome and perhaps embarrassing litigation in UK courts. Therefore this possibility was preempted by the all-embracing and imperative immunity granted by section 14(4).

The Learned Judge highlights the problems of differentiating between commercial and sovereign assets held in a single location by a central bank, especially where commercial resources are used for sovereign purposes.

The global banking system means that states often hold assets in various nations throughout the world, via their central banks or other monetary authorities. The position taken by SIA (1978) appears anomalous when an investor seeks to identify the assets held across several jurisdictions, in order to enforce its award. English law makes this difficult where such assets are held on its territory. In order to conduct an effective arbitration process to its conclusion, the assets of a state central bank, held in the UK, need to be available for enforcement, even where they are used for sovereign purposes. This exemption to the general rule that sovereign assets are immune from seizure, becomes more persuasive if the central bank has been directly involved in dealings with a foreign investor in a commercial transaction. Failure to permit this allows ‘unjust enrichment’ of the state, through protection of its assets held in its government-controlled bank, at the expense of the claimant. The UK’s legislative and judicial approach was different before enactment of the SIA (1978) and the AIG v Kazakhstan judgment. Until then, central bank accounts were treated no differently.

609 AIG Capital Partners (n598) Para 58
from ordinary bank accounts, as was noted in the Trendtex case in 1977,\textsuperscript{610} and confirmed in Hispano Americana Mercantil S.A. v Central Bank of Nigeria in 1979 on similar facts; with attachment of the judgement against the central bank for enforcement purposes was permitted in these cases.\textsuperscript{611}

6.5.2 The Practical Impact of Time on Host State Immunity from Execution

If a state does not comply with its obligations, enforcement of judgements can take many years. In the case of Franz Sedelmayer v The Russian Federation, the claimant, a German citizen, obtained a contract in 1989 to supply the Police Department of Leningrad (GUVD) with equipment, and to establish a training facility in St Petersburg.\textsuperscript{612} His investment totalled in excess of $2 million of property. In August 1991, a joint stock company called Kammenjl Ostrov Company (KOC) was established and Sedelmayer placed his ownership of the property portfolio therein.\textsuperscript{613} Only a year later, the Russian Federation established the Federal Property Fund (FPF) to hold all state property, including assets that government agencies had contributed capital to in joint ventures. This included the joint venture shares of the Leningrad Police Department (GUVD) in KOC, which were subsequently transferred to yet another government agency. The government refused to compensate Sedelmayer, and litigation ensued, to which the state reacted by nullifying the registration of KOC and expropriating its property holdings.\textsuperscript{614} Unsurprisingly, given the overbearing conduct of the state, the claim of Sedelmayer to the tribunal, made under the auspices of the 1998 Germany-Russia BIT, was successful; and consequently the Russian Federation was ordered to pay $2.35 million in compensation.\textsuperscript{615}

\textsuperscript{610} Trendex Trading Corporation v Central Bank of Nigeria (1977) 64 ILR 111 United Kingdom, Court of Appeal, Civil Division, 13 January 1977, 134-135
\textsuperscript{611} Hispano Americana Mercantil SA v Central Bank of Nigeria (1979) 64 ILR 221 United Kingdom, Court of Appeal, Civil Division, 25 April 1979
\textsuperscript{613} David Crawford, Businessman v Kremlin: War of Attrition The Wall Street Journal 6 March 2006
\textsuperscript{614} Hober (n612) 389
\textsuperscript{615} Franz Sedelmayer (n612) 63-73
Enforcement action was taken in Germany when the Russian Federation claimed immunity and refused to pay. The first task was to locate and identify commercial assets that were not protected by sovereign immunity. Over time, Sedelmayer brought more than 20 different actions against Russia to seek his compensation, even attempting, successfully at first, to impound payments made by the German airline Lufthansa to Russia for flying over Russian airspace. However, the Regional Court of Cologne deemed such payments used for sovereign purposes thus were immune from the award execution process. Not to be defeated, Sedelmayer took further action in the German courts, eventually winning an interim order freezing the business accounts held by several German banks and attributable to the Russian state. This allowed him to withdraw up to $300,000 per month; a sum equivalent to the estimated interest the Federation would otherwise have been earning on the property it seized from him. Faced with intransigence from the Russia Federation in achieving satisfaction of his UNICETRAL award, he finally achieved partial redress fifteen years after the initial judgement.

6.6 Conclusion

The review of the theories of state immunity which arise due to state resistance to comply in the arbitral process, produces the restrictive concept of immunity available to a state in dealings with the foreign investments. This is especially so when immunity is potentially waived even where the wrongful act is considered as a “jure imperii”, sovereign act. That is the case in UK under the proclamation of State Immunity Act 1978.

Customary international law has developed a framework of principles designed to support the positive and important values espoused by the concept of state sovereignty while seeking an effective way to limit misuse of such power. In doing

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617 Stefan Kröll and Jörn Griebel, *Protecting Shareholders in Investment Law: To Pierce or Not to Pierce the Veil, That Is the Question!* (2005) 2 Stockholm International Arbitration Review 37, 96
so, the investor finds his position made stronger in challenging wrongful actions. It is an attempt to ameliorate risks of sovereign interference in the project limitations are imposed on sovereignty to hinder and sanction actions of the recalcitrant, un-cooperative state seeking to evading consequences for its unacceptable behaviour towards a foreign investor. With some cynical imagination and foresight, the state may utilise its officials with limited authority to complete the final stages of negotiation and signature, and when problems arise a state could even try to disavow the whole contract through the doctrine of “separability”. This doctrine attempts to differentiate the contract as a whole from the operation of the arbitration agreement. However, Article 7 ILC Draft Article on State Responsibility purports to neutralize this by saying:

‘The conduct of an organ of a State or of a person or entity empowered to exercise elements of the governmental authority shall be considered an act of the State under international law if the organ, person or entity acts in that capacity, even if it exceeds its authority or contravenes instructions’. 619

Throughout the investment and contractual process, to the grant of arbitral awards following disputes, the host state has the upper hand in the bargaining process. A state is sovereign, which attracts immunity from suit or enforcement, at least on the face of it. This obstacle is nevertheless obviated where the state engages in commercial activity or accepts arbitration in dispute settlement, an implied waiver on both jurisdiction and execution issues. The rejection or defeat of the immunity claim, where commerce is the primary activity rather than sovereign administration of the state, may still not bring an end to the investors compensation problems where the recalcitrant fails, or refuses, to comply. The state may be merely dilatory or downright obstructive. Practical methods to enforce compliance need to be examined through a non-judicial and judicial means against states.

619 Art. 7 Draft Articles: Wrongful Acts (n62)
Chapter Seven

Means of Enforcement of Investor-State Arbitral Awards Against Sovereign States

7.1 Introduction

This chapter will provide a broad perspective of the legal framework of the enforcement of arbitral awards and court judgments against sovereign states, and examine of potential reform to the framework will be undertaken. Firstly, given the proliferation of treaties and commercial interaction between foreign investors and sovereign states, it is useful to assess the importance of an effective process of enforcement. The main purpose of this chapter is to analyse the range of enforcement measures available that do not require the utility of formal court procedures, and that provide a valid and effective alternative. It is argued that such measures are less expensive but just as effective; with arbitral award creditors executing their entitlement via a form of surety mechanism, funded by contributions from participating states; presenting an ‘entry fee’ for engaging in financial arrangements that bring foreign capital and knowledge to the host country.

It is also necessary to examine the existing procedures that must be followed in order to enforce an arbitral award against a sovereign state that is resisting making payment. This includes the mechanisms available to a foreign investor seeking a variety of interim forms of relief, as a means of accessing the assets of an evasive host state, considering their value to the principles of enforcement. Consideration must also be given to possible improvements to the existing processes and remedies of the English courts, and the veracity of the convention that propounds the principle of a surety comprising contributions from sovereign states.620

Although the enforcement of obligations will generally be sought in the domestic court system of a recalcitrant nation, the host state may seek to obstruct the actions of

a foreign investor, via the utility of its legal framework. This is particularly problematic where the judicial processes have little independence from the executive, or insufficient authority to enforce judgments against the home state. Developing or authoritarian states may not possess adequate safeguards against bias, corruption or subjective inconsistency, and investors thus face a lack of judicial impartiality in a state whose judicial framework is subject to political pressure.

Sovereign states may also keep their most valuable proprietary assets within their own national jurisdiction, making the enforcement of judgments against them very difficult. Whilst it would be easier to lawfully seize assets when held outside of their borders, they are often indirectly managed, and owned via apparently independent bodies. Other nations in which a recalcitrant sovereign debtor has placed its realisable assets will also be wary of engaging in coercive measures of enforcement, seeking to maintain international relationships and avoid potential tension. As a result, a foreign investor may find that gaining the co-operation of the judiciary of the nation that holds the assets is problematic, with the will to effect enforcement limited. This may leave the debtor state’s property immune from seizure, raising sensitive issues regarding the context of the international legal principles that are applied to the nature and enforceability of any award.621

7.1.1 Arbitral Awards and their Enforceability

The term ‘award’ has been deemed as the conclusion to proceedings, res judicata, ‘the matter has been judged’.622 Hunter asserts that several conditions apply to bring a dispute to its conclusion; requiring a decision by a qualified and properly appointed arbiter, unaffected by corruption or undue influence; must be based upon issues arising from a valid arbitration agreement; and should be made and delivered in accordance with the requirements of the prevailing applicable law. All questions and issues in dispute must be exhausted and resolved, whether by a single award, or more often, linked with an all-encompassing decree of settlement.623 Hunter further adds:

621 ibid
The decree arbitral or award should be the accurate embodiment of the arbiter's own clear, precise, internally consistent, self-contained and unconditional judgment (not mere hope or opinion) upon a disputed question or questions which the parties had agreed to submit for determination. Therefore, an award is not merely the endorsement of a prior agreement between the parties. This sense of finality is reflected in the UNCITRAL. The Model Law on International Arbitration (1985) espoused a definition of an award as:

A final award which disposes of all issues submitted to the arbitral tribunal and any other decisions of the arbitral tribunal which finally determines any question of substance or the question of its competence or any other question of procedure but, in the latter case, only if the arbitral tribunal terms it's decision an award.

Nevertheless, a vital part of the definition of award must be clarity regarding the venue of its enforcement.

Given the complexities of adjudication and enforcement, an award cannot be categorically defined, and there must be an element of fluidity in the terminology, where dispute resolution does not does not attain the recognition or enforcement of an authoritative body; there is obviously little point to an award if it cannot be realised. It is therefore preferable that the law facilitates precision in its definition, and commentators including Pietro and Platte point out that “what qualifies as an arbitral award is important since only this type of decision can benefit from recognition and enforcement under the New York Convention”.

7.1.2 Foreign Arbitral Awards and the Concepts of Recognition and Enforcement

Both the validity and terms of an award must be recognised before enforcement can proceed; generally via an order proving the determination of the dispute from the adjudicating tribunal, and precluding any argument, as per the UNICITRAL
This prevents an unsuccessful litigant discussing previous issues or bringing a related allegation before the court of enforcement. The concept of enforcement refers to the process that implements the satisfaction of the judgment against a recalcitrant party, usually involving orders to sequestrate its assets. An application for the enforcement of an award against a foreign defendant or state will often use the terms together. The main codes of arbitration use them in conjunction with each other, particularly Articles IV and V of the New York Convention (1958) and Chapter 8 of the Model Law, Part III of the English Arbitration Act (1996) (AA 1996), which also makes application of the principles practically inseparable, as foreign arbitral awards must be recognised under the appropriate laws as legitimate and binding before they are enforced. This can make the examination of the precise distinction between the terms problematic, but such separation is necessary in order to determine the meanings of ‘recognition’ and ‘recognition and enforcement’.

The English Law of Equity aids understanding, defining ‘recognition’ as identifiable as a safeguard against a recalcitrant party delaying resolution by claiming unresolved issues; making the enforcement process a mechanism for a successful litigant to effect compliance in the face of a state’s reluctance to co-operate. An application may be made to a competent court of adjudication to take action against the assets of the other by way of sanctions or seizure in order to enforce compliance with the legitimate order. The type and availability of the means of enforcement will vary between states, and will depend on where enforcement is sought. Sanctions may include the seizure of property or the attachment to the value of the award against the assets of the transgressor. Imprisonment is also an option, but only where an individual representative of the state is identifiable. The UK Department of Trade and Industry identifies the importance of recognition and enforcement, highlighting that there is little point in pursuing an arbitral process if the award rendered is not

628 ibid 516; see Lafi Dradkah, Recognition and Enforcement of Foreign Commercial Arbitral Awards relating to International Commercial Disputes: Comparative Study (2004) Thesis (PhD), University of Leeds 2004 17
629 Di Pietro (n627) 516
630 ibid 515
632 ibid
satisfied.\textsuperscript{633} Dispute resolution will not serve any purpose without the availability of a reliable, fair and effective means of giving effect to its result.\textsuperscript{634} Holtzmann observes that ‘if businessmen are not reasonably sure of enforcement of foreign arbitral awards, there will be little or no arbitration’,\textsuperscript{635} showing a rare convergence of opinion between academics and government agencies.

7.2 The General Framework for the Enforcement of Arbitral Awards against Sovereign States

There are two distinct systems that govern the enforcement of awards arising from investment dispute arbitration; depending on the derivation of the adjudication process. The first regime applies to judgements rendered under the ICSID Convention, when the host nation and the domicile state of the investor are both parties to the treaty. Decisions that are not made under the Convention, including cases governed by ICSID Additional Facility Rules, are governed by an alternative structure, which applies to the determination of international commercial arbitration awards.

7.2.1 ICSID Awards

The enforcement of awards under the ICSID Convention is subject to strict rules. Article 53(1) of the ICSID Convention asserts the principle that an award rendered pursuant to the Convention was intended to impose a binding obligation on litigants, which was not to be reviewed by any procedure other than those provided for in the Convention itself. The review provisions are limited to interpretation, as per Article 50, revision under Article 51 and annulment in Article 52. Furthermore, Article 54 specifically requires signatory states to recognise and enforce Convention awards and financial obligations arising therefrom, as if they were final adjudications of the judicature of the state. There are two different duties imposed: firstly, the recognition of the \textit{res judicata} effect of an ICSID award, that the judgment has been made and is

\textsuperscript{633} DTI \textit{Arbitration for Consumers and Small Businesses: Guide to the Arbitration Act 1996} (Department of Trade and Industry London 1997) 34
\textsuperscript{635} Howard M. Holtzmann, \textit{Commentary: International Arbitration in 60 Years of ICC Arbitration: A Look at the Future} (ICC Publishing 1984) 362
final; and secondly, execution of the financial requirements of the award as if it was a definitive local judgment. A proven, binding award must be recognised and executed, unless it is, exceptionally, subject to an annulment application or proceedings to ‘stay’ enforcement. Compliance with specific performance and restitution applications are not included, but this has not been particularly problematic, given that overwhelming majority of ICSID enforcement actions are for the payment of damages or compensation because foreign investors show a reluctance to remain in the jurisdiction of a maleficent host state.

Enforcement action under the Convention may only be undertaken in a national judicature when the arbitral award is recognised as the final judgement of that process; an unlikely prospect when that state still considers the dispute unresolved. The presumption of closure simplifies the enforcement procedure, and protects final awards rendered under the Convention from interference from the national courts of a recalcitrant state. The presentation of a duly certified copy of the final award to the appropriate, competent court or authority of the contracting state in dispute under Article 54(2) provides for the implementation of the state law governing the execution of local judgments. The process is similar to that provided for in the New York Convention (1958).  

7.2.2 Non ICSID Awards

The execution of non-ICSID awards is overseen by the national law regulating arbitration, and international conventions governing the recognition and enforcement of international investment awards. Adjudications may be the result of ad hoc proceedings provided for under the ICSID Additional Facility Rules, or the UNCITRAL Arbitration Code. Other institutions that conduct international investment arbitration include the International Chamber of Commerce, the Stockholm Chamber of Commerce and the London Court of International Arbitration. The New York Convention (1958), ratified at its inception by 145 sovereign states, is perhaps the most significant and familiar of the non-ICSID frameworks. This

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convention regulates the recognition and enforcement of foreign arbitral and other ‘non-domestic awards’ between states and investors, whether arising due to the independent international investment agreement or under international treaties between nations. Most of the New York Convention signatories (but not all) agree to recognise and enforce arbitral awards from other signatory states, meaning that satisfaction may be pursued in any of the legal systems of the 193 signatory nations. The convention’s reputation for efficiency and impartiality has fuelled the growth in commercial arbitration in recent years, making it a vital adjunct to international trade.

The principles, framework and jurisdiction of the recognition and enforcement of both ICSID and non-ICSID awards is succour to a wronged contractual party who seeks not merely the order for recompense, but also its receipt. Legal proceedings are often time consuming, laborious and expensive, and therefore, alternative means of securing the satisfaction of a judgment require examination, particularly in regard to their relative effectiveness.

7.3 Alternative Methods of Extra-Judicial Enforcement Against Recalcitrant Sovereign States

Viñuales and Bentolila comment that ‘difficulties in enforcing investment awards against states have fostered the development of mechanisms that go beyond the conventional exequatur’.\textsuperscript{637} The definition of what actually constitutes a non-judicial process has occupied much academic consideration, but may simply be described as a mechanism where the national judicature of a recalcitrant state is circumvented and other, less formal methods are placed upon a state to encourage compliance. Such methods may even be available to foreign investors without the intervention of the domicile state, particularly where a commercial enterprise has become an integral part of the domestic economy of a host state, although arbitration procedures and the enforcement of awards tend to follow the standard continuation of the process, being conducted through the domestic courts of the host state in dispute. Alternative methods of seeking the satisfaction of an award via non or extra judicial processes have to be identified before their effectiveness in providing satisfaction of the award.

\textsuperscript{637} ibid 2
against a state can be assessed; however, it must be remembered that a debt must still be proved and recognised, and is not enforceable without a court order. Nevertheless, non-judicial means can be used to prove the extent of an investors’ entitlement from a recalcitrant state.

7.3.1 Diplomatic Pressure

Diplomatic pressure from one nation placed upon another is a common practice of persuasion, promoting not only an executive’s economic, trade, and even military strategy and policies, but also protecting the interests of its citizens. Political and economic action is pursued by the domicile state of an international investor whose rights and interests have been infringed. Article 1 of the ILC adopted Articles on Diplomatic Protection (2006) provides a definitive description of the concept:

[D]iplomatic protection consists of the invocation by a State, through diplomatic action or other means of peaceful settlement, of the responsibility of another State for an injury caused by an internationally wrongful act of that State to a natural or legal person that is a national of the former State with a view to the implementation of such responsibility.638

The use of force in this regard is prohibited by international law and the terminology ‘other means of peaceful settlement’ includes all other forms of lawful dispute settlement, ranging from negotiation, mediation and conciliation to arbitral and judicial dispute settlement.639

This definition is the culmination of the long and widely held recognition by arbitration authorities of the value of diplomatic pressure in dispute resolution. The PCIJ was established shortly after World War One, and was the predecessor of the ICJ. In hearing the Mavrommatis Palestine Concessions case in 1924, concerning an award made to a Greek contractor for the cancellation of a transport and utilities project; it stated that:

It is an elementary principle of international law that a state is entitled to protect its subjects, when injured by acts contrary to international law committed by another state, from whom they have been unable to obtain satisfaction through the ordinary channels by taking up the case of one of its

638 Art. 1 Draft Articles: Diplomatic Protection 2006
subjects and by resorting to diplomatic action or international judicial proceedings on his behalf.640

The ICJ acknowledged in the 1970 *Barcelona Traction, Light and Power Company* case, which involved a Canadian registered utility company, with a high proportion of Belgian shareholders, operating in Spain, the effect of diplomatic pressure related to a state protecting its interests through its investors in international projects:

It had been maintained that a State could make a claim when investments by its nationals abroad, such investments being part of a State’s national economic resources, were prejudicially affected in violation of the right of the State itself to have its nationals enjoy a certain treatment.641

Article 27(1) of the ICSID Convention promotes diplomatic pressure and protection as a method of award enforcement, stipulating that where a state fails to comply with the outcome of adjudication:

No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.642

With the principle of the legitimacy and efficacy of diplomatic pressure having been established, it is necessary to examine how the domicile state of a foreign investor can translate persuasion and diplomatic pressure into compliance and enforcement. A presumption is made that more specific dispute resolution procedures have been exhausted; and such measures may be followed by informal lobbying by officials from an investor’s home state, using whatever political leverage it holds in the international arena.643 The degree of success may differ, depending on a state’s international status. An example where the international influence of states is broadly similar is the *Aucoven v Venezuela* case.644 The dispute and subsequent arbitration arose from a construction project contracted to build and operate a highway in Venezuela. Mexico, acting as the domicile state of *Aucoven’s* parent company, took

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640 *Mavrommatis Palestine Concessions (Greece v U.K)* 1924 Permanent Court of International Justice Reports Series A, No.2, 12
641 *Barcelona Traction* (n97) 77
642 Art. 27(1) ICSID Washington Convention
644 *Autopista Concesionada de Venezuela, C.A. (‘Aucoven’) v Bolivarian Republic of Venezuela (‘Venezuela’)* ICSID Case No. ARB/00/5, 23 September 2003
relatively simple diplomatic steps under Article 27(2) of the ICSID Convention, to bring about an amicable solution to the dispute between Venezuela and the investor. This involved writing letters to the Ministry of Foreign Affairs in Venezuela and meeting with government officials to achieve a mutually acceptable solution.

Diplomatic exchanges may also be undertaken through an intermediary state, which is not a party in the proceedings. In the Petrobart v The Kyrgyz Republic case, the defendant host state had managed to avoid compliance with an ECJ arbitral award in favour of the Cypriot energy trader Petrobart Limited. Petrobart had made an application for a formal means of arbitration enforcement. Diplomatic intervention came from the Stockholm Chamber of Commerce in Sweden, driven by an inherent belief in the need for respect and compliance. The result was that the Kyrgyz Republic finally agreed to pay the award, revealing that a variety of tactics can be employed in a dispute resolution process. Experience of government instils a need for the development and use of political and economic negotiation skills.

### 7.3.2 Undermining or Discrediting the Reputation of Host State

A recalcitrant state that fails to fulfil its arbitral award obligations may find itself on the receiving end of allegations of untrustworthiness; a tactic that provides valuable leverage to a foreign investor seeking to collect their entitlement, as bad publicity can undermine the attractiveness of a state as a beneficiary of foreign investment. More formally, non-compliance with awards may adversely impact on creditworthiness. Respected international credit rating agencies such as Moody, Standard and Poor and the Fitch Group analyse the economy and associated financial stability of countries, including the assessment of capacity to service national debt.

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They provide reliable data upon which investment evaluation can be based, assessing the borrowing costs of international development capital, which in turn affects the attractiveness of the investment environment.  

There is an obvious difference between the willingness of a state to pay and its capacity to do so, although both are affected by the vagaries of economics and politics. Tactical complaints made by a disgruntled investor to an appropriate credit-rating organisation regarding the non-payment of an international award can negatively influence their assessment, affecting judgments on the safety of international investments; with a low credit rating indicating a high risk to investments. This increases the difficulties faced by a state in accessing private capital in the global markets, particularly for developing nations. International investment analysts also use such data to report on the financial viability of a state as a trading partner in cost-benefit analysis.

Therefore, the maintenance of national reputation, particularly regarding international finance, is a powerful incentive in complying with a properly adjudicated and recognised award that requires enforcement. In the case of *Azurix v Argentina*, the American investor had the opportunity to encourage compliance from Argentina, with the enforcement process, by advising the banks and credit rating agencies about problems faced with the state in meeting its obligations. However, this method of persuasion risks generating a backlash from the respondent state, damaging both existing and future relationships, aggravating officialdom, and provoking legal action asserting the violation of confidentiality agreements. Such measures must therefore be used with care. In the *Amco v Indonesia* case, the international investor conducted a campaign designed to denigrate the reputation of Indonesia while the arbitration was

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650 Ibid


653 US Trade Representative: *Generalized System of Preferences: 2009 Annual GSP Country Practices Review* Case No. 001-CP-09; *Azurix Pre-Hearing Brief* (n61) 9

654 Viñuales and Bentolila (n645) 17
pending; resulting in an interim application by the respondent state to impose contractual confidentiality constraints, pending conclusion of the enforcement proceedings. The tribunal refused to do so, because neither the ICSID Convention nor the rules of arbitration formally imposed such an obligation on either party.

A concerted campaign of denigration need not be necessary in the sensitive world of international finance and trade. A discreet announcement regarding the non-compliance of duly imposed international legal and financial obligations can be sufficient to undermine the reputation of a state, and thus encourage co-operation. The Grain and Feed Trade Association (GAFTA) arbitration rules specifically provide that:

In the event of any party to an arbitration [...] neglecting or refusing to carry out or abide by a final award of the tribunal [...] the Council of GAFTA may post on the GAFTA Notice Board, Website, and/or circulate amongst Members in any way thought fit notification to that effect.

The mere posting of information has a coercive effect on reluctant states, who fear deterring potential new investors and the consequent negative economic impact.

7.3.3 The Application of Financial Pressure

The domicile state of an investor may view involvement in the exertion of political and economic influence in the enforcement of an arbitral award against a recalcitrant state either positive or negative. Action can take various forms, including the imposition of trade sanctions or the exertion of financial pressure through international agencies such as the International Monetary Fund (IMF) or the World Bank. Such action is notably persuasive where a state depends upon internationally sourced financial capital. Such assistance and investment is particularly difficult for developing countries with problematic credit histories to secure. Interest rates in the international financial markets can be expensive, and at a time of need much reliance is placed on the World Bank; giving the institution considerable influence over its

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655 *AMCO Asia Corporation and others v Republic of Indonesia* ICSID Case No ARB/81/1 Decision on Request for Provisional Measures 9 December 1983, 1 ICSID Reports 377 (1993)

656 Viñuales and Bentolila (n645) 16-29

clients. Persuasion is often utilised by the bank over states that want its money, and it is thus a valuable source of control over those states that do not fulfil their existing international award obligations. Investor domicile states may invoke the Generalised System of Preferences programme (GSP) in order to request a hearing before the United States Trade Representative (USTR); with the aim of excluding non-compliant states from the list of those that may seek the benefit of the services of the bank. A less formal process is achieved by the US Congress simply lobbying the bank for the withdrawal of any outstanding loans.

In the Azurix case, American investors, found Argentina to be reluctant to honour their ICSID arbitral obligations, and $165.2 million was awarded for breaches of the ‘fair and equitable treatment, full protection and security, and arbitrary measures’ protections of the Argentina-United States Bilateral Investment Treaty. In the CMS Gas case, a payment of $133.2 million was ordered for a similar breach of conduct under the treaty. The preferential trade status of Argentina was suspended by the USA in March 2012, under the Generalised System of Preferences (GSP). This seriously inhibited the operation of Argentina’s programme to provide a duty-free regimen for imports from developing nations, with consequent adverse financial effects on both its international trade and domestic economic policies.

The Operational Manual of the World Bank codifies three types of dispute between member countries in which the Bank takes a legitimate interest. These arise from a failure to service external debt, the non-payment of compensation to foreign property owners upon state expropriation of their property, and the breach of governmental contracts. The options available to the bank to encourage compliance with its requirements prior to the release of finance include the suspension of lending or

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659 ibid 519; Viñuales and Bentolilla (n645) 29
660 Azurix Corp. (n61)
661 CMS Gas Transmission Co. (n362)
The suspension, which was made pursuant to 19 U.S.C. 2462(b)(2)(E) and (d)(2), took place on May 28, 2012, sixty days after the presidential proclamation was published in the Federal Register. <http://www.ustr.gov/sites/default/files/GSP%20by%20the%20numbers.pdf> accessed 6 October 2013
663 Generalized System of Preferences (n653)
withdrawal of loans to a client state, where it shows a lack of willingness to resolve its problems or pay debts; with benefits withheld until satisfaction is achieved.\textsuperscript{665} Decisions made by the World Bank are based upon a policy assessment of whether a state is ‘substantially harming’ its credit worthiness;

This is evidenced in the fact that the Bank Procedures for implementing this Bank policy do not require any technical credit risk assessment as a precondition for taking a decision on the continuity of the Bank’s lending.\textsuperscript{666}

Accordingly, the bank is unlikely to consider the efficacy or virtues of an investment project in a country with a questionable history of financial compliance. In the imposition of restrictions and penalties, the World Bank assesses the credit-worthiness of the host state and any associated repayment issues; and in the context of investment arbitration awards, parties to an enforcement dispute are encouraged to find a prompt settlement; indeed where the project giving rise to the conflict has received World Bank finance, assistance may be provided in any negotiations.\textsuperscript{667} States have an obvious vested interest in seeking the speedy resolution of any dispute, in order to avoid the draconian sanction of a withdrawal of the services of the World Bank.

The major international financing organisations, the International Bank for Reconstruction and Development (IBRD) and the International Development Association, have close institutional links with, or form part of, the World Bank Group. Whilst non-compliance with arbitral awards is not stated as a reason for the bank to withhold financial assistance or to suspend benefits from an applicant nation for the purpose of encouraging settlement, academic commentators have suggested that institutional associations can play a significant role in fostering compliance with ICSID awards.\textsuperscript{668} The affiliation of the ICSID to the World Bank Group implies possession of an ‘institutional gravitas that creates an incentive for sovereigns to comply with ICSID awards, lest they have difficulty securing future World Bank financing’.\textsuperscript{669} Some recalcitrant states may have the good fortune, perhaps as a result of a surfeit of natural resources or a prosperous economy, not to require access to

\textsuperscript{665} The World Bank WB OP 7.40 Paras 2-10
\textsuperscript{666} Shams (n658) 124
\textsuperscript{667} World Bank (n646) Para 10
\textsuperscript{668} Schreuer and others (n15) 1107-1108
foreign investment or the services of the World Bank, but inevitably, such a need will eventually arise.

In the early 1950s, The World Bank influenced the resolution of an investment dispute in the Anglo-Iranian Oil Company case, which stemmed from the expropriation by nationalisation of oil exploration by the Iranian state. The World Bank withheld funding applied for by Iran until settlement was made; with a similar stance taken in the Suez Canal dispute in the mid-1950s against Egypt. Although these interventions had little to do with the unpaid ICSID awards, they indicate the kind of economic pressure available to international financiers over prospective clients, as exercised in the 2009 Azurix and CMS cases, detailed above. The 1960s was a particularly busy decade for the nationalisation of core industries as states asserted their sovereign entitlements. During this period, the World Bank regularly used its influence in financially and politically sensitive areas where the instance of disputes with foreign investors left many unsatisfied arbitral awards. A more recent illustration is provided by the American investors who lost out as a result of the actions of the Argentinian government. American votes in the World Bank, and the Inter-American Development Bank decision making process led to the withdrawal and suspension of loans to Argentina; the denial of credit facilities amounting to some US$1.600 million proved an obvious incentive to co-operate with arbitration obligations.

7.3.4 Assigning the Debt and the Right to Collect to a Third Party

Assigning both an arbitral debt and the right to collect to a third party involves transferring the rights conferred by an arbitral award to a collection agency. This provides a simple solution, relieving the investor creditor of inconvenience and difficulty. Debts are generally sold to a third party when they become too problematic to enforce, and therefore this course of action is expensive for an investor-creditor, as the purchaser will expect a significant discount on its investment in order to

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670 Anglo-Iranian Oil (1952) I.C.J. Rep. 93
671 Shams (n658) 125
compensate for the obstacles it must surmount in recovering the debt from a recalcitrant state. In the Energoinvest DD v Democratic Republic of Congo (DRC) case, the defendant state faced actions in various jurisdictions taken by venture fund, FG Hemisphere, arising from a credit agreement with the claimant investor, a Yugoslavian engineering company. The case involved the financing of the construction of a power facility in 1980 through the state-owned electric company Société Nationale d'Électricité (SNEL). The Democratic Republic of Congo failed to repay its debt under the original agreement, and Energoinvest obtained two arbitration awards from the International Chamber of Commerce amounting to US$39m, assigning its rights in the award to FG Hemisphere. This venture capital fund, which described itself as a “financial advisor and investor specialising in sovereign debt obligations in emerging markets”, instituted legal proceedings by the new creditor in the various jurisdictions, virtually tripling the debt owed by the Democratic Republic of Congo before payments were made. Energovest only received part of its award entitlement, with the purchaser of the debt quickly making a profit; while the recalcitrant state paid considerably more than it would have done had it complied in the first instance.

7.4 Judicial Means to Enforce Arbitral Awards in the English Courts

Methods of persuasion may often be sufficient to reach settlement and payment, with initial steps with considerable financial and temporal savings for all parties concerned. However, they may be unsuccessful, with a sovereign state debtor continuing to fail to meet its obligations. In such cases, the investor creditor will have to seek legal means to enforce its award entitlement. In these circumstances, the first task to be undertaken is to identify the international assets of the debtor. Thereafter, although concerns and suspicions about impartiality and independence may remain, the judicial process of the host state should be the first venue considered to seek

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673 Energoinvest DD v Democratic Republic Of Congo, NO. 03-1314 (RJL), 355 F.Supp.2d 9 (2004), United States District Court, District of Columbia. 19 September 2004
674 Heather Stewart and Ashley Seager, *Vulture Fund Swoops on Congo over $100m Debt* The Guardian 8 August 2009 Retrieved 5 March 2013
675 The ICC judgment is unpublished. The facts are reported in *Democratic Republic Of The Congo & Others v FG Hemisphere Associates LLC Case, The Court of Final Appeal of The Hong Kong Special Administrative Region, Final Appeal Nos 5, 6 & 7 Of 2010 (Civil) 8 June 2011, Pages 4-6*; Patrick Wautellet, *Vulture Funds, Creditors and Sovereign Debtors: How to Find a Balance?* 2011 1/56 in Audit M, (2011) LGD General Library of Law and Jurisdiction 104
satisfaction. The asset search will disclose the extent of extra-territorial property controlled and owned by the sovereign debtor, and will guide the choice of venue; with it more appropriate to instigate enforcement proceedings in another country in order to achieve practical satisfaction. Put simply, it makes sense to commence proceedings where the money is located. In a process termed the ‘domestication’ of the ruling, the creditor will seek recognition of the arbitral award in countries where a recalcitrant state’s assets are located, wishing the attachment of the debt and its execution to be placed on debtor assets that do not have sovereign immunity.

The jurisdiction of England and Wales (hereinafter termed ‘England’), is to be examined, considering the more formal legal methods of enforcing foreign orders and awards against debtor states. Consideration should be given to the processes of registration of awards in host state national courts, and their transfer to the English jurisdiction, as well as an assessment of the commitment of the enforcement court to the task.

7.4.1 The Legal Framework of Enforcement in English Courts: A Review of Legislative Provisions

A) Administration of Justice Act (1920) (AJA 1920)

The Administration of Justice Act (1920) (AJA 1920) is intended to ‘facilitate the reciprocal enforcement of judgments and awards in the United Kingdom in a part of Her Majesty’s dominions or territories under her Majesty’s protection’. The term ‘judgment’ includes an arbitral award where it is made in accordance with the applicable law and is enforceable by the court in the jurisdiction of its source. When registered under Section 9(3) of the AJA 1920, which must be within 12 months of the award, subject to discretionary extension; it has the same effect as if it had been rendered by the adjudicating court, and so the successful litigant in foreign proceedings can enforce the award in the UK by virtue of Section 9(5). The investor should be aware that this course of action in the UK courts will not usually lead to the recovery of costs, unless there has been a prior application to register the judgment for

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676 Introductory text of UK Administration of Justice Act 1920 (AJA 1920)
677 s.12(1)AJA 1920
enforcement that has been refused in another jurisdiction, subject to the discretion of the court to order otherwise. A judgment will not be registered if an appeal is pending or if the defendant indicates the intention to appeal.\textsuperscript{678}

\textbf{B) Foreign Judgments (Reciprocal Enforcement) Act (1933) (FJA 1933)}

Where an arbitral award is made in another state, it is enforceable in United Kingdom if the said award is enforceable in the country where it was made.\textsuperscript{679} The Foreign Judgements Act (1933) (FJA 1933) operates on the principle of reciprocity of jurisdiction, and facilitates enforcement in the United Kingdom of judgments given in ‘foreign countries which accord reciprocal treatment to judgments given in the United Kingdom, for facilitating the enforcement in foreign countries of judgments given in the United Kingdom, and for other purposes in connection with the matters aforesaid’.\textsuperscript{680} Section 2(1) of the FJA 1933 requires an application to register the foreign award under the 1933 Act to be made to the High Court within six years of an arbitral award; and the litigant who found success for its argument in another state, that has a reciprocal enforcement arrangement with the UK, may seek satisfaction of its judgement in the UK High Court.


Adherents of the Geneva Protocols (1923) and the subsequent Convention on the Execution of Foreign Arbitral Awards have an obligation to enforce international decisions in accordance with their own national legal procedures.\textsuperscript{681} Enacted by the UK as the Arbitration Act (1950) (AA 1950), Article 1 of the Second Schedule states that arbitral awards that are properly made in accordance with the Protocols, are to be recognised as binding by signatory states and enforced as if made by the nation seized with the settlement thereof. The legislation also ensures that a venue is made available by the UK for the recognition and enforcement of other foreign awards, as defined in

\textsuperscript{678} s.9(2)(e) AJA 1920
\textsuperscript{679} s.10 (A) FJA 1933
\textsuperscript{680} Introductory text FJA 1933
\textsuperscript{681} Geneva Protocol of Arbitration Clauses 24 September 1923. United Kingdom is a signatory and established the Arbitration Act 1950 to adapt the Convention into its legal regime.
Part III of the Act, such as those that do not have the benefit of the 1953 New York Convention jurisdiction; these are enforceable under Section 36 of the AA 1950.\textsuperscript{682}


This Act implements into England the ICSID convention that regulates the process of settlement of investment disputes between states and foreign nationals.\textsuperscript{683} An award registered with the High Court will have the same force and effect in ‘execution as if it had been a judgment of the court’ in the imposition of pecuniary obligations, rendered pursuant to the Convention under Section 2(1).


Where properly registered, the English courts will treat a foreign order as if it were made within its own jurisdiction. Under Section 66, where there is an adjudication under an arbitration agreement, made by an appropriately constituted authority under the law, it may be enforced with the leave of the UK court, in the same manner as the jurisdiction under which it originated. This applies by virtue of Section 101(2) to orders made under the 1958 New York Convention (although Scotland operates an alternative regime).\textsuperscript{684} A New York Convention Award is deemed to be ‘made, in pursuance of an arbitration agreement, in the territory of a State (other than the United Kingdom) which is a party to the New York convention’.\textsuperscript{685}

Prima facie, the volume of English legislation and Convention memberships is evidence of a high degree of motivation to remain at the forefront of international dispute resolution and enforcement. Signatories to the New York Convention may find enforcement removed from their jurisdiction, even if they have conducted the arbitration process; particularly when there is a tactical assessment by an investor of a greater degree of success in the UK courts, or perhaps because the assets of the

\textsuperscript{682} Part II s.36 (1) of Arbitration Act 1950. s.66 of Arbitration Act 1996 states ‘Nothing in this section affects the recognition or enforcement of an award under any other enactment or rule of law, in particular under Part II of the Arbitration Act 1950 (enforcement of awards under Geneva Convention)”

\textsuperscript{683} Introductory text Arbitration Act 1966

\textsuperscript{684} Arbitration (Scotland) Act 2010.

\textsuperscript{685} s.101(2) AA 1996
recalcitrant state are located on British territory. Judgment on arbitration is initiated by a procedure ‘domesticating (the) arbitral award’ in order to facilitate enforcement in the English courts. It should be reiterated that prior to registration, the award, which becomes the ‘cause of action’ in the UK enforcement process, has to be recognised as final and conclusive in the legitimately constituted foreign court that adjudicated on the dispute; and is therefore binding on both parties. The enforcement framework emanates from the New York Convention, and is thus an internationally accepted process in which compliance of signatory states is expected.

7.4.2 Steps to Enforce An Arbitral Award against A Sovereign State Within the English Courts

Throughout history, the UK has been a hub for global trade and finance, and therefore it is no surprise that it should also become a primary repository for the assets of nations, and a major centre for investment dispute adjudication and enforcement of international orders. With a reputation for fairness, political and economic stability, and an independent judiciary, it is logical that an examination of English legal procedures be undertaken to determine how a resolution and enforcement process should operate, and what improvements could be made.

It is prudent to ensure that the necessary assets exist to satisfy an award before judicial measures are undertaken. The application for enforcement is made ex parte, without notice to the other litigant, and must disclose all material facts; the penalty for failing to do so is the setting aside of any order subsequently made. If the documentation proving the award is correct, the High Court will recognise it and a copy of the certification served on the appropriate representative of the defendant state, along with an application for enforcement. This may not prove possible, should the recalcitrant state continue to be obstructive, in which case the court may permit service in another appropriate jurisdiction, where a representative, and not merely the presence of state assets, can be identified. It will be recalled that the recognition

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686 Foster (n620) 668
688 [2004] NLSCTD 244 TMR Energy Ltd. v State Property Fund of Ukraine and State Property Fund of Ukraine (ANTK Antonov)
process requires both proof of legitimacy and finality of the award, so the granting of enforcement measures is likely to receive High Court approval without much argument, with the respondent state given a short time to apply to set it aside. In the absence of such a request, the award is enforced as a judgement of the English courts. Interim applications are made to preserve assets, if not already done so, and the English court enforcement measures are put into effect.

7.5 Indirect Means of Judicial Enforcement

Indirect means of enforcement are those measures taken pending satisfaction of a final award, involving the seizing and freezing of assets, usually to prevent their dissipation by a recalcitrant state. Such measures have considerable tactical value in urging the compliance and satisfaction of an award, removing assets from the control of an uncooperative state that requires their return.

7.5.1 Interim Measures for the Enforcement of the Arbitral Award

There are range of orders available to the courts to ensure the preservation of assets, which can be utilised in the satisfaction of awards. These are usually used by the judiciary in private proceedings against debtor individuals and corporations, but are also available for use against debtor states. Anticipatory or provisional measures are terms employed to describe the purpose of interim relief; whilst protective remedies are orders made to preserve the assets and thus the entitlements of parties pending the determination of the substantive matter of a dispute; as there is little point in pursuing a process that seeks to levy satisfaction against property that has been secreted away, converted or dissipated. Article 47 of the ICSID Convention asserts that

Except as the parties otherwise agree, the Tribunal may, if it considers that the circumstances so require, recommend any provisional measures which should be taken to preserve the specific rights of either party

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689 Jean-Pierre Harb, Edward Poulton and Mathias Wittinghofer, If All Else Fails: Putting Post-Award Remedies in Perspective (2012) The European and Middle Eastern Arbitration Review 16
691 Art. 47 ICSID Convention (n3)
and so initial applications on the constitution of an adjudication tribunal must be to seek interim measures and protective orders from the panel. Article 35.6 of the ICSID Convention provides that “the parties are always free to seek provisional measures from other authorities”, and therefore applications may also be made for protective orders to the courts of the nation seized under the enforcement application or in states where the assets or evidence are located. Jurisdiction by the tribunal to hear the merits and proof of a prima facie case for a successful enforcement application are the pre-requisites of interim measure requests, and they may be tailored to individual disputes, having a useful secondary role in the persuasion process. The English courts use interim measures to enable foreign investors to begin the process of protecting their entitlements, and as the assets of the debtor are brought into the jurisdiction of the courts, the debtor may find that continued resistance to the satisfaction of the arbitral award futile.

The seizure of property pending satisfaction may be undertaken by means of attachment, holding order or injunction. The aim of such an application is to preserve assets representing the value of the subject matter of the dispute, namely the arbitral award. Article 26 of the UNICETRAL Model Law identifies the principle interim measures available to ensure that the time spent on enforcing an arbitral award is not wasted. The seizure and preservation of potentially relevant and material evidence is geared towards easing the resolution of the dispute, and identifying assets capable of contributing to the settlement. Measures that aim to maintain or restore the status quo, pending the determination of the dispute, are invaluable, particularly where a pre-action investigation has located accessible sources of finance. In order to protect the integrity of the arbitration and enforcement process, applications are made that seek to prevent a respondent party acting in a way to cause current or imminent prejudice to the process itself, through for example, the circumvention of its effective provision of relief. Measures to preserve assets from which a subsequent award may be satisfied, and to prevent their transfer from the enforcement jurisdiction or dissipation are generally essential, with a view to final satisfaction, and such measures

692 Art. 35.6 ICSID Convention (n3)
694 Alex Bosch, Provisional Remedies in International Commercial Arbitration–A Practitioner Handbook (de Gruyter, Berlin 1994) 4-5
should be taken as soon as practicable on the inception of the enforcement action, if not done so in the course of the arbitration hearing.695

The role of protective measures may be an aggravating factor in a dispute, but if properly used, they enable the use of pre-emptive action as a method of diplomatic persuasion. Although an arbitrator will not usually have authority equivalent to the national courts, the judiciary in the enforcement jurisdiction will be expected to bolster, support and assist the execution of protective measures ordered by the tribunal, to avoid potential scepticism on status from opposing sovereigns; in England, this is enshrined in Order 14 of the Rules of the Supreme Court.696 Ironically, the tribunal will often find it needs the co-operation of the court system of the recalcitrant state to enact legislation.

A) The Legal Framework of Interim Measures in England

Section 44 of the AA 1996 provides that the court has the same powers to grant orders in interim hearings as it does in full arbitration or enforcement proceedings. Parties that require protective measures, usually as a matter of urgency, must apply for orders that will preserve evidence or assets, otherwise ‘the court shall act only on the application of a party to the arbitral proceedings (upon notice to the other parties and to the tribunal) made with the permission of the tribunal or the agreement in writing of the other parties’.697 Interim action can be taken by the court ‘only if or to the extent that the arbitral tribunal, and any arbitral or other institution or person vested by the parties with power in that regard, has no power or is unable for the time being to act effectively’.698 This anticipates that there are still matters to be resolved between the parties and to orders of the court, even where ‘the seat of arbitration’ has not yet been determined, or is outside of the UK; per Section 2(3) of AA 1996. The jurisdiction issue is also pertinent to the capacity of the High Court to refuse the exercise of interim authority in support of the arbitration tribunal, if it is inappropriate

696 Tamara Oyre, The Power of an Arbitrator to Grant Interim Relief under the Arbitration Act 1996 (1999) 65 Arbitration 125
697 s.44(4) AA 1996
698 s.44(5) AA 1996
to do so, especially where, at the time of the application, proceedings are or are likely to take place, outside of the jurisdiction.\footnote{44(5)(b) AA 1996}

In Section 37(1) of the Supreme Court Act (1981) (SCA 1981) the High Court is empowered, where it deems just and convenient, to grant any interim or final order. Judicial support for the arbitration tribunal procedure is incorporated in Section 25 of the Civil Jurisdiction and Judgements Act (1982) (CJJA 1982), where the High Court retains the discretion to grant interim relief orders, even when arbitral jurisdiction on the issue of enforcement is still in question, such as ‘(a) proceedings commenced or to be commenced otherwise than in a Regulation state; (b) proceedings whose subject-matter is not within the scope of the Regulation’,\footnote{25 Civil Jurisdiction and Judgements Act 1982 (CJJA 1982).} although it will decline to do so if the jurisdiction issue makes such action ‘inexpedient’.\footnote{ibid} Whilst the courts have an impressive range of potentially coercive protective interim orders, it is not reasonable to utilise them prior to the preliminary step of recognition of the award; the entitlement to enforcement must first be proven, and it has been suggested that orders should be limited to preserving the status quo and preventing the dissipation of assets.\footnote{Harb and others (n689) 19}

However, the injunctive relief power can be exercised by the English High Court pending recognition or enforcement upon acceptance of jurisdiction, provided that there is no sovereign immunity issue. In the \textit{Sabah Shipyard (Pakistan) Ltd v The Islamic Republic of Pakistan & Another} case, the applicant, a Pakistani company with Malaysian shareholders, sought enforcement of an arbitration award worth US$6.84million obtained in Singapore.\footnote{[2002] EWCA Civ 1643 Sabah Shipyard (Pakistan) Ltd v The Islamic Republic of Pakistan & Another} The case concerned an agreement for a construction project in Karachi; and incorporated a collateral guarantee, where the host state waived sovereign immunity and agreed dispute jurisdiction in the UK courts. Following delays and losses to the project, Sabah commenced proceedings in England to recover its losses, whilst the defendant initiated proceedings in Pakistan, arguing that it was not bound by the collateral agreement. This led to interim cross-injunction applications to prevent the respective parties pursuing proceedings in

\footnotesize{\begin{itemize}
\item \footnote{44(5)(b) AA 1996}
\item \footnote{25 Civil Jurisdiction and Judgements Act 1982 (CJJA 1982).}
\item \footnote{ibid}
\item \footnote{Harb and others (n689) 19}
\item \footnote{[2002] EWCA Civ 1643 Sabah Shipyard (Pakistan) Ltd v The Islamic Republic of Pakistan & Another}
jurisdictions of their choice; and in Pakistan, that Sabah should be restrained from making any claims based on the guarantee. The High Court, and subsequently the Court of Appeal had to determine whether Pakistan had waived its sovereign immunity, had thereby consented to English jurisdiction on the grant of interim relief, and if it was appropriate and lawful to grant an injunction where the host state court had already restrained Sabah from commencing proceedings in England. Both the High Court and the Court of Appeal decided that the collateral guarantee was enforceable, and that Pakistan had breached it by attempting, in its national court, to prevent Sabah from commencing proceedings in England, a vexatious and unlawful action. The UK was the chosen venue, made clear by the waiver of sovereign immunity, and was thus empowered to grant interim relief.704

B) Arbitral-Interim Measures Against Sovereign States

There remains a perception that the interim measures granted by an arbitral tribunal carry less status and weight in law than those obtained by traditional court order, despite emphasis placed on the former in international agreements. Article 25.1 of the London Court for International Arbitration (LCIA), for example, states that:

The Arbitral Tribunal shall have the power, unless otherwise agreed by the parties in writing, on the application of any party […] to order the preservation, storage, sale or other disposal of any property or thing under the control of any party and relating to the subject matter of the arbitration.705

Article 47 of the ICSID empowers the arbitral tribunal, ‘if it considers that the circumstances so require, [to] recommend any provisional measures which should be taken to preserve the respective rights of either party’,706 while UNICETRAL Article 26 avers ‘the arbitral tribunal may, at the request of a party, grant interim measures’.707 The respect accorded to tribunal rulings is clear, at least where the parties agree to its jurisdiction. However, the execution of protective measures granted by a tribunal may in practice require the support of the traditional courts where the assets are present, but there is no legal jurisdiction.

704 ibid Para 1 Introduction of Lord Justice Waller
705 Art. 25.1 London Court for International Arbitration 1998 (LCIA)
706 Art. 47 ICSID Convention (n3)
707 The Cairo Regional Center for International Commercial Arbitration (CRCICA) contains the same provision at Art. 6
In the absence of agreement, the situation is somewhat more complicated. Article 23 of the ICC supports parity of status, but recognises the entitlement of parties to seek court interventions:

Before the file is transmitted to the Arbitral Tribunal, and in appropriate circumstances even thereafter, the parties may apply to any competent judicial authority for interim or conservatory measures. Going to a court for provisional remedies does not affect the powers of the [arbitral] tribunal or signify a waiver of the arbitration agreement.\footnote{Art. 23.2 International Chamber of Commerce 2012 (ICC)}

Other complicated circumstances may arise, such as parties agreeing in the original contractual negotiations not to take interim action against each other in the event of a dispute; and Article 47 of the ICSID Convention will permit the party subject to the order to apply for it to be set aside as contrary to the agreement provisions.

C) Court Based Interim Measures Against Sovereign State Assets

The fact that the English courts were not involved in the original adjudication, or in the case of assets subject to the application being outside of its jurisdiction is not a bar on the authority of the English judiciary to grant protective interim measures, under Section 44 of the Arbitration Act (1986) and Section 25 of the Civil Jurisdiction and Judgment Act (1982).\footnote{Charles Falconer and Amal Bouchenaki, \textit{Protective Measures in International Arbitration} (2010) 11(3) Business Law International 183, 186} The measures taken by the courts against foreign sovereign states in the course of an award execution application, broadly seek to support arbitral tribunal interim measures, both before and after the award; and to facilitate the actual enforcement of the principal award. Interim orders from tribunals does not necessarily mean that their decision constitutes an award that requires a judgment on the merits; it may be made ex parte, without challenge, and considered on adjudication. Discretion therefore arises in the national court where the subject’s assets are held to decide if it should activate it; if the decision is in the affirmative, a freezing order, for example, will maintain the status quo, pending final tribunal adjudication, and the applicant has no claim in the meantime to use the funds. This provides yet another indication of the relative difference in legal status between tribunals and the traditional courts.
Interim applications have an initially temporary motive to enforce compliance with the principal order. The freezing order, commonly known as a ‘Mareva Injunction’ after the case in which it was first used, is the most common type of interim relief ordered, protecting assets from dissipation pending dispute resolution. As a debtor state may continue with its obstruction, so the investor must move to pursue execution measures, and the collection of the debt from frozen assets. The state may act on the interim measures and comply with its international obligations, thus effecting, upon satisfaction, the release of its property.

D) Freezing Injunctions against States in English Courts

The Mareva, now regulated under the English Courts Civil Procedure Rules, Part 25.1(f), restrains a party from disposing or dealing with its own assets, including bank accounts, shares and securities and all types of physical property. It can be applied for, and made, at any time before arbitral proceedings are issued, during the course of proceedings, after judgment has been obtained and prior to or at the time of enforcement, particularly where an applicant fears the dissipation of the respondent’s assets. The tribunal or court will wish to avoid frustration of enforcement to enable satisfaction of the final award. In addition to its value in the enforcement of the principal award, it has a tactical purpose, as it permits the release of funds to a claimant where the value of the frozen assets is greater than the award. Despite this, it is not a proprietary remedy per se, but is instead a supplementary power possessed by the tribunal to ensure and protect its local and international credibility and efficacy of its final awards. In practice, it has the effect of providing security to an investor for their claim, although this is not grounds for application.

The High Court has the inherent authority to seek to stop the respondent foreign state from secreting or repatriating assets from its jurisdiction, to the extent of the sum owed under an arbitral award. Section 37(1) of the Supreme Court Act (1981), provides: ‘the High Court may by order (whether interlocutory or final) grant an

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710 [1975] 2 Lloyd's Rep 509 Mareva Compania Naviera SA v International Bulkers S.A
712 ibid 412

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injunction or appoint a receiver in all cases in which it appears to the court to be just and convenient to do so’.\textsuperscript{713}

A global freezing injunction may also be granted, this type of order has a restraining effect on the capacity of a state to use its assets; and is more likely to elicit co-operation. The High Court has the authority in both national and international law to freeze, and prevent the dissipation of assets owned by a sovereign state outside of UK territory, although it does usually require the co-operation of the judiciary of the country in which the asset lies. The application can be denied on the grounds of practicality, if it will not constructively and adequately facilitate resolution and payment. In the \textit{ETI v Bolivia and ENTE} case, the UK Supreme Court found the application not only had little connection with the substantive proceedings in New York, but that granting of the order would have little practical value in promoting a solution.\textsuperscript{714} In order to put an asset based on foreign territory temporarily beyond the control of a recalcitrant state in order to prevent its dissipation or to facilitate its potential seizure, an applicant must obtain permission from the English High Court to seek the freezing order, then obtain such attachment from the foreign court with jurisdiction where the asset is held. Issues of jurisdiction will arise, particularly under Section 44 AA 1996, which requires a connection between the tribunal proceedings and the asset for which the order is sought. The court declined to grant the order where the ultimate enforcement of an award was not anticipated in its jurisdiction, as in the Siskina case, which involved an application to prevent the dissipation of a specific insurance pay-out as part of a broader international asset freeze.\textsuperscript{715} In the \textit{Mobil Cero Negro Ltd v Petroleos de Venezuela} case, the applicant was awarded US$12billion due to the state’s nationalisation of its oil interests, but was subsequently unpaid; the global search for state assets to be frozen in order to satisfy the award included the obtaining of a worldwide freezing order before the English High Court, which was challenged by Venezuela on the grounds of jurisdiction.\textsuperscript{716}

\textsuperscript{713} s.37(1) Supreme Court Act 1981
\textsuperscript{714} [2008] EWCA Civ 880 \textit{ETI Euro Telecom International NV v Republic of Bolivia and Another}
\textsuperscript{715} ibid; [1979] AC 210 \textit{Siskina v Distos Compania Naviera SA}
E) Conditions for the Acceptance of a Freezing Injunction Application Against Sovereign States

Freezing injunction applications are not made as of right as the result of a simple procedure, there must be an element of misbehaviour anticipated that leads to a real fear that an award will be unsatisfied, and thus the whole international system of arbitration undermined. The court will ensure, in making the order that it is not simply a tactical or vexatious move by the applicant, but a tangible need.

The UK Courts are not to be viewed as the global supervisors of the adjudication and execution of award frameworks, merely because the legislature has granted them the powers under statute to make orders dealing with the restraint of the property of other sovereign states; there must be some connection between the jurisdiction of the substantive proceedings or the property over which interim control is sought.

Pertinent examples of potential links to the UK jurisdiction were examined in the Royal Bank of Scotland PLC v FAL Oil Co Ltd case, a dispute involving the United Arab Emirates, the host state, which unlawfully expropriated project property. The most obvious link is the fact that the original project agreement between the parties incorporated exclusive English jurisdiction clauses, consented to by the defendant company; which secured additional protections and substantive rights. British banks were the loan financiers of the shipping project, and the accounts, which became disused when the dispute arose, were operated in the UK. Although it was not appropriate, on the evidence, to define assets of the defendants’ British subsidiaries as property of the parent company, their existence showed a business presence on the territory. Although there were no actual assets held on British soil, the jurisdictional nexus was clear, and it was therefore appropriate and expedient for the High Court to grant the worldwide asset-freezing injunction and disclosure orders under Section 25 CJJA 1982 against FAL Oil at the request of the claimant against the UAE.

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717 Baughen (n711) 412
718 [2012] EWHC 3628 (Comm) Para 38-40
719 [2012] EWHC 3628 (Comm) Para 41-45, 47
Assets need not be held in the territory for the UK to accept jurisdiction, where other links to the project or dispute permit global intervention in order to protect property and the reputation of the international dispute resolution process. The *Mobil v Petroleos* case involved the dispossession of Venezuelan oil enterprises in which Mobil had a substantial interest. Mobil appealed to the ICC for arbitration in New York, and applied for, and was granted ex parte, a worldwide freezing injunction by the High Court in London under Section 44 AA 1996, against Petroleos, the Venezuelan national oil company. Walker, on the respondents appeal, reiterated that convenience was not the principle for such a draconian interim order by the UK courts, and if the ICC could easily make and enforce its own orders, it would not be just and reasonable to intervene. In addition, and reiterating the UK’s nexus requirement for jurisdiction, the court found that Petroleos had no assets, presence, dispute or dealings in England, and thus the appeal against the order was successful.

Respect for the authority of other jurisdictions to make the orders that it considers necessary will also be taken into account by the UK courts when considering justification and jurisdiction issues. In the *ETI Euro Telecom v Bolivia* case, the defendant state unilaterally nationalised shareholdings in ETI’s subsidiary company. New York was the venue of the substantive dispute proceedings, but Bolivia also held realisable assets in London, suggesting the jurisdictional link required, and so ETI made an application for the freezing of the defendant state’s property worldwide. However, given that the proceedings in New York related only to the assets held there, Section 25 CJJA did not apply; as the American judiciary had ample powers to protect the efficacy of its own orders.

Lord Justice Mustill described ‘a good arguable case’ while hearing the *Niedersachsen* case as ‘one which is more than barely capable of serious argument, but not necessarily one which the judge considers would have a better than 50% chance of success’. This standard is not an assessment to the standard of a guarantee before interim relief is granted. Indeed, the reason for a respondent’s recalcitrance can provide evidential insight. The conduct of the defendant and the UAE in the *Royal Bank of Scotland PLC v FAL Oil Co Ltd* case was prima facie

720 [2008] 1 Lloyd’s Rep 684
721 [2008] EWHC 1689 (Comm)
722 [1983] 1 WLR 1412
evidence of the strength of the claimant’s assertions of success and the interim risk of dissipation; the only other relevant issue regarding the state’s failure to co-operate was whether this was owing to reluctance or impecuniosity.\textsuperscript{723} By diverting shipping revenue from the company’s UK bank, and refusing to disclose the whereabout of seizable property added to the evidence that the interim order was necessary for ultimate enforcement, and thus the worldwide freezing order was made.\textsuperscript{724}

In addition, any case should be a ‘just and convenient’ one. This is primarily an operation of arbitral and judicial discretion, the exercise of which is often both onerous and precarious. The evidential burden on the applicant of an interim order to exert tribunal or court control over the assets of a corporation or state is not to the standard of proof of claim, but only to a ‘good arguable case’, and therefore the final adjudication may not support the application, causing considerable inconvenience for an ultimately successful litigant. The refusal to grant interlocutory relief may result in the secretion or disposal of assets, not only frustrating the claim, but also undermining international arbitration procedures. Justice and convenience may be value judgements with significant effects on the process as a whole.

The risk of dissipation and frustration of the execution of the final award must be demonstrated, and not merely feared in the ordinary course of proceedings. Neuberger in the \textit{Thane Investments v Tomlinson} case ruled that the claimant must show ‘solid evidence’ in support of their contention that the failure of the court to exert control over a defendant’s property will prejudice its ultimate ability to have an award satisfied.\textsuperscript{725} The risk must therefore be objectively assessed, rather than be merely worrisome. Conduct contrary to good faith dealings with property provides useful evidence; in the \textit{Royal Bank of Scotland Plc. v FAL Oil Co Ltd} case, evidence showed that the defendant had ‘taken deliberate steps to dispose of their assets or to put their assets out of the legitimate reach of their creditors’.\textsuperscript{726} The list of indicative conduct is long; including continuing to operate and trade whilst failing to use agreed banking facilities and diverting payments elsewhere; a refusal to identify the alternative accounts; switching off responders to prevent detection and thus potential seizure; a

\textsuperscript{723} [2012] EWHC 3628 (Comm); [2013] 1 Lloyd's Rep. 327
\textsuperscript{724} [2012] EWHC 3628 (Comm), Para 38-40
\textsuperscript{725} [2003] EWCA Civ 1272 (Neuberger J)
\textsuperscript{726} [2012] EWHC 3628 (Comm); [2013] 1 Lloyd's Rep. 327
lack of contact in order to negotiate or accommodate; and failure to resist the Mareva application per se. These factors combined to assist the court in deciding that there was substantial evidence that it should intervene pending execution.

It is a common practice for states to seek to shelter their assets in an apparently separate, independent commercial enterprise or company; a practice that is also followed by private individuals and businesses attempting to avoid the various financial obligations. In the investigation process to identify assets for enforcement, the UK courts must determine whether the actual ownership of property lies with the recalcitrant state, despite appearances to the contrary. In the Ministry of Trade of Iraq v Tsavliris Salvage (International) Ltd & others case, the Iraqi Ministry was challenging, under Section 67 of the AA 1996, an arbitral award made in favour of the respondent; whilst the appeal respondent was applying for an interim freezing order against the state and its Grain Board to preserve assets to pay the granted award. The dispute had arisen as the result of a salvage contract with the Iraqi Grain Board, who were the managers of a ship carrying wheat that ran aground off the coast of Iraq, its final destination. The contract was supposedly signed (on behalf of the state) with Tsavliris, the salvage company, to have a lien on the cargo, pending payment of security for the project; with dispute jurisdiction designated as London. The ship was recovered and its cargo delivered, but recompense was unforthcoming.

Iraq argued that the Grain Board was a state sovereign department, and that the lien was not enforceable by reason of immunity per SIA 1978; and nor did the arbitrator have jurisdiction to adjudicate under s.67 of AA 1996. Furthermore, despite acting on authority delegated by the Iraqi executive, the Grain Board stated that it did not own the cargo; and that it belonged to the state of Iraq. As it did not own the ship, it therefore could not bind the owners to the agreement, or its arbitration provisions, without their authority. In its assessment of the issues of status, the avoidance of liability by immunity and the application to freeze state assets, the arbitrator determined that the Grain Board was a corporate body distinct from the Iraqi state, did not therefore enjoy sovereign immunity, had control akin to ownership over the vessel and its cargo, and was thus obligated under contract to Tsavliris. There was deemed to

727 ibid Paras 38-40
728 [2008] EWHC 612 (Comm)
be a real risk of secretion or dissipation of the assets, and thus they were frozen pending execution of the award.

The court subsequently rejected Iraq’s appeal, pronouncing the Grain Board a separate commercial body from the state, given its constitution and letters of incorporation describing its purpose as a trading company; and that therefore it could not claim immunity. On the issue of ownership of the vessel and its cargo, the contract signed for salvage asserted title to the ship, and so under Article 6.2 of the International Convention on Salvage (1989), the negotiation and agreement contract for salvage undertaken bound both the owners of the ship and of the cargo. The Grain Board was thus obligated to comply with both the contractual obligations and the award. However, its conduct and challenge was perceived as indicative of a very real risk of obstruction and signalled the need for action to preserve assets to satisfy the debt. As if more evidence were needed, the Grain Board failed to offer to settle on the finding of responsibility, or to furnish security for the sum owed, and therefore the Mareva Injunction was granted.

F) Assets of State and Immunity Against a Freezing Injunction

Assets that are subject to sovereign immunity from execution and enforcement; those not primarily used for commercial purposes; are immune from interim freezing orders. Section 13(2) of the SIA 1978 asserts with specific reference to immune property:

(a) [R]elief shall not be given against a State by way of injunction or order for specific performance or for the recovery of land or other property; and (b) the property of a State shall not be subject to any process for the enforcement of a judgment or arbitration award or, in an action in rem, for its arrest, detention or sale.729

It does not prevent applications where property is ‘for the time being in use or intended for use for commercial purposes’.730 Such rules do not apply when the state has given written consent to the operation of the interlocutory procedure, whether limited or otherwise; for example as a negotiation concession in a prior agreement;

729 s.13(4) SIA 1978
730 ibid
however, merely agreeing to arbitration is not deemed to represent such consent.\textsuperscript{731} Clarity of what person, agency or body is authorised to represent the state in negotiations or contractual agreements in which prior written consent is given remains problematic, as it is in the interests of the state to make this clear in order to protect its immunity, and for an investor to establish the status of the persons they are dealing with.

7.6 Direct Judicial Means of Enforcement of Arbitral Awards Against Sovereign States

The co-operation between the tribunal and the national court system, particularly in the UK, must be examined in the context of its powers of direct intervention and enforcement against a recalcitrant foreign state. The authority and powers available to the English courts are extensive in the range of remedies and discretions at their disposal, able to adapt freely to the particular circumstances of each individual problem and application. The UK is a signatory to both the New York Convention (1958) and the ICSID Washington Convention (1965), with all the authority they confer. Adherence to conventions must also be bolstered by a comprehensive national legislative framework to facilitate the enforcement of arbitral awards, coupled with considerable experience of international diplomacy. The ideal resolution and settlement scenario is full co-operation of the parties; with an award registered against the state, no objections to merit or enforcement are filed, the award is executed as if it were a judgment of the UK courts itself and the debt is paid.

Rule 1(1) Order 45 Civil Procedure Rules (CPR) (1998) (as amended) empowers the courts:

A judgment or order for the payment of money, not being a judgment or order or the payment of money into Court, may be enforced by one or more of the following means, that is to say (a) writ of fieri facias; (b) garnishee proceedings; (c) a charging order; (d) the appointment of a receiver; (e) in a case in which rule 5 applies, an order of committal; (f) in such a case, writ of sequestration.\textsuperscript{732}

\textsuperscript{731} ibid s.13(3)
\textsuperscript{732} Rule (1) ‘Enforcement of judgment … for payment of money’ Rules of the Supreme Court ORDER 45 of The Civil Procedure Rules 1998
These orders are available to the creditors of private individuals, companies and sovereign states alike; those which are most likely, to secure settlement for a creditor against a recalcitrant state are the garnishee, charging and fieri facias orders, by which the English courts seek to pursue their global role in the enforcement of awards.

7.6.1 Third Party Debt - Garnishee Orders

When an applicant for enforcement is owed money under an arbitral award from a state which is reluctant to pay, the recalcitrant state is itself likely to be a creditor of another party, usually in this context a bank, which holds money to the order of its state customer and the award creditor will seek an order to access those funds. It is obtained from the High Court and will only be made after the granting of a definitive award in dispute proceedings, whereupon it may be utilised as an interim or final mode of enforcement pursuant to Practice Direction 72 (Third Party Debt Order) of the CPR. It would be helpful to have the debtor’s account number, whether a private or state debtor, and that it have a credit balance. The Garnishee targets liquid cash, whereas a Charging Order, followed by an Order for Sale, is generally made for the preservation and liquidation of physical assets such as land, stockholding, or vehicles.

The value of a Garnishee order executed to recover money owed by a state to a foreign investor was clearly demonstrated in the Continental Transfert Technique Ltd (CTT) v Nigeria case, that arose from a dispute over a contract for identity cards.\(^\text{733}\) CTT obtained an arbitration award in Nigeria against three constituent departments of the Nigerian Government, amounting to £139,250,000 plus costs and fees. This was unpaid, and permission was granted in London for enforcement against the government departments and the Nigerian state. Two ex parte interim charging orders and a third party debt order were made in the enforcement proceedings which Nigeria applied to discharge.

Another ex parte, application saw CTT seek to join the Nigerian National Petroleum Corporation (NNPC) as a defendant to assist in securing the funds to discharge the award. There followed a dispute regarding its status, with CTT claiming it was a state

\(^{733}\) [2009] EWHC 2898 (Comm)
department. NNPC asserted instead that it was a separate corporation with its own assets; and that under Rule 72.1 of the CPR, the third party debt order could only apply to money owed to it by Nigeria. As there was no such liability, its assets as a separate corporation could not form part of the execution of a judgment debt against other defendants. This applied, it alleged, even if it was found to be part of the state apparatus; although CTT countered that in such circumstances, its assets would effectively belong to Nigeria, and thus be seized to satisfy the judgment.

As a result, the banks used by NNPC were investigated under the third party debt order, with interim applications made to preserve and divert Nigerian liquid assets to the enforcement of the judgement. With the addition of interim charging orders against NNPC property in London, along with its shares in a subsidiary, the interim applications stated, that NNPC was an organ of the state of Nigeria and thus liable to have its property assist in the enforcement. No notice was given to NNPC, to prevent transfer of the liquid assets, and an Interim Third Party Debt Order was made ordering the banks not to make any payments to the judgment debtors, including NNPC and the state, save to the extent that it was from funds which exceeded the amount of the judgment debt, plus costs.

A) The Third Party Order and Judicial Weight of Ambassadors’ Certificate

The third party order and judicial weight of ambassadors’ certificate relates to the issuing of statements of immunity from enforcement of non-commercial state assets including the interim measures to facilitate this under Section 13(2)(b) of the SIA, which states that the ‘property of a State shall not be subject to any process for the enforcement of a judgment or arbitration award or, in an action in rem, for its arrest, detention or sale’. Where this defence is asserted, it should at least be possible to rely upon the word of an Ambassador, who testifies that the targeted funds are for sovereign purposes in facilitating the role of statehood, and not commercial assets;

[T]he head of a State’s diplomatic mission in the United Kingdom, or the person for the time being performing his functions, shall be deemed to have authority to give on behalf of the State any such consent as is mentioned in subsection (3) above and, for the purposes of subsection (4) above, his certificate to the effect that any property is not in use or intended for use by or

734 s.13(2)(b) SIA 1978
on behalf of the State for commercial purposes shall be accepted as sufficient
evidence of that fact unless the contrary is proved.735

The Ambassadors Certificate was deemed by Lord Justice Dingemans in the *AIC Ltd v The Federal Government of Nigeria* case to be a persuasive guide to judgment, providing a virtual presumption of the truth of its content, with the non-commercial, sovereign designation of state property appropriately diplomatically supported: ‘his certificate to the effect that any property is not in use or intended for use by or on behalf of the State for commercial purposes shall be accepted as sufficient evidence of that fact unless the contrary is proved’.736 In *AIG Capital Partners v Kazakhstan*, the creditor sought the execution of an unpaid ICSID award via a third-party debt and charging orders on assets held by a private bank in the UK belonging to the National Bank of Kazakhstan. The assets belonged to a separate legal entity, and were not ordinarily subject to immunity, but the Ambassador certified that they were non-commercial sovereign funds. Lord Justice Atkins found this intervention persuasive:

That is clear and unambiguous. I have seen no evidence to contradict it other than the fact that the securities accounts are traded. For the reasons I have given, the trading of those accounts does not mean they were being used or were intended for use for commercial purposes.737

The assertion of a state representative, with a clear vested interest as an officer of the respondent nation is considered persuasive as to the veracity and truth in court proceedings, potentially despite evidence to the contrary.

It therefore falls to the foreign investor being denied their just settlement to prove that bank accounts subject to Garnishee applications are being used or intended to be used for commercial purposes, despite the assertions of respected officers of the state, whose word is their bond. The *Orascom Telecom Holding SAE (OTH) v Chad* case, involved an agreement to establish a telecommunications company in the state of Chad, entered into by OTH, an Egyptian investor.738 The state subsequently seized control of the substantial investment already made, freezing bank accounts, closing premises and revoking licences; leading to the successful application by OTH for arbitration to the International Chamber of Commerce, and an award of over £3.7

735 s.13(5) SIA 1978
736 [2003] EWHC 1357 QB
737 [2005] EWHC 2239 (Comm) Para 92(4)
738 [2008] EWHC 1841 (Comm)
million. Chad failed to pay, and so enforcement proceedings commenced in the UK, a signatory of the ICC convention; that included an interim application for a third party debt order for access to money held by Citibank N.A, on behalf of Chad, in London.

Chad’s accounts with Citibank, London had been established in order to service loans received from the World Bank for another international development project, designed to exploit and export oil reserves; receiving revenue and facilitating repayments as required. Freezing the accounts inhibited the state’s ability to comply with its World Bank obligations, and therefore OTH amended its application to instead target a single account, thus not jeopardising the other project. Chad argued that the funds in question were for sovereign use and therefore immune from execution. The Ambassador intervened, using his international standing to certify the sovereign status of the account. Mr Justice Burton was scathing in his assessment of the veracity of the Ambassador’s Certificate, which he believed was rendered incredible given the context of the evidence:

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Tactics rather than reputation may be the guiding motive for gaining such a certificate from a recalcitrant state. The Head of Diplomatic Mission in the UK is not an independent post, occupied by a neutral figure, and is instead an essentially political post, paid for by the state, that in turn is trying to avoid its international financial obligations

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739 ibid Para 24
B) The Third Party Order and Piercing the State’s Corporate Veil

Both states and independent commercial enterprises have developed complex corporate frameworks to protect their income and assets, in order to evade or avoid their financial liabilities, even to the extent of concealment as a commercial vehicle organisation. The English courts have in turn accumulated considerable experience in penetrating sophisticated corporate structures in order to trace financial assets and exercise powers to determine the availability of funds to recompense an investor. In the Kensington International Limited v Republic of the Congo case, for example, the state attempted to avoid its debts by trading oil through a network of companies, and concealing the proceeds. In brief, Cotrade SA, was a wholly-owned subsidiary of Société Nationale des Pétroles du Congo (SNPC), a commercial entity owned by the state, which contracted with Africa Oil & Gas Corporation (AOGC) for the sale of oil. AOGC then sold the oil from SNPC to Sphynx (BDA) Limited (Sphynx), which subsequently dealt with Glencore Energy UK Limited (Glencore).

Kensington International Limited was a venture capital company that purchased the arbitral award debt at a significant discount, and sought to enforce it against the state by obtaining a third party debt order. Glencore was to pay Kensington International Limited the monies it owed to Sphynx, on the basis that Sphynx was a commercial manifestation of The Congo. This argument was successful, the order was made, and the award eventually executed. The companies were designed to mislead, and the order made to divert the payments to the satisfaction of the award. Creditors were able to access assets allegedly owned by independent corporations, where they were established to facilitate trading transactions for the state, in order to enable it to shield its assets from creditors.

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740 Piercing the Corporate veil means that ‘in some cases the creditor can ask a court to ignore the company liability shield and reach its owners’. See Michael Spadaccini, Incorporate Your Business: In Any State (Entrepreneur Media 2007) 85
741 [2007] EWCA Civ 1128
742 [2005] EWHC (Comm) 2684, Para 193-202
7.6.2 Charging Orders and Orders for Sale Against States’ Property

In this method of enforcement, whether made by interim or final order, the judgment creditor obtains a charge over a debtor’s property, in a manner similar to a standard mortgage. It is used against private individuals and corporations as well as states, ruling that a physical asset cannot be sold without reference to or without the permission of the charge holder, usually dependant on payment of the appropriate proportion of the proceeds of sale to pay the outstanding debt. It provides a creditor with security for the unsatisfied judgment, realisable on an ‘order for sale’. Before such an order is made, it is wise to ascertain if the property to be so charged holds sufficient equity to satisfy the debt, taking into account any prior charges or interest. Section 2(2) of the Charging Order Act (1979) stipulates the assets upon which a charging order may be made:

(a) [L]and (b) securities (including government stock, stock of any body (other than a building society) incorporated within England and Wales, stock of any body incorporated outside England and Wales or of any state or territory outside the United Kingdom, being stock registered in a register kept at any place within England and Wales, and units of any unit trust in respect of which a register of the unit holders is kept at any place within England and Wales, or (c) funds in court.

A recalcitrant state may hold assets in an apparently private company in order to conceal its real ownership. In the Walker International Holdings Ltd v Congo and Others case, the applicant had purchased debts due from the Congo under a loan agreement at a discount, but had to seek an arbitration award against the state; seeking an interim charging order over the shares of a company, Jackson 31 Limited, and a property owned in its name. It had to establish that the state of Congo had a beneficial interest in the Jackson 31 shares, and the associated property, albeit well hidden. The shares were held by a Congolese company, Financière et Investissements Du Congo SA (FIDC), which was 80 per cent owned by the state oil company Société Nationale des Pétroles du Congo (SNPC). Walker argued that the Republic of Congo and SNPC were to be regarded as a single, entity and therefore that the shares held in Jackson 31 by FIDC, owned by SNPC, was a sham company, designed to give the appearance of ownership by a third party. Therefore, the Jackson 31 shares and

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743 Introductory Text, Charging Order Act 1979
744 s.2(2) Charging Order Act 1979
745 [2005] EWHC 2813 (Comm)

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property were deemed to be owned by the Congo and SNPC, and thus FIDC could be regarded as a body of the state. Walker had suffered damage to its interests, under Section 423 of the Insolvency Act (1986), and in the recovery of the arbitral award it purchased; as a result of the transactions entered into by Congo and SNPC with the clear purpose of placing assets beyond the reach of their creditors. The court found that ‘Congo are beneficially interested in the shares of Jackson and Jackson's property’, ordering enforcement of the award against Congo by charging the assets of Jackson; and so Walker was entitled to interim charging orders over the shares and the London property owned by it. The process and result were similar to those secured by the creditor in the Continental Transfert Technique Ltd v Nigeria case, when it unravelled the complex financial framework set up by Nigeria, detailed above.

The physical receipt of financial restitution by a foreign investor is on an ‘order for sale’, or ‘writ of execution’ of the assets charged, and the payment of the proceeds upon final determination of liability. If the application is uncontested, the sale and realisation of the assets may be obtained by default, subject to the CPR:

Where the claimant obtains default judgment under Part 12 on a claim against a State where the defendant has failed to file an acknowledgment of service, the judgment does not take effect until 2 months after service on the State of (a) a copy of the judgment; and (b) a copy of the evidence in support of the application for permission to enter default judgment.

A ‘writ of execution’ under CPR Rule 6 only requires procedural compliance with the notice provisions before execution, where failure to acknowledge service occurs under Section 14 of the State Immunity Act (1978) and CPR Rule 40.10, that the judgment has taken effect. The two-month dispensation period applies only to state debtors, and not to private individuals or companies.

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746 ibid Para 8
747 ibid Para 128
748 [2009] EWHC 2898 (Comm)
749 Art. 40.10 Part 40 CPR, Rules and Directions
750 Rule 6 (iii) RSC ORDER 46, The Civil Procedure Rules 1998
7.6.3 Writ of Execution, *Fieri Facias*

“*Fieri Facias*” literally translated means ‘what you cause to be made’, the practical act of realising the goal, and is reflected in the new designation of the ‘writ’ that bears its name, the exercise of the control over assets of another.\(^{751}\) The more generic term of ‘Writ of Execution’ includes *Fieri Facias*, possession, delivery, sequestration and any further order to aid the aforementioned writs.\(^{752}\) This is the most common method of execution, historically authorising a sheriff or other officer of the court to claim and seize the ‘goods, chattels or money, and to sue for an amount secured by bills of exchange and other securities’ to fulfil a judgment against a debtor state.\(^{753}\) The creditor concerned should prepare an inventory of the saleable assets and their value owned by the judgment debtor to be sold, usually at auction. As auction value is usually considerably less than the retail equivalent, a debtor may wish to reconsider obstructing enforcement.

In the *Abu Qaoud v Tunisian National Tourist Office* case, a claim for the recovery of a debt arose from an unpaid judgment due to the applicant from the National Tourist Office, cited as a department of the Republic of Tunisia.\(^{754}\) Abu Qaoud was granted permission to issue of writ of *fieri facias* for execution of the assets of the Tunisian National Tourist Office and an interim third party debt order. In response, the National Tourist Office decided to provide fresh evidence of its independence from the state, producing witness statements to the effect that it was a non-administrative public corporation, and that evidence had not been adduced before due to incompetence or inadvertence. It also asserted that if it was found to be a department of state, it was immune from enforcement under Section 13 of the State Immunity Act (1978). This new defence was rejected simply because it had not produced this defence prior to the appeal against the enforcement orders, in accordance with tribunal procedures. The court dismissed the appeal from the host state defendant and granted the enforcement for the claimant.

\(^{751}\) Tribunals Courts and Enforcement Act 2007
\(^{752}\) Rule (1) RSC ORDER 46 Civil Procedure Rules 1998
\(^{753}\) s.12 Judgment Act 1838
\(^{754}\) [2004] EWHC 1755 (QB)
7.6.4 Enforcing Arbitral Awards Against A State’s Ships and Aircrafts Under English Law

Charging orders target the preservation of the property of the state, and writs of execution are aimed at realising the value of goods, money and other state assets that are capable of seizure. Ships and aircraft, as state assets, are mainstays of the economy and the integral provisions of private international law and the exercise of powers of seizure to satisfy an arbitral award raise particularly sensitive concerns. Such items are hugely expensive to build, maintain and finance, and auctions rarely realise the true market value, causing disproportionate losses to a state. Furthermore, arguments of commercial or non-commercial sovereign use exacerbate the problems of resolution.

A) Enforcing Arbitral Awards Against a State’s Ships

A distinction has to be drawn between state owned shipping used for trade, and that owned for non-commercial, governmental purposes such as defence and security, which is immune from enforcement measures under the 1926 Brussels Convention. Note should be taken of Article 9 of the Convention on the High Seas; and Article 22 of the Convention on the Territorial Sea and the Contiguous Zone; which exempts commercially based state-owned ships from immunity from execution. Vessels used primarily for commerce are treated in the same way as privately owned ships. Halsbury’s Laws of England asserts an action in rem: ‘is an action against the ship itself but the view that if the owners of the vessel do not enter an appearance in the suit in order to defend their property no personal liability can be established against them has recently been questioned’.

In such circumstances, the action may become in personam, that is, against the status of the owner state:

755 Art. 1 and 3 Brussels Convention for the Unification of Certain Rules Relating to the Immunity of State-owned Vessels, 10 April 1926, 176 LNTS 199
757 Ibid Art. 2
758 Halsbury's Laws of England Para 310
If the defendant enters an appearance, an action in rem becomes, or continues also as, an action in personam; but the Admiralty jurisdiction of the High Court may now in all cases be invoked by an action in personam, although this is subject to certain restrictions in the case of collision and similar cases, except where the defendant submits or agrees to submit to the jurisdiction of the Court.  

The Admiralty Court of the Queen’s Bench Division of the High Court has the jurisdiction to adjudicate in proceedings in rem against ships belonging to another state, under Part 61 of the Civil Procedure Rules (Admiralty Claims) and the associated Practice Directions and Amendments. Admiralty claims in personam operate under Part 58 of the CPR (Commercial Claims). Actions in rem have a clear advantage in promoting resolution because items are tangible, and upon identifying their whereabouts, can be seized and disposed of. However, in personam orders play an important supporting role in ascertaining the identity of the actual owner where a dispute on its propriety arises. This brings the technical perspective of English law into the practical enforcement of the principle.

From a more practical perspective, an action in rem, against a physical asset, can be made against state owned ships used for commercial purposes: they can be ‘arrested’. According to Section 10(2) of the SIA (1978):

A State is not immune as respect (a) an action in rem against a ship belonging to that State; or (b) an action in personam for enforcing a claim in connection with such a ship if, at the time when the cause of action arose, the ship was in use or intended for use for commercial purposes.

The primary objective of an action in rem is satisfaction of the claim from the property seized, including the cargo, freight or the proceeds of sale of the ship. Therefore, from a tactical perspective, it is important that the subject vessel is within the jurisdiction of the court when the application to enforce the debt payment is

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759 ibid
762 However, The State Immunity (Merchant Shipping) Order 1997 gave an exclusive position to Russia Federation, Republic of Ukraine and Georgia, namely their Ships or cargo would be arrested, even where used in commercial activities; the Consular officer of the state in London would be informed. *Bridge Oil Ltd v Owners and/or demise charterers of the ship ‘Guiseppe di Vittoria’* [1998] C.L.C. 165. The 1997 Order was subsequently revoked by State Immunity (Merchant Shipping) Order 1999
made. The writ is globally binding, including on those who may dispute the claim of the applicant.

B) Proceedings Against a State’s Aircraft

The aeronautical industry has tremendous value to a nation, both in terms of commerce and national pride, as well as security. They fly the national flag, demonstrating economic power and wealth. Arbitral awards against states can be executed through the seizure and sale of such assets. The SIA (1978) is silent on the issue of state immunity regarding such assets, so analogy is drawn with the status of shipping vessels belonging to a state. It has been noted that property of the state can be subject to the process of enforcement, and be seized or arrested if used for commercial purposes. Analysis of published case law shows no orders relating to state aircraft in relation to the satisfaction of an arbitral award, however, this does not mean that it is impossible. The silence of the SIA (1978) on this matter may represent an underestimation of the value of an aircraft to a state, although Parliament may have envisaged a situation where the discretion of the court is unrestricted.

The seizure of ships and aircraft as tangible property appears simple in principle, with the declaration of enforceability of an award, on either an interim or final basis; with the creditor instructing a bailiff to seize specific property. This can be done with remarkable speed, as was discovered by the Thai Prince Maha Vajiralongkorn, who had his plane seized at Munich airport within a few hours, by a creditor seeking payment of an award of £38 million. Where a high degree of sensitivity is involved, a creditor needs to ensure they have acted in good faith. In the TMR Energy Ltd. v State Property Fund of Ukraine case, arising from a Swedish tribunal award that was heard in Canada, and appeared to support the granting of an order against state aircraft. The adjudication was set aside by the Canadian Supreme Court for public policy reasons. The State Property


TMR Energy Ltd. v State Property Fund of Ukraine and State Property Fund of Ukraine (ANTK Antonov).
Fund of Ukraine (SPFU), a state body, failed to perform its joint venture contractual duties with TMR, a Cypriot investor, causing loss and leading to successful arbitration proceedings in Stockholm. Registration for enforcement in Canada led to the Federal Court issuing a writ of seizure and sale against assets of the SPFU, including a heavy lift cargo aircraft owned by the state of Ukraine.

TMR also applied ex parte for, and was granted, recognition and enforcement of the award in the Supreme Court of Newfoundland and Labrador to facilitate asset seizure.\textsuperscript{766} Although the SPFU and the Ukraine had filed challenges to recognition and enforcement, arguing immunity; and TMR was aware of this contention, it had not disclosed this at the hearing for recognition and enforcement. TMR argued that Articles 3 and 4 of the New York Convention (1958) applied, and that their action was ‘intended to operate as a summary procedure’ attached as a schedule to the Newfoundland and Labrador International Commercial Arbitration Act; and thus did not require them to submit extensive documentation or satisfy broad disclosure requirements for recognition.\textsuperscript{767} This disingenuous assertion was not accepted, and Article 5(2) of the New York Convention (1958) permitted the Court to refuse to grant recognition and enforcement on public policy grounds. The applicant, in an ex parte application, must exercise utmost good faith; the non-disclosure by TMR of the potential impact of the Canadian State Immunity Act (1985) on the registration, recognition or enforcement of the award was a material fact that justified not making an order until the issue was resolved.\textsuperscript{768}

7.7 Conclusion

The assertion of state sovereign rights has a major impact on the enforcement of international awards that are granted following the finding of responsibility for unacceptable conduct. Recalcitrant sovereign states tend to be enthusiastic when accepting foreign finance to aid economic development, but are unwilling to meet their obligations if its policies, or other matters beyond their control, damage the project and the interests of their contractual partners. International organisations such

\textsuperscript{766} ibid Para 1-5
\textsuperscript{767} ibid Para 58
\textsuperscript{768} ibid Para 77
as the World Bank and the International Monetary Fund facilitate the process of enforcement, but their intervention and sanctions have a greater, disproportional effect on developing countries. The main declared purpose of such organization is to assist in the financing of state economic development through provision of loans to assist with strategic planning. The legal system in the UK has considerable experience, along with a reputation for independence, as well a wide range of powers to enable foreign investors to become involved in projects which may carry some risk.

It is unforgivably remiss not to incorporate an arbitration clause within the project investment agreement or BIT. A balance of influence and power between the sovereign state and the private investor in the event of a dispute must be created and preserved. Failure to do so deprives the investor of the opportunity to seek redress and enforcement from the neutral ICSID Convention. Arbitration is the ‘friend’ of the weaker party to the agreement, and it is only on the grant of an award that the assistance of the courts of England can be sought for enforcement.
Chapter Eight

Findings and Proposals for Change

This thesis has tried to examine the principle of state sovereignty, and its impact on investor-state disputes under public international law in general and investment law in particular. The thesis has scrutinised the role of investment arbitration in rebalancing the role of the investor. The legal framework in England has, due to its history, influence and experience, served as a benchmark for this research. The purpose of this study was to consider the extent to which the state may use its sovereign superiority in regulating its relationship with a foreign investor, and the suitability and efficacy of using the investor-state arbitration process to minimise any potential exploitation of a host state’s authority. The principle objectives of the research have been to:

1. Examine the impact and limitations of state sovereignty in the context of the rights and entitlements of a foreign investor. In analysing this dimension, it has become clear that the arbitration process requires improvement.

2. Consider whether the current international customary and investment precepts of law offer adequate protection to foreign investors faced by the power held by a host state power.

3. Examine whether a host state can refuse to implement and satisfy a foreign arbitral award, asserting sovereign immunity by the invocation of its domestic law.

4. Explore whether current international investment law and the UK Sovereign Immunity Act (1978) adequately balance the demands of state sovereign immunity in investment arbitration and the protection of the rights of a foreign investor in a dispute.

5. Consider if a claimant is able to enforce an arbitral award against a state or its assets, under international investment law in the jurisdiction of England and Wales.

8.1 The Impact and Limitations of State Sovereignty

It is clear that there are limitations placed upon the exercise of state sovereignty, when considering the rights of a foreign investor. Such restrictions may be incorporated into
a bilateral investment treaty between the states concerned, or written into the specific investment contract itself. Customary international law also has a role to play in the constraint of unrestricted host state action, allowing sovereign authority to be negotiated in the attempt to attract foreign investment. Investors are likely to understand that the absence of limitations on formal sovereign power poses a considerable risk to their business, and host states acknowledge that without such restrictions, there will be little prospect of attracting foreign resources into the economy; and as a consequence, regulations have been established in order to improve the protections available to a foreign investor. Nevertheless, all business transactions involve a degree of risk, to secure potentially significant rewards. This is particularly true in the international commercial arena, where the degree of uncertainty may be termed ‘country risk’, present in alternative national economic frameworks, political administrations and philosophies, socio-political cultures and institutions, even the physical geography or currency.\textsuperscript{769} This concept of ‘risk’ carries with it the implication that uncertainty can be easily assessed and defined. In reality, such assessment involves a complex exercise of information gathering and observation on a scale significant enough to develop a statistical basis upon which to appraise a risk-reward equation that can be scrutinised under a probability analysis. An investment opportunity that is beyond the scope of such analysis carries with it a high degree of uncertainty.\textsuperscript{770}

A host state earmarked for possible investment will be subject to a risk assessment of its legal, economic and political stability, conducted by major companies and financial agencies, considering the investment environment and its attractiveness to foreign investors.\textsuperscript{771} Non-commercial aspects of the political and socio-economic environment of a host that could affect the safety and viability of the investor project will also be explored. Such analysis is not synonymous with sovereign risk, as the assessment considers the more general downside of a country’s business environment rather than the sovereign credit risks arising from default on any commercial debt

\textsuperscript{770} ibid
obligations. Both types of risk analysis are necessary, as “country risk” provides an indicator of the stability of the business environment for foreign direct investment (FDI); whilst sovereign risk analysis assesses the ability and stability of a state to pay its bills, which is particularly relevant to portfolio investment, providing an investor with a wider impression of the macro policies of a host state.

There remains the prospect that a host state may exercise their sovereign authority to the detriment of the foreign investment, despite thorough risk assessment and the existence of an agreement, whether a treaty between states or a specific contract provision. Businesses must then decide whether or not to advance with their investment plans, drawing upon expert advice, using a well drafted and managed contractual process, in a trade environment governed by a bilateral investment treaty that includes an arbitration clause to resolve any dispute. Exercising sovereign power also has considerable consequences for a host state, as if it fails to honour its own agreement clauses, choosing to impose its sovereign will upon a foreign investor in such a way that is likely to harm the profitability and effectiveness of a project, this will not only damage the prospect of attracting future investment, but also alienate that which is already there.

8.2 Protection Available to the Foreign Investor

With regard to the second question on the legal protection of foreign investor’s interests, there are two types of protection guarding against a host state’s unilateral exercise of power, particularly where the pretext of sovereignty is used as justification. State responsibility will arise where the alleged breach is one of customary international law or of a bilateral investment treaty, and liability will be exercised if the breach is of the specific contractual agreement. The protections of customary international law generally do not require the presence of a prior agreement between either the treaty states or the contract parties in order to ascertain the just limitations on host state sovereign action in dealings with a foreign investor.

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772 Marcel Heinrichs and Ivelina Stanoeva, Country Risk and Sovereign Risk-Building Clearer Borders Euromoney Handbook, Page 15

773 MIGA (n771) 22-23
Boundaries are set in order to prevent the breach of the principles of international trade and fair treatment, including the denial of justice, unjust enrichment of the state at the expense of the foreign investor, the provision of full protection and security, and international minimum standards of treatment. These obligations upon a host state apply even where they are not specifically negotiated between treaty states and contractual parties, and therefore a foreign investor can reasonably be expected to acquire these protections as a result of their relationship with a state partner. Indeed, such protections may be more extensive under customary international law than those negotiated between treaty states.

A contractual investment agreement governs the relationship between a host state and a foreign investor, and is project specific. Liability arises under the contract where the use of sovereign powers breach agreed obligations. Different liabilities and responsibilities arise, depending on which obligation is breached, whether contractual or inter-state bilateral treaty, or both. There will inevitably be some overlap between the international customary and international investment laws where state action contravenes both systems. Such a situation will have a significant impact on the issue of state responsibility for the transgression, and the liability to compensate for it. It is useful to consider the following examples:

Where state action is considered to be in breach of both customary international law and the inter-state bilateral treaty, the domicile state of a foreign investor has the option to pursue a double claim, before the International Court of Justice (ICJ) for contravention of customary international law; and before the arbitration tribunal for the breach of the bilateral investment treaty (BIT). This may occur where, for example, a host state act violates the ‘most-favoured-nation’ treatment expected under a treaty; coupled with a denial of justice by the court of the host state, which is in breach of customary international law.

Claims under both a treaty and a contract would also arise where a sovereign act of state breached both agreements. This is problematic, as any such claims may be
pursued in different jurisdictions without using the principle of *lis alibi pendens* with the potential for contradictory judgments on the same course of action.\(^\text{774}\)

A problem may also arise if a foreign investor may wish to pursue a claim against the host state to the ICJ for breach of customary international law, on the basis of state responsibility. Where the BIT does not incorporate an arbitration clause, a foreign investor must go through the diplomatic protection channels of their domicile state. An assumption is made that the domicile state will give its investor the benefit of diplomatic assistance, prompting a claim to the ICJ, and that this will be accepted by the host state whose initial action caused the problem. The expectation exists that a host state will appear voluntarily, to answer the complaint, as there is no method of enforcement available to the ICJ without its compliance. In contrast, proceedings issued under ICSID rules, commercial arbitration or the New York Convention (1958) may enforce arbitral awards, even if a host state fails to appear before it, or comply with its outcome. Such arbitration, and its capacity to take more direct enforcement action against a host state has a more powerful impact on a transgressing host state than action taken by the ICJ.

Treaties made between states under public international law in the pursuit of global trade provide a fundamental framework for investor-state arbitration. Bilateral instruments between individual states currently number more than 3,000 BITs, and these are supplemented by numerous, intricately negotiated, multilateral agreements, such as the ICSID Convention and the Energy Charter Treaty, as well as more regional treaties, including the North American Free Trade Agreement (NAFTA) and the Central American Free Trade Agreement (CAFTA).\(^\text{775}\)

The International Court of Justice, despite an illustrious history and connections to the United Nations, does not actually possess a mechanism of enforcement of its judgements, or a monitoring or policing body to exact compliance with its decisions.\(^\text{776}\) Dependence is placed instead on what Desierto terms a ‘horizontal

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\(^{774}\) See Chapter 4


\(^{776}\) Constanze Schulte, *Compliance With Decisions Of The International Court Of Justice* (Oxford University Press 2004) 36-38
relationship with the United Nations Security Council for the enforcement of its
decisions’. The process starts with what appears to be a promise made under
Article 94(1) of the United Nations Charter, which states that ‘[e]ach Member of the
United Nations undertakes to comply with the decision of the International Court of
Justice to which it is a party’; followed by Article 94(2), which outlines the somewhat
imprecise consequence of non-compliance:

If any party to a case fails to perform the obligations incumbent upon it under
a judgment rendered by the Court, the other party may have recourse to the
Security Council, which may, if it deems necessary, make recommendations
or decide upon measures to be taken to give effect to the judgment.

If the UN Security Council does not garner sufficient support for a given sanction, the
state seeking to enforce the judgment of the Court

Could take non-forceful measures such as reprisals, for example, by seizing
the assets of the defaulting State within its jurisdiction. It could try to gain the
cooperation of a third State by asking it to use its own power to deprive the
defaulting State of certain rights.

Enforcement of international decisions from such an august body must seek to
balance both law and politics. In contrast, it is striking that even national domestic
courts hold the power of persuasion over their executive branch to enforce their writs,
orders, and judgments, as they may be required to do so under ICJ adjudication.

Therefore, the international framework of arbitration appears fundamentally more
effective in resolving disputes with foreign investors than public international law
dispensed by the ICJ. This highlights the importance of the arbitration clause in
investment contracts or in inter-state BITs. Foreign investors tend not to rely on
public international law in their investment disputes, with both the ICJ and the UN
having to acknowledge differing political imperatives, being constrained by the need
to satisfy both states in any judgments. In contrast, the refusal by an irksome host
state to participate in arbitral proceedings will not prevent an arbitral tribunal from

777 Diane Desierto, The International Court of Justice in the Settlement of International Investment
Disputes (2012) 1(1) Journal of Dispute Prevention and Resolution 44
778 United Nations Charter Articles 94(1) and 94(2)
779 John Collier and Vaughan Lowe, The Settlement Of Disputes In International Law: Institutions And
Procedures (Oxford University Press 2005) 178
780 Desierto (n777) 44
hearing evidence from an investor claimant, and adjudicating in accordance therewith.\textsuperscript{781}

### 8.3 Implementation of Arbitral Awards

The domestic law of a state may require that disputes arising from major investment contracts, particularly those where the contract is considered subject to administrative law, should not be settled via arbitration. An example is provided by the Euro Disney Project in France:

In 1986, when the Administrative Supreme Court was consulted by the government on the possibility to insert an arbitration agreement in a contract between French administrative bodies and the Walt Disney company in connection with the Euro Disney project. The Administrative Supreme Court referred to Articles 2060 and 2061 of the Civil Code and surprisingly concluded that the contract between the French State, other state-owned entities and Walt Disney Productions, a U.S. company, should be governed by French domestic public policy rules, and ‘not governed by principles applicable to international commerce.’\textsuperscript{782}

The French legislature, in the enactment of its law, was conscious of the limiting effect of international arbitration on the sovereignty of the state and sought to prevent its dilution. As a result of the Disney decision, French law has been modified to ensure compatibility with international law and specifically Article 27 Vienna Convention on the Law of Treaties which states:

A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty.

The BIT between the USA and France accepted that the arbitration clause would be accepted and promulgated more usually within the ‘administrative’ contract in France.

This study addresses and resolves the circumstances where an investment contract may be agreed and signed by officials who lack the appropriate authority under the domestic law of the state, especially where that contract includes an arbitration clause.

\textsuperscript{781} Art. 45 ICSID Convention (n\textsuperscript{3})

and the state attempts to resist the obligation to arbitrate in an international forum. This affects analysis of potential investment risk, due to the inherent need for an administrative contract to adapt and change in accordance with the host state domestic law from which it derives. This will usually accompany the assertion that the law is revised by the state to improve its own position and to negate or undermine the contractual rights of an investor, particularly where direct expropriation is evident or where domestic tax or economic policies are amended. Administrative acts is usually benefit state enterprises. However, they may also detrimentally impact on competitors or foreign investment partners, even releasing the state from its obligations made under contracts, justified by the claim of *ultra vires*.\(^{783}\) This difficulty has been resolved by Article 7 ILC Draft Article on State Responsibility:

> The conduct of an organ of a State or of a person or entity empowered to exercise elements of the governmental authority shall be considered an act of the State under international law if the organ, person or entity acts in that capacity, even if it exceeds its authority or contravenes instructions.

### 8.4 International Investment Law and the State Immunity Act (1978)

This research has shown that international investment law and the UK Sovereign Immunity Act (1978) honour the principle of state immunity in the regulation of its impact on investor-state disputes. They incorporate a differentiation in the treatment of an act of state, when exercised in the context of sovereign dominion, *acta jure imperii*, or in the circumstances of a business merchant, *acta jure gestionis*. However, complications arise when a measure is taken that is a combination of both; in recognition of inherent sovereign authority, there is no sanction for dominion acts where the state engaged in a commercial transaction as part of the same enterprise, or where the *act jure imperii* relates to the breach of an agreement that incorporates an arbitration clause.

However, a state is not accorded absolute immunity in its dealings with foreign investors, as such engagements are generally considered to be commercial in nature. It is more a question of finding a balance between competing international principles, preserving state sovereignty over the manner in which it exercises its public duties on its home territory and in relation to foreign states; whilst avoiding harm in contractual

\(^{783}\) Böckstiegel (n775) 579
relationships with those who, as a consequence of their investment, bring much needed economic development. In the context of investor-state arbitration, the ICSID stresses, in Article VI (43) that the convention does not impose enforcement where it will be contrary to the principle of immunity of the state, subject to an adverse judgement:

The doctrine of sovereign immunity may prevent the forced execution in a State of judgments obtained against foreign States or against the State in which execution is sought. Article 54 requires Contracting States to equate an award rendered pursuant to the Convention with a final judgment of its own courts. It does not require them to go beyond that and to undertake forced execution of awards rendered pursuant to the Convention in cases in which final judgments could not be executed. In order to leave no doubt on this point Article 55 provides that nothing in Article 54 shall be construed as derogating from the law in force in any Contracting State relating to immunity of that State or of any foreign State from execution.⁷⁸⁴

Section 13(2) of the SIA 1978 appears to bring little promise of hope for an investor, stating that;

(a) [R]elief shall not be given against a State by way of injunction or order for specific performance or for the recovery of land or other property; and (b) the property of a State shall not be subject to any process for the enforcement of a judgment or arbitration award or, in an action in rem, for its arrest, detention or sale.⁷⁸⁵

Nevertheless, Section 13(3) and (4) somewhat ameliorate the strictly preventative nature of the law, seeking to introduce a balance to investor rights when faced with the sovereignty dilemma.

Subsection (2) above does not prevent the giving of any relief or the issue of any process with the written consent of the State concerned; and any such consent (which may be contained in a prior agreement) may be expressed so as to apply to a limited extent or generally; but a provision merely submitting to the jurisdiction of the courts is not to be regarded as a consent for the purposes of this subsection […] subsection (2)(b) above does not prevent the issue of any process in respect of property which is for the time being in use or intended for use for commercial purposes.⁷⁸⁶

Therefore, UK law seeks equilibrium between parties, where an investor seeks to enforce a judgment against state property, which had previously formed part of a recalcitrant state’s commercial portfolio.

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⁷⁸⁴ Art. VI(43) ICSID Convention (n3). Report of the Executive Directors on the Convention
⁷⁸⁵ s.13(2) SIA 1978
⁷⁸⁶ s.13(3) and (4) SIA 1978
8.5 Enforcement of Arbitral Awards

The fifth question considers the enforcement of arbitral awards, by examining how claimants gain access to the assets of a host state where a claim of sovereign immunity against execution has been turned down. The international approach is less formal, and has various dimensions. Diplomatic pressure may be exerted by the domicile state of an investor, acting as a guardian of its interests; while financial pressure is imposed by an investor’s domicile state upon international institutions directly, with the aim of persuading them to exclude the recalcitrant host state from its list of beneficiaries; or, indirectly, by undermining its global credit rating, which can hamper the attraction of foreign investment.

8.6 Means of Judicial Enforcement

The legal system of England and Wales was considered as the benchmark for this study, although other countries have their own frameworks for recognition and enforcement. The jurisdiction of England and Wales offers numerous opportunities for an injured investor to seek just recompense. Enforcement of foreign arbitral awards may be made by the Common Law; under Part II of the Arbitration Act (1950), where it comes within the Geneva Protocol or Convention; under Part III of the Arbitration Act (1996) if the award was made pursuant to the New York Convention (1958); or under Section 66 of the Arbitration Act (1996) by summary procedures. In the interests of completeness, other enforcement options in the English courts include awards made in one country that can be enforced in another under Part II of the Civil Jurisdiction and Judgements Act (1982); made in countries to which Part II of the Administration of Justice Act (1920) applies; or to which Part I of the Foreign Judgments (Reciprocal Enforcement) Act (1933) has been extended and can be enforced in England as if it were a judgment by registration under that legislation. Under the Foreign Judgments (Reciprocal Enforcement) Act (1933) pursuant to a contract for the international carriage of goods by road may be enforced by registration; and under the Washington Convention and Arbitration (International Investment Disputes) Act (1966) may be registered for enforcement as if it were a judgment. Under the Multilateral Investment Guarantee Convention, enacted by the Multilateral Investment Guarantee Agency Act (1988), pursuant to the Washington
Convention, and finally, where an arbitral award has been made enforceable by judgment in a foreign country, it can be enforced in the same way as any other foreign judgment.\textsuperscript{787}

This choice of enforcement available to a successful litigant not only demonstrates the principles of the English courts in seeking a just final resolution, but also permits tactical decisions to be made, depending on a litigant’s assessment of the prospects of a successful outcome. For example, where the Geneva Convention applies, the enforcement method provides a choice between Section 36(1) Part II of the Arbitration Act (1950), Section 66 of the Arbitration Act (1996), or by action in Common Law. Alternatively, under the auspices of the New York Convention (1958), a choice can be made between Section 101 Part III of the Arbitration Act (1996), as well as Section 66 of the 1996 Act or under Common Law. Additionally, the country from which an award emanates may prompt enforcement under the Administration of Justice Act (1920) or the Foreign Judgment (Reciprocal Enforcement) Act (1933), enforced upon proper registration. Furthermore, registration as a judgment under the Administration of Justice Act (1920), the Foreign Judgments (Reciprocal Enforcement) Act (1933), or Part II of the Civil Jurisdiction and Judgements Act (1982) does not prevent a successful litigant from seeking enforcement of payment at Common Law or under Section 66 of the 1996 Act.\textsuperscript{788}

There are various means of securing payment of the judgment in English law. The Garnishee Order is one particularly drastic measure, allowing the seizure of money belonging to a recalcitrant state held in bank accounts in the England and Wales jurisdiction, where they hold the proceeds of commercial transactions undertaken by the state; the burden of proof of this source of funds lies with a foreign investor creditor. However, such accounts may be held upon the order of a host state’s central bank, as in the Kazakhstan case, or be used for sovereign purposes, such as meeting the expenses of a national embassy. Here the burden of proof is on the state, and precedent shows that the certificate of an ambassador carries considerable weight.

\textsuperscript{788} ibid 618
The Charging Order and Order of Sale both target the tangible property of a host state, such as buildings or land; and the intangible assets, like stocks and shares. A foreign investor will seek to secure sufficient funds to execute their award, by obtaining a charge on as many assets of the host state as possible. The advantage of intangible stocks and shares over land is their relatively simple conversion to cash. Tangible property requires the organisation of an auction, an assessment of market value and the finding of purchasers, and therefore foreign investors will usually seek more easily liquidated property upon which to attach a Charging Order and Order for Sale. Land and buildings may be more valuable, and indeed prove to be of greater worth than the total of the debt payment sought, and will serve as an incentive to a recalcitrant state to comply with its obligations. A Writ of Control, formally known as *fieri facias*, has a similar effect, and is executed by the sheriff upon permission from the court. An action *in rem*, ‘against the thing or property’ may be undertaken against the ships or aircraft of a recalcitrant state, where they are used for commercial proposes. This is a popular remedy, because it has visible results and is not dependent on the owner being present, so long as it is identifiable as commercial property of the state. It also provides security for the execution of the judgment in a manner that proceeding against an individual *in personam* would not.\textsuperscript{789}

**8.7 Proposals for the Development of Investment Agreements**

The purpose of this study has been to explore the mechanisms available to protect the efficacy of the investor-state agreement, and to seek to provide proposals for how current international investment law and investment arbitration could balance the interests of a foreign investor and a host state. The proposals made here outline the national and international efforts made to achieve equilibrium between apparently conflicting interests both seeking advantage. The author argues that once these steps are taken, it will encourage and increase the number of FDI projects within both developing and developed states. There are a number of issues that must be considered by each legislature, arbitral tribunal or international body responsible for devising regulations and operating the framework within which investment disputes are resolved.

In the interests of enhancing the protection available to foreign investors consideration should be given to the amendment of Article 25(2)(a) of the ICSID Convention, to allow natural persons with dual nationality to qualify for such safeguards as the convention provides. At the very least, the effective link approach should be applied to domicile status, where a host state national actually resides elsewhere, as effected under customary international law. This would engender a degree of stability in the protection of investors who have an effective link to a home state that is not the contracting host state. However, it would also provide an incentive for a host state investor to seek alternative nationality, perhaps on payment of a premium, in order to sue their natural home state in the event of problems with an investment. Nevertheless, the effective link test is customarily investigated where claimed, and is usually applied carefully and with discretion on a case-by-case basis. In the Mergé case, for example, elements of ‘real and effective nationality’ were measured through an individual’s circumstances, including their ‘habitual residence, his participation in public life, attachment shown by him for a given country and inculcated in his children.

Much consideration is given to the rights of the investor, arguably at the expense of the sovereign interests of a host state. In the interests of fair, reasonable and acceptable adjudication, an arbitral tribunal should acknowledge that the ICSID Convention also consider a state’s concerns and rights. Nations including Venezuela have espoused that there has been insufficient recognition of their statehood entitlement given by the Arbitration Centre, verging on bias. Venezuela subsequently withdrew from the ICSID Convention in 2012. It is therefore suggested that the credibility and acceptability of arbitral tribunal decisions could be enhanced by changes in the way it operates.

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790 The latest amendments of the ICSID Regulations and Rules adopted by the Administrative Council of the Centre came into effect on April 10, 2006. See ICSID Convention Introduction (n3).
791 Nottebohm case (the effective link) (n75)
792 Art. 25(2) ICSID Convention defines the ‘National of another Contracting State’ as ‘(a) any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration’.
793 Mergé Case, 14 R. Int’l Arb. Awards 236 (Italian-U.S. Conciliation Commission 1955) at 244 citing Nottebohm, cited in Timothy G. Nelson (n76) 457
In the case of direct expropriation, the arbitral tribunal should base its assessment of fault and value of an action on the specific seizure of control of the assets of a foreign investor. This may be the date of the executive decree, or of the police action of seizure. Where expropriation is ‘creeping’ it may be difficult to identify an active date, as the process is iterative and prolonged. The decision reached upon when to base adjudication or valuation can lead to a potential injustice for a host state, albeit that its behaviour will have given rise to the claim. A sovereign act of a host state, which is a breach of contract or BIT should not however be classified as ‘creeping expropriation’, for vigilance in the protection of its own interests should fall to a foreign investor.

In the event of a breach of both a contract and a treaty obligation and, where one is incorporated, the contract forum clause of any contract will prevail over the BIT framework, in order to avoid the double jeopardy issue that effectively prejudices the interests of the state, as parties in an investor-state dispute risk their adversary resorting to an alternative jurisdiction, different arbitral institution, or a combination of tribunal and national court; potentially resulting in the issuing of two arbitral awards by two different arbitral institutions, with the associated enforcement complications. However, the conflict between institutions, whether tribunals, courts or both, hearing the same facts and cause of action, and potentially producing differing judgments, results, are not insurmountable. This problem arose in the CME v Czech Republic case, where an investment dispute, involving undisputed facts, produced conflicting awards from arbitral tribunals held in London and Stockholm, and gave rise to litigation in the Czech Republic, the US and Sweden.794

Where a dispute is the subject of proceedings in two or more arbitration institutions, by virtue of separate applications made under a contract and the BIT, such clashes in jurisdiction can be resolved upon the issuing of a notification from the investor that has commenced proceedings, to the state to attend a particular arbitration panel, thereby informing the other arbitral institution that the cause is seized elsewhere. The defendant state should then take action to declare its case, and the alternative arbitral panel can cease the process that duplicates the case. The matter should be decided

794 Redfern and others (n631) 30
upon by whichever tribunal seized the matter first, leading to a simplification of the enforcement procedure.

The domestic court of a host state may find itself seized of an application by its governing state by virtue of an investment contract that subsequently proceeds to international arbitration by tribunal under the contract agreement or the inter-state BIT. There is then the potential for a foreign judgment and separate arbitral award to be made on identical issues of dispute between the same parties that are then brought to the same venue for enforcement. Methods of enforcement for foreign judgements are not the same as those for a foreign award, raising the question of which will be utilised. It has been noted that the courts of England and Wales will enforce a foreign arbitral award under Section 32 of the Civil Jurisdiction and Judgements Act (CJJA 1982), but will refuse to recognise or enforce a foreign judgment if the proceedings from which it resulted were ‘contrary to an agreement under which the dispute in question was to be settled otherwise than by proceedings in the courts of that country’; for example, contrary to the arbitral agreement.795

A dispute based on the same facts may come for settlement, via an investment contract, to the domestic courts of two countries, rather than an arbitral institution. Under English law, it has been suggested that a foreign judgment made in a member state of the Lugano or Brussels Jurisdiction, and the Brussels Convention Enforcement of Judgments in Civil and Commercial Matters Convention (1968) should be differentiated from one made in a non-contracting state.796 Article 27(5) of the Brussels Convention will be applied ‘if the judgment is irreconcilable with an earlier judgment given in a non-Contracting State involving the same cause of action and between the same parties, provided that this latter judgment fulfils the conditions necessary for its recognition in the State addressed’.797

In the enforcement against states context, Article 54(1) of the ICSID Convention makes it obligatory for each contracting state to

796 Redfern and others (n631) 196
797 Art. 27 Brussels Convention
Recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State.\footnote{Art. 54(1) ICSID Convention (n3)}

The possible result of an investor-state arbitration process is the lack of a specific mechanism for managing enforcement arising from parallel proceedings. A foreign investor in dispute with a host state may achieve a favourable judgment, and subsequently seek to enforce this award in one of the many states signed up to the ICSID convention (if that is the source of the award), or the New York Convention (1958), should that be its origin. There is no provision in either convention to inhibit enforcement to a single specific signatory nation, and an investor may be inclined to attempt to secure enforcement in several countries, and thereby multiply the amount of the judgment. If it is assumed, by way of an example, that a foreign investor gains judgment in the amount of US$100 million against a host state, they may enforce it in the UK by ex party order, which, due to the nature of the application, the host state does not receive notice of. The same judgment is then transported to the U.S. for enforcement, and then Germany, until the investor, who is either vacillating or seeking unjust enrichment, runs out of states to utilise. Co-operation of signatory states with their convention obligations, a lack of communication or of host state oversight, may (technically) result in the accrual of several hundred million dollars in excess of the original award.

It is logical to resolve such activity that inhibits the process of justice via establishment of an international court for the consolidation of procedures and enforcement of the arbitral awards. Currently, there is a lack of harmonious interaction between the domestic laws of states that handle recognition and enforcement, giving rise to different standards in the implementation of principles of justice. As a consequence of the efforts from both practitioners and academics for the standardisation of international commercial arbitration, it has been suggested that a new court should replace the variety of national approaches to the recognition and enforcement of arbitral awards. Such a body of jurists would, suggests Judge Holtzmann,

Promote uniform standards and predictability. In addition, it would be better positioned to avoid the delays that are often experienced in crowded municipal
courts where it can take years to reach a final judgment. Also, it would facilitate international trade and investment by reducing the risks and uncertainties that business people fear when they must submit their affairs to the court of a foreign country.\textsuperscript{799}

The achievement of such an international consensus would face considerable obstacles. However, including an appended clause to a protocol in the ICSID and New York Conventions could specify the rendering and enforcement of an award in a specific state, thus resolving the issue of the pursuit of multiple payments.

The existence of such a court would further promote the protection of individual investors and companies, through providing direct access to the ICJ as an inter-states tribunal. In the Barcelona Traction case, decided nearly forty years before the Diallo case,\textsuperscript{800} the Court advanced the general rule on companies’ diplomatic protection

Where it is a question of an unlawful act committed against a company representing foreign capital, the general rule of international law authorises the national State of the company alone to make a claim.\textsuperscript{801}

Therefore, individuals and companies that are not supported in their actions by their domicile state, usually for reasons of inter-state relationships and diplomacy, will have the opportunity to assert that their rights have been breached by the host state.

Pursuant to the support of the efficacy of awards, any international court of justice would need to ensure that it incorporated a commission to supervise and ensure the implementation of its judgment; these are currently lacking, calling into question its ultimate effectiveness.\textsuperscript{802} The implementation of an ICJ judgment, where issues of diplomatic protection arise, has largely been conducted by the domicile state of a foreign investor, relying on the good auspices of the host state against which the ICJ judgment is made; as there is no method of enforcement held by the tribunal. The UN, of which the ICJ forms a part, is not enthusiastic in using its diplomatic, multi-state role regarding enforcement and supervision of investment matters. Therefore, the

\textsuperscript{800} Ahmadou Sadio Diallo, \textit{Republic Of Guinea V Democratic Republic of The Congo} International Court of Justice, Judgment 19 June 2012. This clarifies the scope of Diplomatic Protection of Corporate and Shareholder Rights.  
\textsuperscript{801} Barcelona Traction (n97) Para 88  
\textsuperscript{802} For example the U.S.-Iran and U.S.-Mexico commissions}
establishment of a permanent commission pursuing human rights issues on behalf of
an investor, such as denial of justice by a host state, may have to prove adequate at
this stage.

Confidence in the decision-making of the foreign investor will, in the view of author,
be increased in the ability of the English jurisdiction to settle differences with
sovereign states where somewhat unhelpful issues with the State Immunity Act 1978
resolved, It will be recalled that Section 13(2) of the SIA 1978 asserts that, subject to
subsections (3) and (4),

(a) Relief shall not be given against a State by way of injunction or order for
specific performance or for the recovery of land or other property; and (b) the
property of a State shall not be subject to any process for the enforcement of a
judgment or arbitration award or, in an action in rem, for its arrest, detention
or sale.803

Section 13(3) requires the ‘prior consent’ of a host state in order to impose the
injunction relief against its assets, stating that:

Subsection (2) above does not prevent the giving of any relief or the issue of
any process with the written consent of the State concerned; and any such
consent (which may be contained in a prior agreement) may be expressed so
as to apply to a limited extent or generally; but a provision merely submitting
to the jurisdiction of the courts is not to be regarded as a consent for the
purposes of this subsection.804

This leads to practical difficulties, as it is hard to envision when a recalcitrant host
state would ever give its consent to impose an injunction relief on its assets. It is
therefore the opinion of the author that Section 13(3) should be amended to
encompass injunctive relief against a host state, given the obvious weaknesses
contained in the current provision, which does not support what effectively is a
unilateral application.

Section 13(4) avers that where immunity applies to the protection from enforcement
under Section 13(2)(b), this does not apply to the issue of proceedings aimed at
securing property ‘for the time being in use or intended for use for commercial
purposes’. Therefore, the position of injunctive relief appears less important than the

803 s.13(2) SIA 1978
804 s.13(3) SIA 1978 (emphasis added)
enforcement process itself in securing the payment of an award. Such enforcement should not have to require the prior consent of a host state in order to be available to an investor. This is especially so where enforcement is sought against assets ‘for the time being in use or intended to be used for commercial purposes’.

Another change will be necessary; specifically in Section 13(5) of the SIA 1978 states that

[T]he head of a State’s diplomatic mission in the United Kingdom, or the person for the time being performing his functions, shall be deemed to have authority to give on behalf of the State any such consent as is mentioned in subsection (3) above and, for the purposes of subsection (4) above, his certificate to the effect that any property is not in use or intended for use by or on behalf of the State for commercial purposes shall be accepted as sufficient evidence of that fact unless the contrary is proved.

This aspect of the legislation seems untenable in its present form. Ambassadors are not neutral parties in investor-state claims, and instead are subject to the demands of the state they represent to issue a certificate. It is inappropriate that their certificate will be accepted as ‘sufficient evidence’ that the property subject to award enforcement attention is used solely for sovereign purposes, shifting the burden to prove to the contrary to an investor. States may utilise their employees to act in the best interests of their people, but in the interests of justice, the court should call for a neutral investigation to establish the nature of properties. The expense of such an independent investigation should fall on the losing party, with the appropriate proportion of costs.

It would be advantageous and productive to consider amendment to section 14(4) SIA 1978, given that it somewhat problematically enacts the

Property of a State’s central bank or other monetary authority shall not be regarded for the purposes of subsection (4) of section 13 above as in use or intended for use for commercial purposes; and where any such bank or authority is a separate entity subsections (1) to (3) of that section shall apply to it as if references to a State were references to the bank or authority.

The resources of the central bank of a recalcitrant state, or indeed any ‘other monetary authority’ accounts, currently hold an almost blanket immunity exemption from

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805 s.13(5) SIA 1978
adjudication enforcement. However, access is necessary for freezing or seizure, where funds held therein result from or are used for commercial activities. This is particularly so when the central bank concerned is engaging in a commercial transaction with a foreign investor. There should therefore be a more specific definition of the term ‘other monetary authority’ to include some of a host state’s executive branches, such as the Ministry of Finance or State Treasury, which engage in commercial transactions with foreign investors on behalf of the state as a whole.

In summary, the foreign investor will seek the protection of the ICSID Convention. However that will conflict with the Article 25(2)(a) of the Convention where the investor has a dual nationality for both home and host state. This needs to be modified by ICSID to accept future claims from the dual nationality investor, and to avoid duplication of execution of their award, it is suggested that an international court be established to execute the award in specific state. Where this poses insurmountable difficulties, a clause to a protocol may be appended in the ICSID and New York Conventions which specifies the rendering and enforcement of an award in a specific state, resolving the issue of the risk of pursuit of multiple payments.

Consideration needs to be given to amendment of the UK Sovereign Immunity Act 1978 to develop a more effective way of challenging the immunity arguments of the recalcitrant state and enhance foreign investor protection. The requirement for consent of host state needs to be removed if injunction relief is to be effectively applied to its property and the ambassador’s certificate should not be unconditionally accepted as a testimony due to a bias which is anathema to the pursuit of justice. The court may alternatively instruct a neutral body or agency to determine the nature of property attributable to state ownership, and its use for sovereign or commercial proposes. Finally, the national assets of the Central Bank or any monetary fund should not be immune under the legislation from measures of execution where they are attributable to commercial transactions. In consequence, foreign investors will have greater business confidence in their dealings with host states. The State of Qatar should take the opportunity to enact effective legislation to regulate the sovereign powers of host states subject to suit in its courts, especially on the issue of state immunity against execution, in much the same manner as and improved UK SIA 1978.
8.8 Conclusion

The thesis assumes that the commercial private investor is always the more vulnerable party in investor-state agreements in the context of potentially unrestricted state sovereignty and its associated immunity. It has been suggested that this thesis should include greater acknowledgement of the role of the principle of ultra vires by apparent state representatives, as examined in Chapter Five, a State may be represented by a wide range of agencies which cannot always be relied upon to be act in the interests of that State. That is only one factor amongst several of the excuses used by recalcitrant nations to evade obligations, and sight should not be lost of the relatively more substantial importance of the other methods of resistance arising from basic immunity arguments. “Good faith” is of major importance in any contractual agreement and the foreign investors must acknowledge the onus upon them in fair dealings.

This study has sought to analyse the whole process of determination of investor-state disputes, arising as a result of foreign investment; and the problematic relationship with the concept of state sovereignty. In doing so, it has been necessary to discuss the impact of sovereign acts and the attraction of international investment, along with the preservation of existing enterprises on host territory. There has also been a detailed review of the historical development of the legal principles that currently apply. These are essential factors in the growth of industrial and economic development projects, and provide insight into the effectiveness of international arbitration, which depends not only on reaching decisions, but also on the enforcement of such findings and financial awards against a sovereign party. Consideration has been given to the growth of public, international and investment law, and the conventions and treaties that establish their operation, especially the ICSID Convention. Such conventions reflect the intention of countries to define their position, with the aim being to safeguard the efficacy of world trade and protect weaker, or less influential foreign investor parties in conflicts with sovereign host nations in Chapters One and Two respectively.
Chapter Three scrutinised the circumstances in which a host state may seek to impose its sovereign authority against a foreign investor. These can be in a number of areas of territorial governance, resulting from legal, economic and political powers of the state, and such factors are viewed as a serious risk by foreign investors. In circumstances where such action damages the interests of investors acting on host territory, public international law must adjudicate on the treatment of foreign business interests by a state. This subsequently, as examined in Chapter Four, seeks to determine a state’s responsibility in the context of a breach of public international law.

There is an interaction between public international law and the provisions of the inter-state BIT that brings the precedent system of the United Nations affiliated International Courts of Justice into an adjudication role in trade matters. Such case law and the international standards expected of state practice requires modification in order to enhance the existing protection of investor interests. The inter-state BIT increases the level of protection available to an investor under public international law, providing greater influence to the domicile home state, and more direct diplomatic influence before the ICJ. A BIT that incorporates its own arbitration clause is more powerful than that which directs disputes to the ICJ. The treaty usually includes an arbitration clause to support its investor claims before an arbitral tribunal, without the need for home state support, whereas the ICJ requires investors to possess the diplomatic support of their home state.

The Fifth chapter focused on the challenges faced by a foreign investor when in dispute with a host state. A BIT largely regulates and limits a host signatory state’s sovereign acts, whereas a specific investment contract monitors its commercial acts. It tends to be simpler to identify the breach of a BIT, given its international standing and clear parameters, which may not be the case with a specific project related investment contract, where sovereign powers are exercised in a less obvious manner, such as a change to domestic law regarding the arbitration clauses that govern an investment contract, or a claim of incapacity of the signatory official. Chapter Four also considered the problem of a conflict between judgment forums, where a foreign investor opts for resolution of a dispute via a treaty claim, while the host state is under contract via an umbrella clause; the solution being to examine the nature of the act
itself, whether sovereign or commercial, and determine appropriateness under the *Lex specialis* principle of a suitable forum for the subject matter.

In Chapter Six, an attempt was made to achieve a balance of principles between a foreign investor and a host state’s sovereign immunity with regard to the arbitration process. There has been an examination of the effect of a claim of jurisdictional sovereign immunity by a host state in defending its actions before an arbitral tribunal, but clearly such a principle can be abridged in the negotiations to establish both a BIT and a specific investment contract. Such agreements are voluntarily entered into in pursuit of economic development, and compromise is inevitable. Nevertheless, a state may seek to utilise the principle of immunity against the execution of an arbitral award that it believes contrary to its interests. The impact is likely to deprive a foreign investor of the opportunity to execute the favourable arbitral award against a recalcitrant host state, particularly where the latter claims everything it owns has a sovereign and non-commercial purpose. An alternative tactic employed by a state to circumvent an award may be to entangle the assets of a commercial and sovereign nature, claiming overall immunity on the sovereignty designation; this particularly applies to the use of national central bank accounts held overseas, and as has been noted, relies upon the certification of the national representative servant of the state, the Ambassador. Changes should be made to the UK SIA (1978), to permit a successful litigant access to state property such as central bank accounts, in order to ascertain their true nature, and must also impose a stricter burden of proof on a state regarding their status than the word of an Ambassador.

Both the suitability and efficacy of current international investment law, and the legislation of England and Wales was discussed in Chapter Seven, in order to determine whether it provides a sufficiently powerful means of enforcing arbitral awards against sovereign states. The range of extra-judicial methods of award enforcement available may prove invaluable in providing potentially successful precursors to formal proceedings in the international arena. Given its history and experience in global trade affairs, the English jurisdiction proves both an informative and sound basis upon which to base the judicial foundation of international arbitration and upon which to assess its impact on an investor-state dispute. In final analysis, it is clear that a state must carefully balance its needs and interests when it deals with
foreign investors; for while it takes a long time to build a positive international reputation and consequent wealth and economic stability, it can only take a single act to lose it, especially when such action results in a concerted effort to avoid responsibility.

It is anticipated that the proposals asserted and argued in Chapter Eight will enhance discussion on the contribution and value of methods of protection for the foreign investor against the potentially overwhelming effect of state sovereign power under international investment law. The proposals made for amendment to the English legislation, it is expected, will increase the opportunity for foreign investors to resolve conflict with the host state of their money and expertise through the English courts in the execution of arbitral awards. The author expresses his hope and expectation that Qatar will benefit from the example of the English jurisdiction in the adoption of a suitably modified State Immunity Act.
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**Miscellaneous**

