II. History and Limitations of the Traditional System for Resolving Investment Disputes

A. Harms Suffered by Foreign Investors

Investment is by definition a risky enterprise, and foreign investment particularly so. History is replete with government actions that, while viewed as necessary or constructive from the local point of view, brought disaster to economic actors from abroad.

For example, in 1938 Mexico's President Lázaro Cárdenas nationalized the country's petroleum industry, which was then dominated by U.S. and U.K. corporations. Cárdenas' action delivered to the Mexican government a monopoly in the exploration, production, refining, and distribution of oil and natural gas and in the manufacture and sale of basic petrochemicals. Although President Cárdenas offered compensation, U.S. oil companies pressured their government to place an embargo on all imports from Mexico to discourage similar nationalizations in other countries. The boycott was in effect briefly, but the U.S. government soon convinced the oil companies to come to terms with Mexico in furtherance of President Franklin D. Roosevelt's Good Neighbor Policy and U.S. security interests arising from World War II. In 1943 Mexico and the oil companies reached a final settlement, under which the companies received US$24 million (a fraction of the book value of the expropriated facilities) as compensation.[1] The date of the nationalization is still celebrated in Mexico as a national holiday. In Spain the Franco regime's seizure of a Barcelona street car company set in motion one of the longest-running disputes in international law, justifying Dickensian depictions of the futility of legal process.[2] Lacking the political

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1 *See* Mexico, The Economy, Oil, http://countrystudies.us/mexico/78.htm. Daniel Yergin, *The Prize: The Epic Quest for Oil, Money & Power* 271–79 (1992).

2 *Case Concerning the Barcelona Traction, Light and Power Company* (*Belgium v. Spain*), 1970 I.C.J. Rep. 1970.

influence of their domestic competitors, foreign investors in such circumstances often find themselves at the mercy of host governments.

Such government actions can have serious long-term consequences. The following newspaper article describes how one country's lack of an impartial legal regime and reliable forum to resolve economic disputes has raised the cost of capital and diverted investment flows to other parts of the world.

> Beneath the jungles and volcanoes of the Indonesian archipelago are buried some of Asia's richest treasures—vast deposits of gold, copper, coal and other natural resources. But foreign companies have all but stopped investing in new operations to mine them.
>
> Despite huge reserves of oil and natural gas, Indonesia faces the prospect in the next few years of crippling power outages, like those that darkened most of the capital for two days last month. No new power stations are being built on the main Java-Bali electric grid. Foreign investors, whose money is needed for projects of this size, say they are not interested in developing new plants.
>
> In both the mining and power industries, investors say that the poverty of Indonesia's legal system is a major part of why they're staying away. It has contributed to a general lack of confidence that is draining away badly needed capital and undermining the country's struggle to recover from the 1997–98 Asian financial crisis.
>
> Foreign investors complain they are subject to the arbitrary demands of government officials, tax collectors and local partners. They have little meaningful recourse in the courts, where bribery is rampant and favoritism the legal standard.
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> . . . .
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> "Investors in Indonesia doubt whether their rights will be preserved and about the sanctity of contracts," said Hikmahanto Juwana, a professor of international economic law at the University of Indonesia. "The main thing is that Indonesia is no longer a good place to invest."
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> . . . .
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> The most jarring example, foreign investors say, came this summer. A three-judge panel held that the local unit of Canadian insurer Manulife Financial Corp. was bankrupt, even though the company insisted it was still solvent. The ruling came in response to a claim by Manulife's former Indonesian partner in a joint venture, which had been seeking to win millions of dollars through the bankruptcy process. After the ruling, Manulife claimed it had been the victim of a "public mugging." For a time, it seemed the local Manulife unit, which has 4,000 employees and 400,000 policyholders in the country, would have to close, even though it had assets now worth about $522 million and profits in its insurance business that exceeded $8 million last year, according to Syarifudin Yunus, Manulife's local spokesman.
>
> The Canadian government threatened sanctions. U.S. and other diplomats in Jakarta launched a petition drive on behalf of the company, raising their objections directly with President Megawati Sukarnoputri. A month later, facing intense political pressure, the Supreme Court overturned the decision. The three judges who declared the unit bankrupt were suspended on suspicion of taking bribes. Foreign and Indonesian corporate executives said the Manulife decision was unique only for the extensive political fallout that forced a reversal of the decision. "In almost every way, the law is manipulated. If we are truly interested in restoring our economic development, the most important thing is

certainty in the implementation of the law," said Eddie Lembong, who runs Pharos Indonesia Ltd., a big pharmaceutical company.[3]

Foreign investors may be subject to unusual and unpredictable problems, and in attempting to overcome those problems, they face many obstacles.

B. Barriers to Recovery by Foreign Investors

1. Barriers in Host Country Courts

In general, foreign investors usually face serious obstacles to obtaining redress in the host country's courts. Although judicial systems vary widely, even within the developing world, certain systemic barriers are pervasive and tend to affect foreign businesses in a range of less developed countries.

a. Local Bias

One serious barrier to obtaining redress in some host-country courts is local bias. Although judges are not necessarily more sympathetic to their countrymen than to foreigners, the contrary perception is common, in some cases with good reason.[4] Indeed, the possibility of local bias is a phenomenon not unique to developing countries. The U.S. Constitution acknowledges and expressly addresses the problem. To account for "apprehended discrimination in state courts against those not citizens of the state,"[5] the constitution's drafters created what is known as "diversity" jurisdiction in the U.S. federal courts; so in a lawsuit involving citizens of different states, the out-of-state defendant can demand a presumably more neutral federal court. Similar protection against local prejudice is a prominent feature of the international legal system, especially in the investment treaty system.[6]

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3 Alan Sipress, *Flawed Legal System Impeding Indonesia; Lacking Confidence, Foreign Investors Flee*, Wash. Post, Oct. 29, 2002, at A17.

4 *See, e.g.*, the difficulties encountered by Western investors in resolving disputes before courts and arbitral tribunals in Pakistan and Indonesia, Peter Cornell & Arwen Handley, *Himpurna and Hub: International Arbitration in Developing Countries*. Mealey's Int'l Arb. Rep., Sept. 2000, at 39.

5 *Erie Railroad Co. v. Tompkins*, 304 U.S. 64, 74 (1938). *See also Bank of the U.S. v. Devaux*, 9 U.S. (5 Cranch) 61, 87, 3 L.Ed. 38, 45 (1809) ("However true the fact may be, that the tribunals of the states will administer justice as impartially as those of the nation, . . . it is not less true that the constitution itself either entertains apprehensions on this subject, or views with such indulgence the possible fears and apprehensions of suitors, that it has established national tribunals for the decision of controversies . . . between citizens of different states").

6 *See generally* John P. Gaffney, *Due Process in the World Trade Organization*, 14 Am. U. Int'l L. Rev. 1173, 1196 (1999) (discussing the 1903 arbitration proceeding between a U.S. citizen and the Venezuelan government, *Rudolf v. Venezuela*).

b. State Immunity

Until the second half of the twentieth century, foreign investors and traders faced a serious and immediate barrier to judicial remedies for uncompensated expropriation and other harm suffered at the hands of host governments. Both the local courts and the judiciary of the investor's home state were unlikely to adjudicate such a dispute, out of deference to sovereign immunity. Such immunity was widely viewed as absolute, even if the foreign investor's claim would have been cognizable against a private party in similar circumstances.

The concept of sovereign immunity can be traced far back into the recesses of international legal development.[7] A state's immunity from the jurisdiction of its own courts is somewhat different in origin and justification from its insulation from suit before foreign judges. The former situation, whereby a government is protected from suit in its own court system absent consent, is the product of the age-old axiom that "the king can do no wrong."[8] Particularly in common-law countries, it was reasoned that the law-making authority, which freely dispenses of rights and obligations within its own territory, should not—or could not—be subordinated to its own power. Thomas Hobbes reasons as follows:

> The sovereign of a Commonwealth, be it an assembly or one man, is not subject to the civil laws. For having power to make and repeal laws, he may, when he pleaseth, free himself from that subjection by repealing those laws that trouble him, and making of new; and consequently he was free before.[9]

The same tradition existed in the civil law:

> [T]he development of the restrictive theory regarding state immunity has its basis in the Napoleonic system, which was created in the first decade of the nineteenth century. At that time, following the absolutist approach, no one could sue the state. However, there was a struggle for more than a century over the means for making the state responsible for its actions and wrongs.
>
> Eventually, the courts differentiated between public acts and private acts. Under that approach, a citizen could sue the domestic sovereign in an ordinary court when it acted in a "private capacity" and before the Conseil d'Etat when it acted in a "public capacity." That way of thinking transferred to the problem of foreign sovereigns, creating the practice known as the "restrictive theory of foreign states." Concerning the domestic sovereign

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7 *See generally* Richard B. Lillich, *The Protection of Foreign Investment* 3–9 (1965).

8 Edwin Borchard, *Government Liability in Tort*, 34 Yale L. J. 1, 2 (1924).

9 Thomas Hobbes, *Leviathan* (1660), chapter XXVI, 2. *See also The Western Maid*, 257 U.S. 419, 432 (1922) (Holmes, J.) ("the authority that makes the law is itself superior to it").

immunity (and later, foreign state immunity), the courts examined the nature of the act, i.e., whether the state acted in a private or public capacity.[10]

Two distinct approaches to the public/private divide have coalesced since then, one emphasizing the purpose of the state's act and the other emphasizing the nature of the act. For the most part, civil law systems have adopted the latter approach. Moreover, most civil law countries have a divided legal system, with separate fora for the adjudication of administrative law issues and civil disputes.[11] As discussed in the following text, this *divided* approach to state immunity still appears in various guises, including the extent to which states may be found liable for breach of contract. Regardless of the particular approach to immunity, the consequence for foreign investors is that in cases where the host country government is the cause of the foreign investor's damage, local courts may not be authorized to provide any remedy.

c. Inefficient Local Courts

Efficiency of local courts is another concern of many foreign investors, because developing countries often lack responsive, robust legal systems capable of effectively and quickly adjudicating complex claims. A particularly telling example concerns the 1984 Union Carbide gas plant tragedy in India, in which more than 2,000 deaths and 200,000 injuries resulted from a toxic gas leak at a chemical gas plant owned by Union Carbide India Limited, a company incorporated under Indian law but majority-owned by Union Carbide Corporation of New York.[12] Rather than processing claims in Indian courts, the government of India enacted legislation to vest in the Indian government the exclusive right to represent Indian plaintiffs anywhere in the world.[13] And it then filed claims on behalf of Indian citizens in New York federal courts.[14] In resisting the defendant's efforts to transfer the cases back to India, the Indian government acknowledged the inefficiency

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10 Reinhard Von Hennigs, *25th Anniversary of the Foreign Sovereign Immunities Act: European Convention on State Immunity and Other International Aspects of Sovereign Immunity*, 9 Williamette J. Int'l L. & Disp. Res. 185, 190 (2001).

11 *See* discussion below at p. 18.

12 *In re Union Carbide Corp. Gas Plant Disaster at Bhopal, India*, 634 F. Supp. 842 (S.D.N.Y. 1986), *aff'd*, 809 F.2d 195 (2d Cir.), *cert. denied*, 484 U.S. 871 (1987).

13 *Id.*

14 The unusual posture of this case—a U.S. corporation strenuously trying to escape U.S. jurisdiction, and a foreign government strenuously trying to invoke it—is almost certainly attributable to Union Carbide's justifiable fear of the extremely high awards that U.S. courts are prone to award, especially in personal injury cases.

of its own courts. It argued to the New York court that India's judicial system suffered from "procedural and discovery deficiencies that would thwart the victims' quest for justice."[15] The U.S. court ultimately determined that Indian courts would be a more appropriate forum for the litigants, but the Indian government's characterization of its own judicial system reflects the experience of many foreign investors.

d. Calvo Doctrine

In the past, partially in response to perceived abuses by foreign investors, some host nations tried to restrict a foreign investor's remedies to its local courts and deprive them of the protection of international law, aware that any remedy there would likely be illusory. According to this doctrine, international liability cannot be triggered so long as the host state provides a judicial or administrative adjudicative system that is impartial and comports with generally accepted standards of due process, regardless of the outcome of the investor's local claim.[16] This doctrine, known as the Calvo clause after its chief proponent the Argentinean lawyer and statesman, Carlos Calvo, was especially prevalent in South America:

> The impact of [the] Calvo doctrine on the legal traditions of Latin American States is reflected in the following propositions: (a) international law requires that the host State accord national treatment to aliens; (b) national law governs the rights and privileges of aliens; (c) national courts have exclusive jurisdiction over disputes involving aliens, who may therefore not seek redress by recourse to diplomatic protection; (d) international adjudication is inadmissible for the settlement of disputes with aliens.[17]

The opposite position has been held just as strongly for an equally long time, namely that "the state to which a foreigner belongs may intervene for his protection when he has been *denied* ordinary justice in the foreign country, and also in case of a plain *violation* of the substance of natural justice."[18] Mexico was one of the most prominent proponents of the Calvo Doctrine (and did not effectively abandon it until the advent of the North American Free Trade Agreement), as the following case illustrates.

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15 *Id.* at 847.

16 *See, e.g.*, Alwyn Freeman, *International Responsibility of States for Denial of Justice* 330 (1938); Charles Hyde, *International Law* 731–32 (1945).

17 Louis Henkin, et al., *International Law* 685 (3d ed. 1993); *see also* Edwin M. Borchard, *Decisions of the Claims Commissions, United States and Mexico*, 20 Am. J. Int'l Law 536, 538 (1926); Sir John H. Percival, *International Arbitral Tribunals and the Mexican Claims Commissions*, 19(3) J. Comp. Legis. & Int'l L. 98, 102 (1937); G. Godfrey Phillips, *The Anglo-Mexican Special Claims Commission*, 49 L. Q. Rev. 226, 234 (1933); Lionel Summers, *La Clause Calvo: Tendences Nouvelles,* 12 Rev. de Droit Int'l 229, 232 (1933).

18 Letter from U.S. Secretary of State to Mr. McLane, Minister to France from the United States, June 23, 1886, *reprinted in* 6 Moore's Int'l Law Digest 266 (1906).

North American Dredging Company of Texas (U.S.A.) v. United Mexican States

4 R.I.A.A. 26 (1926)

This case is before this Commission on a motion of the Mexican Agent to dismiss. It is put forward by the United States of America on behalf of North American Dredging Company of Texas, an American corporation, for the recovery of the sum of $233,523.30 with interest thereon, the amount of losses and damages alleged to have been suffered by claimant for breaches of a contract for dredging at the port of Salina Cruz, which contract was entered into between the claimant and the Government of Mexico, November 23, 1912. The contract was signed at Mexico City. The Government of Mexico was a party to it. It had for its subject matter services to be rendered by the claimant in Mexico. Payment therefore was to be made in Mexico. Article 18, incorporated by Mexico as an indispensable provision, not separable from the other provisions of the contract, was subscribed to by the claimant for the purpose of securing the award of the contract. Its translation by the Mexican Agent reads as follows:

> "The contractor and all persons who, as employees or in any other capacity, may be engaged in the execution of the work under this contract either directly or indirectly, shall be considered as Mexicans in all matters, within the Republic of Mexico, concerning the execution of such work and the fulfilment of this contract. They shall not claim, nor shall they have, with regard to the interests and the business connected with this contract, any other rights or means to enforce the same than those granted by the laws of the Republic to Mexicans, nor shall they enjoy any other rights than those established in favor of Mexicans. They are consequently deprived of any rights as aliens, and under no conditions shall the intervention of foreign diplomatic agents be permitted, in any matter related to this contract."

1. The jurisdiction of the Commission is challenged in this case on the grounds . . . (second) that a contract containing the so-called Calvo clause deprives the party subscribing said clause of the right to submit any claims connected with his contract to an international commission.

The Calvo clause

3. The Commission is fully sensible of the importance of any judicial decision either sustaining in whole or in part, or rejecting in whole or in part, or construing the so-called "Calvo clause" in contracts between nations and aliens. It appreciates the legitimate desire on the part of nations to deal with persons and property within their respective jurisdictions according to their own laws and to apply remedies provided by their own authorities and tribunals. . . .

4. The Commission does not feel impressed by arguments either in favor of or in opposition to the Calvo clause, in so far as these arguments go to extremes. The Calvo clause is neither upheld by all outstanding international authorities and by the soundest among international awards nor is it universally rejected. . . .

. . . .

Lawfulness of the Calvo clause

8. The contested provision, in this case, is part of a contract and must be upheld unless it be repugnant to a recognized rule of international law. What must be established is not that the Calvo clause is universally accepted or universally recognized, but that there exists a generally accepted rule of international law condemning the Calvo clause and denying to an individual the right to relinquish to any extent, large or small, and under any circumstances or conditions, the protection of the government to which he owes allegiance . . .

9. The commission does not hesitate to declare that there exists no international rule prohibiting the sovereign right of a nation to protect its citizens abroad from being subject to any limitation whatsoever under any circumstances. The right of protection has been limited by treaties between nations in provisions related to the Calvo clause. While it is true that Latin-American countries—which are important members of the family of nations and which have played for many years an important and honorable part in the development of international law—are parties to most of these treaties, still such countries as France, Germany, Great Britain, Sweden, Norway, and Belgium, and in one case at least even the United States of America (Treaty between the United States and Peru dated September 6, 1870, Volume 2, Malloy's United States Treaties, at page 1426; article 37) have been parties to treaties containing such provisions.

10. What Mexico has asked of the North American Dredging Company of Texas as a condition for awarding it the contract which it sought is, "If all of the means of enforcing your rights under this contract afforded by Mexican law, even against the Mexican Government itself, are wide open to you, as they are wide open to our own citizens, will you promise not to ignore them and not to call directly upon your own Government to intervene in your behalf in connexion with any controversy, small or large, but seek redress under the laws of Mexico through the authorities and tribunals furnished by Mexico for your protection?" and the claimant, by subscribing to this contract and seeking the benefits which were to accrue to him thereunder, has answered, "I promise."

11. Under the rules of international law may an alien lawfully make such a promise? The Commission holds that he may, but at the same time holds that he can not deprive the government of his nation of its undoubted right of applying international remedies to violations of international law committed to his damage. . . . But while any attempt to so bind his Government is void, the Commission has not found any generally recognized rule of positive international law which would give to his Government the right to intervene to strike down a lawful contract, in the terms set forth in the preceding paragraph 10, entered into by its citizen.

. . . .

The Calvo clause and the claimant

18. If it were necessary to demonstrate how legitimate are the fears of certain nations with respect to abuses of the right of protection and how seriously the sovereignty of those nations within their own boundaries would be impaired if some extreme conceptions of this right were recognized and enforced, the present case would furnish an illuminating example. The claimant, after having solemnly promised in writing that it would not ignore the local laws, remedies, and authorities, behaved from the very beginning as if article 18 of its contract had no existence in fact. It used the article to procure the contract, but this was the extent of its use. It has never sought any redress by application to the local authorities and remedies which article 18 liberally granted it and which, according to Mexican law, are available to it, even against the Government, without restrictions, both in matter of civil and of public law . . . The record before this Commission strongly suggests that the claimant used article 18 to procure the contract with no intention of ever observing its provisions.

. . . .

20. Under article 18 of the contract declared upon, the present claimant is precluded from presenting to its Government any claim relative to the interpretation or fulfillment of this contract. If it had a claim for denial of justice, for delay of justice or gross injustice, or

for any other violation of international law committed by Mexico to its damage, it might have presented such a claim to its Government, which in turn could have espoused it and presented it here.

Extent of the present interpretation of the Calvo clause

. . . .

23. Even so, each case involving application of a valid clause partaking of the nature of the Calvo clause will be considered and decided on its merits. Where a claim is based on an alleged violation of any rule or principle of international law, the Commission will take jurisdiction notwithstanding the existence of such a clause in a contract subscribed by such claimant. But where a claimant has expressly agreed in writing, attested by his signature, that in all matters pertaining to the execution, fulfilment, and interpretation of the contract he will have resort to local tribunals, remedies, and authorities and then wilfully ignores them by applying in such matters to his Government, he will be held bound by his contract and the Commission will not take jurisdiction of such claim . . . .

The North American Dredging tribunal thus drew a crucial distinction. With respect to breach of contract, a foreign investor or contractor could indeed waive its rights to certain types of international protection by signing on to a Calvo clause. But this was not the case for other state acts constituting violations of international law, such as denial of justice or expropriation. As discussed in the following text, this distinction reappears in other forms in international jurisprudence.

2. Barriers in Foreign Investor's Home Courts

As a result of the potential shortcomings previously described, foreign companies often hesitate to entrust their disputes to the judicial system of the host state. Rather, they frequently look to courts in other countries with a factual connection to the dispute, most often the investor's domicile. But then they face an entirely different, but no less challenging, series of obstacles.

a. Jurisdiction

Absent contractual provisions to the contrary, the courts in the investor's home country are unlikely to exercise in personam jurisdiction over the host state actor. In most investment disputes, the material events have taken place in the host country, and the critical actors are the host country government or corporations operating in the host country. Often in such circumstances there is an insufficient nexus of fact with the investor's country to provide a foundation for jurisdiction.

In the United States, for example, a court may only exercise personal jurisdiction if the foreign entity has sufficient "minimum contacts" with the United States, "such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'"[19] Other countries have similar restrictions.[20] This initial jurisdictional barrier precludes the resolution of many disputes in the investor's home courts.

b. Foreign Sovereign Immunity

Just as a host government is often immune from suit in its home courts, it is usually also immune in the foreign investor's courts.[21] Judge Higgins of the International Court of Justice explains:

> Under classical international law, states, including governments thereof, were granted immunity from the territorial jurisdiction of other states. Various reasons of policy have been suggested, all interrelated. First, the reason may be found in the doctrine of Sovereign equality . . . which means that no state could be expected to submit to the laws of another. Secondly, it has been said that it would offend the dignity of a state to submit to the jurisdiction of another.[22]

Until the middle of the twentieth century, most commentators agreed—and most states insisted—that the shield of sovereign immunity was absolute. As a result private disputes with government-owned entities were outside the jurisdiction of national courts.[23]

Even now, exceptions to sovereign immunity exist only in limited circumstances. In the United States, for example, the Foreign Sovereign Immunities Act (FSIA) establishes the narrow circumstances in which foreign states can be sued.[24] In general, the FSIA only allows actions that result from a sovereign's *commercial* activity. This may not include sovereign acts such as expropriation or even regulatory acts. Consequently, even if the investor's home courts could exercise jurisdiction, they are unlikely to adjudicate many claims.

c. Act of State Doctrine

In addition to immunity, some courts, especially those in the United States, are reluctant to pass judgment on the actions of foreign states. What is known as the "act of state doctrine" effectively forecloses most legal actions in an investor's domestic courts against foreign governments for harm to the investor's foreign investments

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19 *See International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

20 *See, e.g.*, the limitations set on service of documents on defendants who are located outside of England under the Civil Procedure Rules of the United Kingdom, Section III, Special Provisions on Service Out of Jurisdiction, ¶ 6.17 *et seq.*, *available at* http://www.dca.gov.uk/civil/procrules_fin/contents/parts/part06.htm#ruleIDAXHUYC.

21 Troland S. Link, *Foreign Sovereign Immunity, Expropriation, Act of State, and Community*, 703 PLI/Comm. L. & Prac. Handbook Series 183 (1994); Noah Rubins & Stephan Kinsella, *International Investment, Political Risk, and Dispute Resolution* 140–51 (2005).

22 Rosalyn Higgins, *Problems and Process: International Law and How We Use It* 78–79 (1994).

23 *Schooner Exchange v. McFadden*, 11 U.S. 116 (1812).

24 Foreign Sovereign Immunity Act, 28 U.S.C. § 1330 *et seq.* (1976).

through expropriation and other governmental measures.[25] The United States Supreme Court's decision in *Banco Nacional de Cuba v. Sabbatino* is perhaps the most celebrated case where the doctrine was applied:

Banco Nacional de Cuba v. Sabbatino

376 U.S. 398 (1964) [footnotes omitted]

Mr. Justice Harlan delivered the opinion of the Court.

The question [that] brought this case here, and is now found to be the dispositive issue, is whether the so-called act of state doctrine serves to sustain petitioner's [(Banco Nacional's)] claims in this litigation. Such claims are ultimately founded on a decree of the Government of Cuba expropriating certain property, the right to the proceeds of which is here in controversy. The act of state doctrine in its traditional formulation precludes the courts of this country from inquiring into the validity of the public acts a recognized foreign sovereign power committed within its own territory.

In February and July of 1960, respondent Farr, Whitlock & Co., an American commodity broker, contracted to purchase Cuban sugar, free alongside the steamer, from a wholly owned subsidiary of Compania Azucarera Vertientes-Camaguey de Cuba (C.A.V.), a corporation organized under Cuban law whose capital stock was owned principally by United States residents. Farr, Whitlock agreed to pay for the sugar in New York upon presentation of the shipping documents and a sight draft.

On July 6, 1960, the Congress of the United States amended the Sugar Act of 1948 to permit a presidentially directed reduction of the sugar quota for Cuba. On the same day President Eisenhower exercised the granted power. The day of the congressional enactment, the Cuban Council of Ministers adopted "Law No. 851," which characterized this reduction in the Cuban sugar quota as an act of "aggression, for political purposes" on the part of the United States, justifying the taking of countermeasures by Cuba. The law gave the Cuban President and Prime Minister discretionary power to nationalize by forced expropriation property or enterprises in which American nationals had an interest. Although a system of compensation was formally provided, the possibility of payment under it may well be deemed illusory. Our State Department has described the Cuban law as "manifestly in violation of those principles of international law which have long been accepted by the free countries of the West. It is in its essence discriminatory, arbitrary and confiscatory."[26]

Between August 6 and August 9, 1960, the sugar covered by the contract between Farr, Whitlock and C.A.V. was loaded, destined for Morocco, onto the [*SS*] *Hornfels,* which was standing offshore at the Cuban port of Jucaro (Santa Maria). On the day loading commenced, the Cuban President and Prime Minister, acting pursuant to Law No. 851, issued Executive Power Resolution No. 1. It provided for the compulsory expropriation of all property and enterprises, and of rights and interests arising therefrom, of certain listed

25 *See generally* Richard B. Lillich, *The Protection of Foreign Investment* 45–113 (1965). On the act of state doctrine in England, *see* Jones, *Act of Foreign State in English Law: The Ghost Goes East*, 22 Va. J. Int'l L. 433 (1982); Michael Singer, *The Act of State Doctrine of the United Kingdom: An Analysis, with Comparison to United States Practice*, 75 Am. J. Int'l L. 283 (1981). On application of the doctrine in Hong Kong, *see* Donna Lee, *Discrepancy between Theory and Reality: Hong Kong's Court of Final Appeal and the Acts of State Doctrine*, 35 Colum. J. Transn. L. 175 (1997).

26 SN: *See* State Dept. Note 397, July 16, 1960 (to Cuban Ministry of Foreign Relations).

companies, including C.A.V., wholly or principally owned by American nationals. The preamble reiterated the alleged injustice of the American reduction of the Cuban sugar quota and emphasized the importance of Cuba's serving as an example for other countries to follow "in their struggle to free themselves from the brutal claws of imperialism."

. . . .

The classic American statement of the act of state doctrine, which appears to have taken root in England as early as 1674, *Blad v. Bamfield*, 3 Swans. 604, 36 Eng. Rep. 992, and began to emerge in the jurisprudence of this country in the late eighteenth and early nineteenth centuries, see, e.g., *Ware v. Hylton*, 3 Dall. 199, 230; *Hudson v. Guestier, 4 Cranch 293*, 294; *Schooner Exchange v. M'Faddon, 7 Cranch 116, 135*, 136; *L'Invincible, 1 Wheat. 238, 253; The Santissima* Trinidad, 7 Wheat. 283, 336, is found in *Underhill v. Hernandez*, 168 U.S. 250, where Chief Justice Fuller said for a unanimous Court (p. 252):

> Every sovereign State is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgment on the acts of the government of another done within its own territory. Redress of grievances by reason of such acts must be obtained through the means open to be availed of by sovereign powers as between themselves.

Following this precept the Court in that case refused to inquire into acts of Hernandez, a revolutionary Venezuelan military commander whose government had been later recognized by the United States, which were made the basis of a damage action in this country by Underhill, an American citizen, who claimed that he had been unlawfully assaulted, coerced, and detained in Venezuela by Hernandez.

Therefore, rather than laying down or reaffirming an inflexible and all-encompassing rule in this case, we decide only that the Judicial Branch will not examine the validity of a taking of property within its own territory by a foreign sovereign government, extant and recognized by this country at the time of suit, in the absence of a treaty or other unambiguous agreement regarding controlling legal principles, even if the complaint alleges that the taking violates customary international law.

Respondents claim that the economic pressure resulting from the proposed exception to the act of state doctrine will materially add to the protection of United States investors. We are not convinced, even assuming the relevance of this contention. Expropriations take place for a variety of reasons, political and ideological as well as economic. When one considers the variety of means possessed by this country to make secure foreign investment, the persuasive or coercive effect of judicial invalidation of acts of expropriation dwindles in comparison. The newly independent states are in need of continuing foreign investment; the creation of a climate unfavorable to such investment by wholesale confiscations may well work to their long-run economic disadvantage. Foreign aid given to many of these countries provides a powerful lever in the hands of the political branches to ensure fair treatment of United States nationals. Ultimately the sanctions of economic embargo and the freezing of assets in this country may be employed. Any country willing to brave any or all of these consequences is unlikely to be deterred by sporadic judicial decisions directly affecting only property brought to our shores. If the political branches are unwilling to exercise their ample powers to effect compensation, this reflects a judgment of the national interest which the judiciary would be ill-advised to undermine indirectly.

. . . .

However offensive to the public policy of this country and its constituent States an expropriation of this kind may be, we conclude that both the national interest and progress toward the goal of establishing the rule of law among nations are best served by maintaining intact the act of state doctrine in this realm of its application.

Although this specific articulation of the doctrine is applicable only in the United States, it illustrates the reluctance of many courts to condemn the sovereign, political acts of foreign governments. Whether or not this reluctance is codified in legal doctrine, it undoubtedly exists and forms an important barrier to investors seeking recovery of their investment.

d. Choice of Law

Even if a foreign investor is able to surmount the problems of jurisdiction, immunity, and act of state doctrine, the foreign investor's home courts may apply the host country's laws in resolving the dispute. Investment disputes are normally centered around events that took place in the country where the investment was made. Under most law regimes, the controlling law is that of the country where the transaction and dispute are centered.[27] But host country law may well be hostile to foreign investors; indeed, the host country law may have been changed expressly to curtail the rights of the foreign investor. Nonetheless, it is certainly possible, perhaps probable, that the investor's home court, applying normal choice of law principles, would apply that hostile body of law. Because the host state's actions are usually consistent with its own law, this choice of applicable law may well result in dismissal of the investor's claim.[28]

3. Political Barriers: The New International Economic Order

In addition to the formal legal hurdles noted above, foreign investors have at various times faced significant political hostility to their attempts to recover their investments. Although such hostility is perhaps predictable in the host state in the aftermath of an investment dispute, overt anti-investor hostility has surfaced in international institutions, and even in the political attitudes of the investor's home country. Prior to the demise of communism, such sentiment was (and to some degree still is) particularly prevalent in leftist sectors.

One striking example of anti-investor sentiment was the New International Economic Order (NIEO). The governments supporting the NIEO movement—developing countries and communist regimes—sought to counter the development of customary international law standards protecting foreign investments from uncompensated expropriation. In the 1960s and 1970s (the peak of the NIEO movement's strength), these states sponsored a number of United Nations

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27 *See, e.g.*, *Restatement (First) of Conflicts of Laws*, § 311, Place of Contracting (1934).

28 Sometimes, however, the public policy of the investor's home state may intervene in its favor. In the 1920s and 1930s, after the Soviet government confiscated the property of foreigners, a wave of litigation ensued around the world. In one of the cases brought in New York, the court accepted that by operation of the conflict of law principles, the Soviet law should govern the issue; and accordingly, the confiscation should be enforceable. Yet, it refused to recognize the confiscation, on the ground that it was in conflict with New York's public policy. *See Vladikavkazksy Ry. Co. v. N.Y. Trust Co.*, 263 N.Y. 369, 189 N.E. 456 (1934).

General Assembly (UNGA) resolutions reserving for themselves broad discretion to protect their economic interests, to the detriment of capital exporters.[29] The first of these was UNGA Resolution 1803, which set forth two important principles: Foreign investments remain subject to the domestic law of the host state;[30] and the compensation an investor is due in exchange for its expropriated assets should be "appropriate," rather than the "prompt, adequate and effective" compensation advocated by the developed world.[31] In relevant part Resolution 1803 provided the following:

> 3. In cases where authorization is granted, the capital imported and the earning on that capital shall be governed by the terms thereof, by the national legislation in force, and by international law . . .
>
> 4. Nationalization, 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, 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. . . .

Thereafter, a debate ensued as to the norm-creating ability of General Assembly resolutions and the jurisprudential value of the NIEO resolutions.[32] Professor Dupuy considered the issues in the *Texaco Overseas Petroleum Company v. Libyan Arab Republic* arbitration:

> 88. . . . Resolution 1803 (XVII) appears to a large extent as the expression of a real general will[;] this is not[, however,] at all the case with respect to the other Resolutions mentioned above. . . . In particular, as regards the Charter of Economic Rights and Duties

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29 Permanent Sovereignty over Natural Resources, G.A. Res. 1803, U.N. GAOR, 17th Sess., Supp. No. 17, at 15, U.N. Doc. A/5217 (1962) [hereinafter Res. 1803]; Declaration on the Establishment of the New International Economic Order, G.A. Res. 3201, U.N. GAOR, 6th Spec. Sess., Supp. No. 1, at 3, U.N. Doc. A/9559 (1974); The Charter of Economic Rights and Duties of States (CERDS), G.A. Res. 3281, U.N. GAOR, 29th Sess., Supp. No. 31, at 51, U.N. Doc. A/9631 (1974).

30 *See also* pp. 13 *et seq.* above on Calvo doctrine.

31 For a more detailed discussion of the Hull formula, *see* Chapter XVI on expropriation.

32 With respect to the normative value of General Assembly resolutions, *see Legality of the Threat or Use of Nuclear Weapons*, ICJ Advisory Opinion (1996), ¶ 70, *available at* http://www.icj-cij.org/icjwww/icases/iunan/iunanframe.htm (last viewed Sept. 8, 2004). ("It is necessary to look at [a General Assembly resolution's] content and the conditions of its adoption; it is also necessary to see whether an *opinio juris* exists as to its normative character. Or a series of resolutions may show the gradual evolution of the *opinio juris* required for the establishment of a new rule").

> of States, several factors contribute to denying legal value to those provisions of the document which are of interest in the instant case.[33]

Thus, although the NIEO failed to achieve most of its goals, Resolution 1803 may have had some effect on certain norms of customary international law, and in particular the Hull formula for the standard of compensation for expropriated property.[34]

In 1974, a campaign initiated against the prevailing norms of equal and nondiscriminatory treatment for foreign investors resulted in another UNGA resolution known as the Charter of Economic Rights and Duties of States (CERDS),[35] which envisaged preferential treatment for local capital. Moreover, CERDS set forth a new standard for the treatment of investments, one vehemently opposed by developed countries in the General Assembly: "Every State has and shall freely exercise full permanent sovereignty, including possession, use and disposal, over all its wealth, natural resources and economic activities."[36] Although the general exhortatory provisions of CERDS were approved by a wide margin, the most controversial provision—Article 2, which purported to remove the act of nationalization from the protections of international law—was adopted only over the objections of all the major industrialized and capital-exporting nations, as well as several developing countries.[37]

The CERDS marked the peak of NIEO influence, as well as the start of its decline. Several factors contributed to this process, including the failure of NIEO prescriptions to ameliorate conditions in developing countries; the collapse of Soviet Union, which had supported the NIEO cause[38]; and the conclusion of hundreds of

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33 *Texaco Overseas Petroleum Company v. Libyan Arab Republic*, 17 I. L. M. 1, 30 (1978); Professor Brownlie believes that Res. 1803 is the evidence of existing customary law, *see* Ian Brownlie, *Principles of Public International Law* 519 (6th ed., Oxford University Press 2003); *see also* C. F. Amerasinghe, *Issue of Compensation for the Taking of Alien Property in the Light of Recent Cases and Practice*, 41 Int'l & Comp. L. Q. 22, 36 (1992); *cf.* Haliburton Fales, *A Comparison of Compensation for Nationalization of Alien Property with Standards of Compensation under United States Domestic Law*, 5 Nw. J. Int'l & Bus. 871, 881 (1983); Brice M. Clagett, *The Expropriation Issue Before the Iran-United States Claims Tribunal: Is "Just Compensation" Required by International Law or Not?*, 16 L. & Pol'y in Int'l Bus. 813, 818 (1984).

34 The conclusion of several lump sum agreements settling disputes as to the proper standard of compensation also supports this conclusion. *See* Malcolm N. Shaw, *International Law* 750 (5th ed., Cambridge University Press 2003).

35 G.A. Res. 3281, 29 U.N. GAOR, 29th Sess., Supp. No. 31, at 50, 51–55, U.N. Doc. A/9631 (1974), *reprinted in* 14 I.L.M. 251, 252–60 (1975) [hereinafter CERDS]. *See* Patricia Robin, *The BIT Won't Bite: The American Bilateral Investment Treaty Program*, 33 Am. U. L. Rev. 931, n.93 (1984).

36 CERDS, *supra* note 35, at 254–55.

37 Robert von Mehren & P. Nicholas Kourides, *International Arbitration between States and Foreign Private Parties: The Libyan Nationalization Cases*, 75 Am. J. Int'l L. 476, 523 (1981).

38 Thomas W. Wälde, *A Requiem for the "New International Economic Order"—Rise and Fall of Paradigms in International Economic Law*, in *International Legal Issues Arising under the United Nations Decade of International Law* 1323–26 (Najeeb Al-Nauimi & Richard Meese eds., Martinus Nijhoff Publishers 1995).

bilateral investment treaties that codified high levels of investment protection in accords that trumped the attempted dilution of customary law norms.[39] The central declarations in the NIEO movement have therefore receded largely into irrelevance, but some studies suggest that the Hull formula has not entirely recovered from NIEO attacks.[40]

C. Traditional Remedies for Foreign Investors

Faced with the many legal and political barriers to recovery of property seized or damaged by local government, foreign investors historically had little choice in remedies to seek. Until the Second World War, one possible remedy for expropriation was the use of military force. A more common and less extreme form of redress, and one still occasionally applied today, was diplomatic espousal by the investor's home state.

1. Gunboat Diplomacy

Gunboat diplomacy is not some colorfully exaggerated historic term: It was the literal practice of capital-exporting nations well into the 1890s.

> In the early 1800s, Latin American nations who had recently achieved independence from the colonial powers eagerly sought foreign investment. Shielding their local economies from foreign penetration was a secondary concern. To encourage investment by foreigners, these countries' new constitutions promised foreigners equality of treatment with nationals, which was surprising in light of the lingering political hostility towards many European nations and the United States. The effort by these countries to attract foreign investment was initially a great success.
>
> By 1833, however, every Latin American bond issue was in default, and most of the foreign companies established to conduct business in the area had collapsed. In the following years, foreigners as well as nationals were exposed to economic losses. The inability of Latin American governments and judicial institutions to protect foreigners' property led many foreigners to appeal to their governments for relief either through diplomatic intervention or the use of armed force.[41]

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39 S. Schwebel, *Investor-State Disputes and the Development of Customary International Law: The Influence of Bilateral Investment Treaties on Customary International Law*, 98 ASIL Proc. 27, 28 (2004).

40 *See* World Bank, *Report to the Development Committee and Guidelines on the Treatment of Foreign Direct Investment*, 31 I.L.M. 1363, 1376 (1992) (suggesting that only the "adequate" element of the formula is part of the customary law, and that there is no consistent body of precedent to support "promptness" and "effectiveness" elements).

41 Christopher K. Dalrymple, *Politics and Foreign Investment: The Multilateral Investment Guarantee and the Calvo Clause*, 29 Cornell Int'l L. 161, 164 (1996).

Thus, in 1900 the U.S. secretary of state approved the dispatch of a naval vessel to Venezuela to prevent the destruction of property belonging to the New York & Bermudez Company, an American corporation. The secretary instructed the secretary of the navy that "the gunboat should also protect all existing rights and maintain the status quo pending an investigation and decision as to an attempt which was alleged then to be in contemplation to deprive the company of its property by executive action."[42]

One of the more notorious examples of the use of armed force to obtain relief in an investment dispute arose out of the *Jecker* claim, which was triggered when the Mexican government defaulted in 1860 on a loan from J. B. Jecker and Company, a Franco-Swiss bank.[43] Mexico had originally arranged for a loan of 75 million francs, but actually borrowed only 3.75 million francs. When it defaulted on that sum, it was deemed to have defaulted on the entire contracted amount.[44] The inability of French investors to secure compensation through Mexican courts and administrative bodies triggered a French invasion in 1861 to 1862,[45] and France maintained a puppet government in Mexico until 1867. The French-installed ruler of Mexico, Emperor Maximilian, was eventually overthrown and executed by firing squad.[46]

Investment disputes today are rarely so dramatic. The CERDS has outlawed the use or threat of force by all states, including by militarily powerful capital-exporting states, except in self-defense.[47] And in any event, gunboat diplomacy rarely produced what foreign investors most frequently sought: full compensation.

2. Diplomatic Espousal

a. Practice of Espousal

Another mode of redress for mistreatment of foreigners and their property under customary international law was diplomatic espousal: intervention by the foreign citizen's home government in the form of diplomatic correspondence. Elements of

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42 Letter from Mr. Hay to Sec. of Navy, Dec. 28, 1900, 250 MS. Dom. Let. 8, *reprinted in* 6 Moore's Int'l Law Digest 258 (1906).

43 Dalrymple, *supra* note 41, at 165.

44 *Id.*

45 D. Shea, *The Calvo Clause* 14 (1955); Ibrahim Shihata, *Towards a Greater Depoliticization of Investment Disputes: The Roles of ICSID and MIGA* 1 n.2 (1992).

46 Dalrymple, *supra* note 41, at 165.

47 M. Sornarajah, *The International Law on Foreign Investment* 8–9 (1994); *see also generally* M. Sornarajah, *Power and Justice in Foreign Investment Arbitration*, 14 J. Int'l Arb. 103 (1997); J. Cable, *Gunboat Diplomacy: Political Applications of Limited Force* (1981); Matthew B. Cobb, *The Development of Arbitration in Foreign Investment*, Mealey's Int'l Arb. Rep. Apr. 2001.

this long, cumbersome, and generally ineffectual procedure[48] were described in an early guidebook for U.S. diplomatic officials:

Printed Instructions to Diplomatic Officers of the United States § 170 (1897)

When a diplomatic representative is satisfied that an applicant for protection has a right to his intervention, he should interest himself in his behalf, examining carefully into his grievances. If he finds that the complaints are well founded, he should interpose firmly, but with courtesy and moderation, with the authorities in his behalf and report the case to the Department of State for its further action, if any be required.

Following is a communiqué from the U.S. secretary of state to the American minister to Turkey, instructing him to bring a formal complaint to the Greek government on behalf of Jonas King, a U.S. citizen who had been banished and whose property had been confiscated by Greece after a trial:

Letter from Mr. Everett, U.S. Secretary of State to Mr. Marsh, Minister to Turkey, Feb. 5, 1853, reprinted in 6 Moore's Int'l Law Digest 264 (1906)

There is a single point only in which, at first view, Dr. King's claim upon his own government to interfere in his behalf may seem premature, and that is his omission to seek redress by bringing an action against the Greek government, as authorized by the code of civil procedure. The rule of public law is settled, that a private citizen in a foreign country is not entitled to the forcible interference of his government to procure him redress of wrongs till justice has been denied him by the local tribunals. This consideration would perhaps prevent the President, at this time, from interfering, had not the conduct of the courts of Greece, in the trial of Dr. King, sufficiently shown that he could not expect justice at their hands. . . . Such being the state of things, the President feels it his duty to interfere to procure redress to Dr. King.

You will therefore, if still in Austria, immediately on the receipt of this letter, repair to Spezzia, which is the rendezvous of the United States squadron in the Mediterranean. Commodore Stringham will be instructed to convey you to Athens, where you will forthwith put yourself in communication with the proper department of the Greek government. You will state, in general terms, the opinion entertained by the President of Dr. King's trial and condemnation as above intimated, and his expectation that a formal remission of the sentence of banishment should be granted by the proper department; and you will state in a general way the reasons why the President forbears in any other respect to make a national question of the treatment of Dr. King on this occasion. You will then represent the affair of Dr. King's land in the light in which it is placed in your report.

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48 According to one contemporary lawyer involved in the prosecution of investor-state claims, "If you use a general diplomatic note [to obtain redress for injury to investments], you can all have coffee and talk for years and be seen to be doing something about it." Barry Appleton, *Canadians Docile in Face of Extraterritorial U.S. Laws*, Law Times, Aug. 23–29, 1999.

State strongly and briefly the results of your inquiry, taking care, as far as possible, not to be drawn into a lengthened discussion for the purposes of delay. Avoid the tone or language of menace, but let the government of Greece perceive that the President is quite in earnest . . . .

Having . . . ascertained, as far as practicable, what sum of money would be a reasonable compensation to Dr. King, propose at once to the Greek government to allow it, and urge upon it the expediency of at once putting an end to this long delayed and vexatious affair. If the Greek government is discreet, they will immediately close with this offer, and you will use all your address to induce them to do so. If they decline, you will then make them this proposition, viz: to refer the whole question to the arbitration of a friendly power. . . .

Despite the somewhat hesitant tone of the secretary's instructions, Mr. Marsh's visit to Greece resulted in the reversal of the banishment sentence, but he was unable to obtain compensation for Dr. King's land. Two years later, however, a special envoy was sent to Greece to negotiate an indemnity and succeeded in obtaining US$25,000 in compensation for the seizure,[49] a rare instance of limited espousal success.

The general practice of diplomatic espousal has changed relatively little in the century since then.[50] In particular, states tend to be quite selective about the claims they agree to espouse. Some limitations on diplomatic protection are clear from the Canadian Foreign Ministry's informational bulletin for foreigners abroad.

State Responsibility: Espousal of Claims by the Canadian Government by the Intervention of the Foreign Ministry

1. General Principles

a. The Canadian government cannot, in accordance with generally recognized principles of customary international law, espouse claims related to the loss of human life, to assets, to interest, or to the debts of Canadians, unless such individuals are Canadian citizens at the moment of the loss, confiscation, expropriation, or nationalization. Furthermore, claims must have belonged to Canadian citizens since the events that gave rise to them, and the claimants must be Canadian citizens at the moment of the presentation of claims.

b. Normally, the government of Canada will not espouse any claim of a Canadian against a foreign State unless the claimant has exhausted all legal remedies provided by the internal law of the country in question (that is all available remedies up to an appeal to the court of last resort in the foreign State) without obtaining redress. However, if in exhausting these local judicial remedies, the claimant has been subjected to prejudice or has met with obstructions constituting a denial of justice, the government of Canada may have reason to intervene in his name to obtain the appropriate redress.

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49 President Franklin Pierce, Annual Address, Dec. 31, 1855.

50 *See generally* United Nations Commission on Trade and Development, *Dispute Settlement: State-to-State* (2003); Rubins & Kinsella, *supra* note 21, at 405–16.

d. As for claims made by corporations, the Government of Canada cannot, pursuant to customary international law, espouse claims related to assets nationalized or otherwise confiscated abroad, unless the claims originate from a company formed under the law of Canada or a Canadian province, and unless the corporation was formed before the date of the claim.[51]

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b. The Limitations of Espousal

Even where an investor's home government is willing to espouse the investor's cause, numerous barriers to compensation remain.

i. Exhaustion of Local Remedies

Under customary international law, diplomatic espousal is normally impermissible unless the foreign investor has exhausted all remedies available within the judicial or administrative system of the country where the investment is located. This doctrine of exhaustion of local remedies has evolved in customary international law from the middle ages to the present day.[52]

The local remedies rule is based on the premise that "the home government of the complaining citizen must give the offending government an opportunity of doing justice to the injured party in its own regular way, and thus avoid, if possible, all occasion for international discussion."[53] The rule is designed at once to protect state sovereignty to the extent possible and reduce the number of international claims initiated.[54]

The application of the exhaustion rule, however, can be quite complex. One particular point of dispute is whether a foreign national must raise all arguments, including allegations of breaches of international law, at the national level before his or her state can pursue an international claim on his behalf. On the one hand, there would seem to be little reason for foreign investors to assert claims based on international law in the context of municipal court or administrative proceedings, so long as they introduce all the relevant issues of fact. On the other hand, some tribunals have required that claimants assert international causes of action as a necessary element of exhausting local remedies, even if such claims are unrecognized by the

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51 Government of Canada, *L'Entraide Judiciaire Internationale: Services Juridiques Fournis par le Ministère des Affaires Extérieures Concernant L'Entraide Judiciaire Internationale et Certains Autre Matières* (63) 1987.

52 C. F. Amerasinghe, *Local Remedies in International Law* 11 (2004); *Interhandel Case (Switzerland v. U.S.)*, 1959 I.C.J. Rep. 5, 27 ("the rule that local remedies must be exhausted before international proceedings may be instituted is a well-established rule of customary international law").

53 Edwin Borchard, *Diplomatic Protection of Citizens Abroad* 817 (1915); Amerasinghe, *supra* note 52, at 97; William S. Dodge, *Exhaustion of Remedies and Res Judicata under Chapter Eleven of NAFTA*, 23 Hastings Int'l & Comp. L. Rev. 357, 361–62 (2000).

54 M. N. Shaw, *supra* note 34, at 730; Rubins and Kinsella, *supra* note 21, at 133.

relevant system of domestic law. In the *Finnish Ships Arbitration*,[55] the tribunal held not only that assertions of fact must have been made in prior litigation, but furthermore "propositions of law which are brought forward by the claimant government [before the international tribunal] . . . must have been investigated and adjudicated upon by the municipal Courts."[56] The *Finnish Ships* tribunal was neither the first nor the last to take so broad a view of exhaustion.[57]

From Robert Bruno, ACCESS OF PRIVATE PARTIES TO INTERNATIONAL DISPUTE SETTLEMENT: A COMPARATIVE ANALYSIS (1997), *available at* http://www.jeanmonnetprogram.org/papers/97/97-13.html

[According to the principle of exhaustion,] resort[ing] to dispute settlement on the international level through diplomatic protection is not admissible until the injured person has exhausted the legal remedies (judicial or administrative proceedings) available in the state allegedly responsible for the injury, unless the application of the rule is dispensed with either by an agreement between the claimant and the responding states, or by estoppel on the part of the latter.

. . . .

It has been rightly observed that this rule, which certainly works as a restriction on the applicability of diplomatic protection, is not the necessary consequence of the system of international law as a whole, but rather it is the consequence of political and practical considerations.[58] As to the former, the ICJ [International Court of Justice] held in the *Interhandel* case that "the rule requiring the exhaustion of domestic remedies as a condition of the presentation of an international claim is founded upon the principle that the respondent State must first have an opportunity to redress by its own means within the framework of its own domestic legal system the wrong alleged to have been done to the individual."[59] Furthermore, it may be submitted that another policy ground for the application of the rule is that the alien, by conducting activities within the territory of the host state, both enjoys protection and is correspondingly accountable under the laws and before the courts of that state; thus, it may be fair to hold that she should first seek redress under those laws and before those courts. These two arguments seek not to make the international dispute settlement machinery vexatious to states and to accord a high degree of deference to their sovereignty as expressed by the exercise of their jurisdiction. As to the latter, among various practical considerations put forward from time to time, there are some [that] are worth mentioning, such as: the need to avoid a flood of claims on the international law level, which is undesirable due to the limited resources of international tribunals and to the adverse impact they may have on the delicate relations between states; the fact that domestic courts have often a higher degree of expertise and sophistication than international tribunals; the fact that the determinations made by domestic courts may provide international tribunals

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55 *Finish Ships Arbitration* (*Finland v. U.K.*), 3 U.N.R.I.A.A. 1479 (1934).

56 *Id.* at 1502.

57 *Case of Certain Norwegian Loans* (*France v. Norway*), 1957 I.C.J. Rep. 9, 41–42 (separate opinion of Lauterpacht, J.); *see also* Amerasinghe, *supra* note 52, at 196.

58 SN: Brownlie, *Principles of Public International Law* 435 (4th ed. 1990).

59 SN: ICJ Rep. 27 (1959).

with extremely useful if not unique elements for the settlement of the dispute pending before them. . . .

Similarly, it can be observed that some issues arise out of the basic idea that the rule implies seeking redress before a local court. For instance, it may be relevant whether the action is brought for breach of either municipal law or international law or both; moreover, it may be asked whether the local court needs [to] have jurisdiction under either municipal law or international law.

Other important aspects of the rule of exhaustion of local remedies concern the question when such remedies can be deemed available and/or exhausted. On the one hand, reference is to be made to the structure of the relevant proceedings before the local courts. Usually the plaintiff will have to go through all the various (normally no more than three) instances, and rights of actions are afforded even in respect of acts or omissions of the executive power. On the other hand, the international tribunal assessing the admissibility of the claim has to address this question very carefully, because sometimes remedies may prove ineffective even if formally accorded to the injured party. This may be the case when an appeal would be still available, but either because of legislative intervention or because of the *stare decisis* principle, it would not be effective being the outcome of the claim already set forth. This may also be the case when judicial or administrative proceedings are flawed by interference of the executive power. In these as well as in other cases the *de jure* or de facto ineffectiveness of the remedy produces the same result as its exhaustion in more traditional forms, and the claim should be admissible before an international forum. Moreover, in some instances, ineffective remedies may also be regarded as somewhat connected to the concept of denial of justice.

Finally, the most recent developments of the rule by the ICJ's case law are contained in the *ELSI* case.[60] One of the major issues arising out of this case . . . was that the case was brought by the US against Italy under their Treaty of Friendship, Commerce and Navigation of 1948. The Treaty provided that disputes between the two states arising from its implementation be brought before the ICJ, but it did not expressly dispense the parties with complying with the rule of exhaustion of local remedies. While the US interpreted this provision as implicitly dispensing the parties with the application of the rule, the ICJ held that "it finds itself unable to accept that an important principle of customary international law should be held to have been tacitly dispensed with." As Shaw puts it, "in other words, the presumption that local remedies need to be exhausted can only be rebutted by express provision to the contrary."[61] . . . In conclusion, it may be observed that the rule of exhaustion of local remedies is not necessarily bad, in the sense that its underlying rationale can be deemed sound, and it will be seen that it may also work as a useful, if not necessary, device to filter claims in those mechanisms of international dispute settlement where the injured individual can or should be entitled to directly enforce her rights against the host state before an international forum. . . . The main criticism this rule attracts is that it is in its same nature to work against the process of delocalization of international economic disputes.

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ii. Nationality of the Investor

The success of diplomatic espousal claims often turns on whether the individual or corporation at the heart of the dispute is internationally recognized as a *national* of the espousing state. Customary international law, from which espousal derives its

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60 SN: ICJ Rep., 15, 42 (1989).

61 SN: Shaw, *International Law* (3d ed., 1991).

force and legitimacy, accords rights to states in relation to the harm suffered by individuals[62] and corporations only if the state can demonstrate a bond of nationality with the harmed entity. Although many international non–investment-related disputes involve relatively straightforward sales or licensing agreements, investment disputes often arise out of large-scale construction or energy-related projects financed by investors from more than one state and can raise complex issues of nationality.

One prominent example of an investor's claim that failed for want of proper nationality is the *Barcelona Traction* case.[63] That case involved a company incorporated in Canada that had developed an electricity generation plant and distribution system in Spain. Most of the Canadian company's shareholders were nationals of Belgium. In 1936 the Spanish government suspended payment on the company's bonds as a result of the Spanish Civil War. Although some restrictions were relaxed during World War II, the company was never again able to pay creditors outside Spain, and it was placed in bankruptcy in 1948. In the 1950s, the Belgian government, on behalf of Belgian shareholders, sought reparations from the Spanish government for its destruction of the shareholders' investment in the Canadian electric company. In 1970 the ICJ ultimately determined that Belgium lacked standing to espouse its nationals' claims, because the Spanish government's actions were aimed at the Canadian company rather than at Belgian investors. The case was dismissed.[64]

Barcelona Traction arose some years before the era of modern investment treaties. If a modern investment agreement had been in force between Spain and Belgium, the Belgian shareholders might well have had standing to recover some or all of their lost investment. One chief purpose of the modern investment protection regime is to allow the substance of capital investments to take precedence over the type of legal formalities that ultimately led to the dismissal in *Barcelona Traction,*[65] which is clarified later in this book.

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62 Fransisco Orrego Vicuña, *Changing Approaches to the Nationality of Claims in the Context of Diplomatic Protection and International Dispute Settlement*, in *Liber Amicorum Ibrahim Shihata: International Finance & Development Law* 503 (Schlemmer-Schulte & Tung eds., 2001); Ian Sinclair, *"Nationality of Claims: British Practice*, 27 Brit. Y. B. Int'l L. 125 (1950); Rubins & Kinsella, *supra* note 21, at 135–40.

63 *Barcelona Traction, Light & Power Co. Ltd.* (*Belgium v. Spain*), Second Phase, 1970 I.C.J. 3.

64 For an interesting journalistic account of the *Barcelona Traction* case and its fate, see John Brooks, *Annals of Finance, Parts I and II,* New Yorker (1979).

65 The rule of continuous nationality in international law, which deals with the nationality of claims, may also prevent investors from pursuing their claims. Continuous nationality rule requires that "claims must continuously without interruption have belonged to a person or to a series of person (a) having the nationality of the State by whom it is put forward, and (b) not having the nationality of the State against whom it is put forward. . . ." *See generally* Brownlie, *supra* note 33, at 459–60; for a discussion of the application of this rule and its implications in the modern investment treaty arbitration *see* Maurice Mendelson, *Run Away Train, "Continuous Nationality" Rule from* Panavezys-Saldutiskis *Railway Case to* Loewen, in *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* 97 (Weiler ed., Cameron May 2005).

D. Some Early Investment Protection Regimes

Although the current legal structure and formalized practice of investor-state arbitration developed only during the last three decades of the twentieth century, the concerns that led to that innovation are not recent. The desire of both capital exporters and importers to establish a legal regime that would keep capital flowing resulted in occasional attempts to conclude an appropriate framework agreement, or to resolve a particular set of investment-related disputes. The legacy of these attempts is to some degree reflected in the present system of investor-state arbitration.

1. Jay Treaty (1794)

Perhaps the first use of special-purpose tribunals to resolve investment disputes was the 1794 Jay Treaty, concluded between the United States and Great Britain in the aftermath of the American Revolution.[66] The Jay Treaty was intended to ensure a continued flow of capital from Britain, then one of the largest economies in the world, by resolving the British claims of property damage, expropriation, and breach of contract that arose during the conflict. The treaty established a standing international arbitration tribunal to hear all such claims by British investors, where "full compensation for [their] losses and damages [could] not . . . be actually obtained . . . in the ordinary course of justice."[67]

Prominent American political figures such as Alexander Hamilton campaigned hard for ratification of the pact, recognizing that America was in dire need of foreign capital to help its fledgling economy grow. These leaders understood that without investment guarantees and a neutral forum in which to resolve past disputes, the flow of foreign capital could be curtailed.[68] The commissioners who would adjudicate claims were appointed in 1797, and the following year Congress allocated $300,000 to establish a fund for payment of the commission's awards.[69]

66 Treaty of Amity, Commerce, and Navigation, Nov. 19, 1794, U.S.-Grt. Brit., 8 Stat. 116. *See generally* Barton Legum, *Federalism, NAFTA Chapter Eleven and the Jay Treaty of 1794*, News from ICSID (Spring 2001).

67 Jay Treaty, art. 6; Barton Legum, *The Innovation of Investor-State Arbitration Under NAFTA*, 43 Harv. Int'l L. J. 531, 534 (2002).

68 Alexander Hamilton & Rufus King, *The Defence No. XIV*, Sept. 9, 1795, *reprinted in* 19 *The Papers of Alexander Hamilton* 245, 249–50 (Harold C. Syrett ed., 1974).

69 Legum, *supra* note 66.

The Jay Treaty of Amity, Commerce, and Navigation
Signed at London, November 19, 1794

2 TREATIES AND OTHER INTERNATIONAL ACTS OF THE U.S. 245, 249–53 (1931)

ARTICLE 6

Whereas it is alleged by divers British Merchants and others His Majesty's Subjects, that Debts, to a considerable amount, which were bona fide contracted before the Peace, still remain owing to them by Citizens or Inhabitants of the United States, and that by the operation of various lawful Impediments since the Peace, not only the full recovery of the said Debts has been delayed, but also the Value and Security thereof, have been in several instances impaired and lessened, so that by the ordinary course of Judicial proceedings the British Creditors, cannot now obtain and actually have and receive full and adequate Compensation for the losses and damages which they have thereby sustained: It is agreed that in all such Cases where full Compensation for such losses and damages cannot, for whatever reason, be actually obtained had and received by the said Creditors in the ordinary course of Justice, The United States will make full and complete Compensation for the same to the said Creditors.

For the purpose of ascertaining the amount of any such losses and damages, Five Commissioners shall be appointed and authorized to meet and act in manner following—viz—Two of them shall be appointed by His Majesty, Two of them by the President of the United States by and with the advice and consent of the Senate thereof, and fifth, by the unanimous voice of the other Four; and if they should not agree in such Choice, then the Commissioners named by the two parties shall respectively propose one person, and of the two names so proposed, one shall be drawn by Lot in the presence of the Four Original Commissioners.

The commission's activities were permanently discontinued after only a year of work, in July 1799, in part because of personality clashes and disagreement among the commissioners over the local remedies rule,[70] but the structure and operation of the Jay Treaty tribunal lent much to the modern investor-state arbitration system of the late twentieth century.

2. Ad Hoc Arbitration

Many of the disputes concerning mistreatment of foreigners that arose in the nineteenth and early twentieth centuries were resolved by ad hoc tribunals or umpires, who were charged with the case either by treaty provision or by mutual agreement of the two governments involved to submit to neutral dispute resolution. These arbitrators operated without any particular procedural framework, specific scope of jurisdiction, rules of evidence, or other guidelines; and

70 *Id.*

therefore they faced serious challenges in rendering awards efficiently and on a consistent and coherent basis.

The *Gentini*[71] case exemplifies the procedural and substantive ambiguity inherent in ad hoc tribunals. In that case Italy brought a claim against Venezuela in 1903 to seek compensation on behalf of an Italian national whose store was looted by Venezuelan soldiers in 1871. The umpire decided that potentially applicable municipal statutes of limitation could not bar international claims but also held that the concept of a limitation in time is essential to the administration of justice and therefore must apply to international claims in some way. Without expressing an opinion regarding the number of years that would bar such a claim, the umpire dismissed the case on grounds that the claimant "had so long neglected his supposed rights as to justify a belief in their non-existence."[72] Such lack of precision came to characterize the development of customary international law on foreign investment.

3. Binational Claims Commissions

Periods of protracted civil unrest or instability in particular countries in the nineteenth and twentieth centuries often spawned entire sets of disputes. These were sometimes resolved by international claims commissions with jurisdiction over a broad category of disputes.[73]

Longstanding problems between Mexico and the United States resulted in one such international commission. The U.S.-Mexico General Claims Commission was constituted under the terms of the General Claims Convention in 1923.[74] The convention, which took effect in 1924, was intended to improve relations between the countries by forming a quasi-judicial organ to settle claims arising in the previous fifty-five years (after 1868). Its jurisdiction encompassed claims against one government by nationals of the other "for losses or damages suffered by such nationals or their properties" and "for losses or damages originating from acts of officials or others acting for either government and resulting in injustice." Most commission

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71 *Gentini (Italy v. Venezuela)*, Mixed Claims Commission, 1903, J. H. Ralston, *Venezuelan Arbitrations of 1903*, 720 (1904).

72 *Id.*

73 *See, e.g.*, Report of Fred Nielsen, *American and British Arbitration under the Special Agreement of August 18, 1910* (Wash., D.C., Gov't Printing Off. 1926); B. Hunt, *American and Panamanian General Claims Arbitration, Reports of the Agents for the United States* (1934); Claims Commission between France and Mexico, *La Reparation des Dommages causes aux etrangers par des mouvements revolutionnaires, Jurisprudence de la Commission franco-mexicaine des Reclamations* (1924–1932) (Pedone 1933); Report of B. Hunt, *American-Turkish Claims Settlement under the Agreement of December 17, 1932* (Wash., D.C., Gov't Printing Off. 1934); Jackson Ralston, *Venezuelan Arbitrations of 1903* (1923); Jackson Ralston, *French Venezuelan Mixed Claims Commission of 1902* (1905).

74 See generally A. H. Feller, *The Mexican Claims Commissions, 1923–1934, A Study in the Law and Procedure of International Tribunals* (Macmillan 1935).

rulings arose from claims for cases of wrongful killing, denial of justice, seizure of property, unlawful arrest and detention, breach of contract, and disputes over taxes. Cases stemming from events related to revolutions or other civil disturbances in Mexico were excluded from the jurisdiction of the General Claims Commission.[75]

The commission was composed of three members—one from the United States, one from Mexico, and one from a neutral country—and it applied principles of international law in resolving disputes. The commission met from 1924 to 1931 in Washington, D.C., and Mexico City. Work resumed in 1934 under a new agreement and format and ended in 1937, but final settlement was not reached until 1941.[76] Although ad hoc in nature, the structure of the commission embodied many of the structural elements now present in the investment treaty regime.

4. Friendship, Commerce, and Navigation Treaties

Beginning in the nineteenth century, developed countries (primarily the colonial powers) entered into commercial agreements with less developed trading partners known as Friendship, Commerce, and Navigation (FCN)[77] treaties. The FCN treaties emerged from the tradition of jurisdictional treaties and treaties of amity, but established a more formally equal status between the parties, and preserved a greater degree of sovereignty for the developing state parties. These agreements were primarily designed to ensure developed states access to expanding markets for the sale of finished goods in the developing world, and therefore focused primarily on rules regarding free trade and transport of goods, although they sometimes also regulated compensation for expropriation and the protection of foreign property.[78] The FCN treaties have largely been superseded by bilateral investment treaties (BITs), free trade agreements (FTAs), and multilateral agreements in the area of investment protection; but they remain important both as historical background to the development of modern investor-state dispute resolution and as a source of law and interpretative guidance still frequently used in modern arbitration.[79]

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75 Herbert W. Briggs, *The Settlement of the Mexican Claims Act of 1942*, 37 Am. J. Int'l L. 222, 227 (1943).

76 The final settlement was memorialized in the Convention Respecting Claims between the United States and Mexico, Nov. 19, 1941, U.S.-Mex., 56 Stat. 1347.

77 Dieter Blumenwitz, *Treaties of Friendship, Commerce and Navigation*, EPIL IV 953 (2000).

78 Michael Avramovich, *The Protection of International Investment at the Start of the Twenty-First Century: Will Anachronistic Notions of Business Render Irrelevant the OECD's Multilateral Agreement on Investment?* 31 J. Marshall L. Rev. 1201, 1233–34 (1998).

79 F. A. Mann, *British Treaties for the Promotion and Protection of Investments*, 52 Brit. Y.B. Int'l L. 241, 249 (1981) ("The importance of the [Friendship, Commerce and Navigation (FCN) treaties] lies in the contribution they make to the development of customary international law, in their being a source of law. . . . [T]hese treaties establish and accept and thus enlarge the force of traditional conceptions."); *see generally Restatement (Third) of Foreign Relations Law*, Introductory Note, at 18 (1987) (treaties are an important source of "international law" because they "have become the principal vehicle for making law for the international system").

5. Lump Sum Settlement Agreements

After World War II, bilateral treaties known as *lump sum agreements* became a prominent means for the settlement of international claims for damage to and expropriation of foreign property by governments.[80] Lump sum agreements relegated large classes of complex individual claims to adjudication by an administrative tribunal within the home state of the injured parties, allowing the states in question to resolve complex outstanding legal issues and improve diplomatic relations more generally. Pursuant to a typical lump sum agreement, the host state transferred a particular amount of money, normally arrived at through a political negotiation process, to the injured individuals' home state. In return, both states agreed to prohibit any further private claims arising out of the same government measures, either in national courts or at international law. The injured parties' state then established an internal administrative process, or employed existing structures, to distribute the lump sum to qualifying citizens.[81] Excerpts from a lump sum settlement agreement are set forth in the following text.

Agreement Between the Republic of Austria and the German Democratic Republic on the Settlement of Unresolved Questions Relating to Property Rights

August 21, 1987 (entered into force June 1, 1988)

[1988] B.G.B.1 1887

The Republic of Austria and the German Democratic Republic, desiring to contribute to the further development of friendly relations between the Republic of Austria and the German Democratic Republic, in an effort to settle finally the unresolved questions relating to property rights . . . in the interest of both parties, have agreed as follows:

Article 1

The German Democratic Republic shall pay to the Republic of Austria a lump sum of 136,400,000. . . . Austrian schillings in settlement of property claims of the Republic of Austria, Austrian citizens, or Austrian juridical persons because their property has come

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80 Burns H. Weston, et al., *International Claims: Their Settlement by Lump Sum Agreements* 7 (1999); M. A. Ruíz Colomé, *Lump Sum Agreements in Spanish Practice*, 6 Spanish Y.B. Int'l L. 1(2002).

81 In the United States, the Foreign Claims Settlement Commission (FCSC), which is an independent quasi-judicial federal agency, is in charge of determining "the validity and valuation of claims of United States nationals for loss of property in foreign countries, as authorized by Congress or following government-to-government claims settlement agreements." Foreign Claims Settlement Commission of the United States, *1995 FCSC Ann. Rep.*, 1; *see also* the Web site of Foreign Claims Settlement Commission, http://www.usdoj.gov/fcsc/.

exclusively within the control of the German Democratic Republic through a takeover by a public administrator or though other public measures by the German Democratic Republic.

Article 2

This Agreement also shall settle property claims of the German Democratic Republic, as well as of citizens and juridical persons of the German Democratic Republic, against the Republic of Austria, Austrian citizens, or Austrian juridical persons in relation to the property referred to in Article 1.

Article 6

1. The distribution of the lump sum referred to in Article 1 shall be within the exclusive jurisdiction of the Republic of Austria.

Article 7

With the full payment of the sum referred to in Article 1, all property claims referred to in Articles 1 and 2 shall be finally settled. Neither of the parties, after the entry into force of this Agreement, shall raise or in any way support claims settled by the present Agreement vis-à-vis the other party.

Article 8

1. The German Democratic Republic shall fulfill its payment obligation set out in Article 1 as follows:

> The total amount shall be paid from the State Bank of the German Democratic Republic to the Austrian National Bank in successive yearly installments.
>
> The first installment of 31,400,000 . . . Austrian schillings shall be due 6 (six) months after the entry into force of this Agreement.
>
> The amount of further yearly installments shall always equal 0.8% of the proceeds of the trade export of the German Democratic Republic to the Republic of Austria, which shall be based upon the official Austrian statistics for foreign trade for the preceding calendar year. . . .

In the eyes of the ICJ, such lump sum agreements are the product of politics and economics rather than of legal norms; and, therefore, despite their prominence, they have contributed relatively little to the development of investment protection jurisprudence:

> Also distinct are the various arrangements made in respect of compensation for the nationalization of foreign property. Their rationale . . . derived as it is from structural changes in a State's economy, differs from that of any normally applicable provisions. Specific agreements have been reached to meet specific situations, and the terms have varied from case to case. Far from evidencing any norm as to the classes of beneficiaries of compensation, such arrangements are sui generis. . . . It should be clear that the developments in question have to be viewed as distinctive processes, arising out

> of circumstances peculiar to the respective situations. To seek to draw from them analogies or conclusions held to be valid in other fields is to ignore their specific character as lex specialis and hence to court error.[82]

Some commentators disagree, however, asserting that the decisions of arbitrators in the context of lump-sum arrangements "must be treated in the same manner as any other international prescription," and in particular as an important source of customary international law.[83]

6. Investment Guarantee Programs

Some developed countries have established investment guarantee programs to provide some level of security for the investment of their citizens abroad, mainly by insuring their nationals' investments against the occurrence of political risk. These guarantees have the advantage of enabling an investor claiming injury to deal with its own governmental agencies. In this way, the "safety of the invested capital [became] . . . independent of the actions of the country of investment."[84] The following excerpt concerning the United States government's investment insurance initiatives is illustrative in this regard.

Kenneth J. Vandevelde, *Reassessing the Hickenlooper Amendment,*
29 Va. J. Int'l L. 115, 123–4 (1988)[85]

> The period following World War II saw the initiation of . . . [an] effort to protect U.S. investment overseas. The Economic Cooperation Act of 1948 authorized the sale of insurance to overseas investors against the risk, initially, of nonconvertible currency, and, after 1950, of expropriation. Subsequent legislation broadened the authority and revamped the bureaucratic management of the investment guarantee program, creating in 1969 the Overseas Private Investment Corporation (OPIC) which administers the program today. Under this program, investors purchase insurance from the federal government and are reimbursed for losses due to expropriation within the limits of the policy. Insurance whereby investors, through the pooling of the premiums, actually pay for the loss, however, must be distinguished from a remedy, whereby the wrongdoer is compelled to pay for the loss. Thus, an insurance program is, from one perspective, technically no remedy at all. Moreover, OPIC, like any insurer, only covers specified risks for certain people at a cost to the insured.

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82 *Barcelona Traction, Light & Power Co. Ltd.* (*Belgium v. Spain*), 1970 I.C.J. 3 (Second Phase), Judgment of Feb. 5, 1970, at 39–40.

83 Weston et al., *supra* note 80, at 1; Richard B. Lillich & Burns H. Weston, *Lumps Sum Agreements: Their Continuing Contribution to the Law of International Claims*, 82 Am. J. Int'l L. 69 (1988).

84 *See* Progress Report by the Secretary-General, E.S.C., 29th Sess., U.N. Doc. E/3325 (1960), ¶ 170 [hereinafter E/3325]. *See also* A. A. Fatouros, *Government Guarantees to Foreign Investors* 101–3 (Columbia University Press 1962); *Oppenheim's International Law* 915, n. 8 (Sir Robert Jennings & Sir Arthur Watts eds., 9th ed. 1992).

85 Source notes have been deleted.

> Nevertheless, the investment guarantee program for the first time provided expropriated investors with a source of recovery which was not dependent upon the agreement of the expropriating country to negotiate or the agreement of the U.S. government to espouse the claim. The U.S. government does become involved to the extent of negotiating agreements with other countries in order to include those nations in the OPIC program. Further, in accordance with the agreements, the U.S. government, through OPIC, has the right to demand arbitration of the insured's claim, to which OPIC becomes subrogated as the insurer. Investors, however, are compensated regardless of OPIC's decision to arbitrate or not to arbitrate.
>
> To the extent that the U.S. government through OPIC does pursue claims and obtain compensation, the investment insurance program may be regarded as an indirect remedy. But precisely to the extent that the program is a remedy, it is dependent upon the involvement of the U.S. government in the dispute.[86]

As early as 1948, the World Bank sponsored multilateral discussions regarding the promotion of international investment through political risk insurance. After much discussion, negotiation, and numerous drafts, these talks led to the creation of Multilateral Investment Guarantee Agency (MIGA) under auspices of the World Bank.[87]

7. The Algiers Accords

In the aftermath of the Iranian revolution of 1979 and the subsequent taking of American hostages by Iranian student protesters, the United States froze all Iran's assets in the United States, pending the resolution of claims put forward by U.S. citizens against Iran. As part of the agreement that led to the hostages' release, the United States was able to negotiate a binding dispute resolution arrangement with Iran, codified in the Algiers Accords of 1981. Pursuant to this treaty, the United States was to unblock restrained assets, and the payment of all claims would be adjudicated by a standing tribunal of international arbitrators drawn from U.S., Iranian and third-country jurists.[88]

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86 A related effort, which started earlier, was creation of Export Credit Agencies (ECAs) by the governments of developed and then developing countries. ECAs provided export credit guarantee and insurance to promote export of products from the issuing states abroad. The first such agency was Federal of Switzerland (1906); thereafter other countries followed suit. The United States created its own ECA (Export Import Bank) in 1934. *See generally* Delio E. Gianturco, *Export Credit Agencies—The Unsung Giants of International Trade and Finance* (Quorum Books 2001).

87 *See generally* Chapter One in Ibrahim F. I. Shihata, *MIGA and Foreign Investment* (Martinus Nijhoff Publishers 1988).

88 *See generally* George H. Aldrich, *The Jurisprudence of the Iran-United States Claims Tribunal* (1996) (*see, e.g.,* nationality issues (44 *et seq.*), standing and admissibility (124 *et seq.*), expropriations/takings (171 *et seq.*), damages (293 *et seq.*), evidence (332 *et seq.*), and the table of cases (524 *et seq.*); *see also* Charles N. Brower & Jason Brueschke, *The Iran-United States Claims Tribunal* (Martinus Nijhoff 1998).

By July 2005, nearly 4,000 claims had been submitted, with approximately a thousand adjudicated. Approximately US$2.5 billion was paid out to U.S. investors in Iran.[89]

E. Limitations of Historic Dispute Settlement Processes

Some of the limitations characterizing domestic law and customary international law as far as the private investor is concerned have been outlined above. Within the courts of the host country a variety of barriers such as partiality of the forum, immunity of the state, adoption of the Calvo doctrine and the inefficiency of such courts often left no meaningful means of redress for the aggrieved foreign investor. Further, because of the immunity of foreign sovereigns in national courts and the application of the act of state doctrine and similar legal rules, courts of the home country of the investor often did not provide a viable option either.

Meanwhile, customary international law frequently proved inadequate to provide relief to private investors that had suffered harm as a result of host government measures. Procedurally, remedies were normally dependent on espousal by the investor's home state, which could depend on political factors and was not always available to all nationals on an equal basis. Even if an investor managed to persuade its home country to espouse its claim, customary international law requirements of exhaustion of local remedies and continuous nationality had to be satisfied before a tribunal would examine the merits of the case.[90] Substantively, once procedural barriers were overcome, investors could find themselves without a cognizable claim against the host state, because the threshold of state liability at customary international law left a range of inequitable treatment unactionable.[91]

The dilemma that foreign investors faced was summarized in 1968 by Aron Broches, the former General Counsel of the World Bank:

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89 Mark Clodfelter, *U.S. State Department Participation in International Economic Dispute Resolution*, 42 S. Texas L.R. 1273, 1274 (2001). For more recent data *see* Iran-U.S. Claims Tribunal, Communiqué No. 05/3 (July 26, 2005), *available at* http://www.iusct.org/communique-english.pdf. Unlike lump sum settlements, here the winning investors receive 100 percent on a dollar.

90 A good example of jurisdictional hurdles is the claim of *Anglo-Iranian Oil Co. v. Iran*. The United Kingdom espoused the claim of Anglo-Iranian Oil Co. and brought a claim against Iran for nationalization of the assets of Anglo-Iranian before the ICJ. The ICJ, however, held that it lacked jurisdiction, because Iran had not accepted the jurisdiction of the court for disputes that had arisen out of treaties concluded before 1932. Anglo-Iranian Oil Co. Case (*U.K. v. Iran*), Preliminary Objections, 1952 I.C.J. Reports 20 (Judgment of July 22, 1952); a summary of the judgment is available at http://www.icj-cij.org/icjwww/idecisions/isummaries/iukisummary520722.htm.

91 *See, e.g.*, Oscar Chin Case, (*UK v. Belgium*) (Dec. 12, 1934). 1934 P.C.I.J. Reports, Series A/B, No. 63. For a detailed discussion of this case *see* Todd Weiler, *Saving Oscar Chin: Non-Discrimination in International Investment Law*, in *Arbitrating Foreign Investment Disputes: Procedural and Substantive Aspects* 159 (Horn ed., Kluwer Law Int'l 2004).

Economic Disputes Between Governments and Private Individuals or Corporations

1. The nature of the problem may be briefly described as follows:

(a) in the absence of an agreement to the contrary between the foreign investor and the host Government, the investment is subject to the laws of that Government (local law) and the redress of grievances which the investor may seek by direct access to that Government is equally determined by local law.

(b) If the investor feels aggrieved by actions of the host Government he may invoke the diplomatic protection of his national State or he may request his national State to espouse his case and bring a claim before an international tribunal. It is to be noted, of course, *first*, that in some countries the foreign investor may, as a condition of entry, be required to waive diplomatic protection and, *second*, that even if the national State is willing to espouse the investor's case, it may find that the host Government is unwilling to submit to the jurisdiction of an international tribunal. However, even in the absence of these obstacles, the present situation may be regarded as unsatisfactory because of the investor's inability to proceed with an international claim *directly* against the host Government. The necessity of espousal of his case by his national Government before an international claim can be lodged, introduces a political element. An investor may well find that his national Government refuses to espouse a meritorious case because it fears that to do so would be regarded as an unfriendly act by the host Government. And this consideration is even more likely to cause the national Government to refrain from acting if the merits of the investor's case are not wholly clear in its view, thus withholding from the investor an opportunity to have his case judged by an impartial tribunal.

(c) In an attempt to overcome these difficulties, some investors, mostly large corporations especially in the field of extractive industry, have been able to negotiate arbitration agreements with host Governments, providing for detailed rules regarding the selection of arbitrators, the arbitral procedure and, in some cases, the law to be applied by the arbitral tribunal. It is quite clear that only a few investors can be in a position to negotiate such agreements. However, the validity of such agreements is sometimes questioned. If the Government refused to proceed with the arbitration, the investor's remedy would once again be either a request to his national State for diplomatic intervention or for an espousal of his case before an international tribunal.

(d) The absence of adequate machinery for international conciliation and arbitration often frustrates attempts to agree on an appropriate mode of settlements of disputes. Tribunals set up by private organizations such as the International Chamber of Commerce are frequently unacceptable to governments and the only public international arbitral tribunal, the Permanent Court of Arbitration, is not open to private claimants. . . .[92]

Out of this dilemma evolved the Washington Convention and the modern system of investment treaties.

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92 Note by Aron Broches, General Counsel, transmitted to the Executive Directors: "Settlement of Disputes between Governments and Private Parties," SecM 61–192 *in* 2 *Convention on the Settlement of the Investment Disputes between States and Nationals of Other States, Documents Concerning the Origin and Formulation of the Convention*, 1–2 (1968).