# Domestic courts in investor-state arbitration : partners, suspects, competitors

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# 2. THE HISTORICAL FRAME OF REFERENCE

The purpose of this chapter is to set the scene for the analysis of arbitral jurisprudence that will be undertaken in the later parts this study, by providing a historical frame of reference through which the relationship between investment tribunals and domestic courts can possibly be thought of and conceptualized. The point I intend to make is that the investment tribunals' current attitude towards domestic courts, and the perceptions that they have about domestic court's role in the settlement of investment disputes, are not the result of recent interactions between both categories of adjudicatory bodies. Rather, they appear to be the consequence of a long line of efforts, from at least the nineteenth century onwards, to exempt foreign investment from constraints posed by local contexts, both procedurally and substantively.[1]

The argument that I intend to make is three-fold. *First,* that the investment tribunal's present attitude has much to do with the historical premises under which investor-State arbitration was introduced as a distinct mechanism for adjusting conflicts between foreign investors and host States – namely, as one that allows investors direct recourse to international adjudication without the previous exhaustion of local remedies. For, it is this particular design that eventually enabled investor-State arbitration to progressively establish itself as a fully-fledged alternative to local litigation of investment disputes (a development which I term as the *functional* shift), leading in turn to a perception of redundancy of local courts. *Second*, that such perception of redundancy has been further underpinned by the gradual emergence of international law as the body of law prescribing the standards through which the propriety of host States' dealings with foreign investors is now predominantly measured. For, once domestic law had ceased to provide the relevant normative benchmarks (a development which I term as the *substantive* shift), domestic courts were further deprived of the possibility to claim epistemic priority over other adjudicatory bodies.[2] And *third*, that this procedural and substantive internationalization of investor-State relations can actually be linked to the long prevailing distrust among capital-exporting/Western States towards the ability of foreign, non-Western courts to adequately adjust controversies between foreign investors and the host States of their investments. For, it was this lack of trust that had historically been advanced in justification for investor-State arbitration (the problem of *distrust*). The ensuing parts of this chapter are devoted to elaborating upon these three themes, by discussing the historical antecedents pertaining to the functional shift (2.1.), to the substantive shift (2.2.), and to the problem of distrust (2.3.), respectively.

## 2.1. The Functional Shift: Investor-State Arbitration Establishes Itself as Procedural Alternative to Domestic Litigation

The emergence of investor-State arbitration as a specialized dispute resolution mechanism has certainly been an important reason for the declining relevance of domestic courts in the resolution of investment disputes. The growth in its use today is largely attributable to the proliferation of international investment treaties which, in addition to providing foreign investors with certain substantive guarantees concerning the treatment that they can expect to receive from the host State of their investment, grant them the procedural capacity to directly enforce those

[1] For this claim, see M Koskenniemi, 'It's not the Cases, It's the System' (2017) 18 Journal of World Investment & Trade 343 at 344.

[2] Arguably, this perception of redundancy may in some cases be further reinforced by the fact that, in view of the constitutional limitations in some countries, domestic courts may also not necessarily be capable of adjudicating investment disputes by reference to these international standards.

guarantees before arbitral tribunals operating independently from the domestic judicial system of the host State. Yet, the fact that investor-State arbitration has established itself as a mechanism allowing foreign investors to bypass domestic courts is not the result of treaty developments that occurred in the last few decades. It is the product of a longer process of legalization and internationalization of investment dispute settlement, of its ostensible de-politicization through the granting of direct remedial procedures, and of its gradual entrenchment as an independent mechanism that is capable of being employed in lieu of domestic judicial procedures.

### 2.1.1. The "Legalization" of Dispute Settlement and the Emergence of the Law of International Claims

The emergence of investor-State arbitration in the later part of the twentieth century forms part of the much longer process of "legalization" of international economic disputes that has been going on since the end of the eighteenth century. Traditionally, there were two ways[3] in which controversies over the treatment of property of nationals abroad could be resolved. In the more extreme form, redress was obtained through the (threat of) use of force, either by means of armed interventions on the part of the foreigner's State of nationality (a phenomenon often described also as "gunboat diplomacy", in view of the recurrent practice of capital-exporting States that dispatched naval vessels to secure the protection of their nationals' property),[4] or through the use of privateers authorized by governmental letters of marquee. The alternative, less violent way of dealing with controversies was through diplomatic interposition. The matter was brought to the attention of the foreign government and a complaint was formally pressed through diplomatic channels, coupled with the demand that the injury be remedied. The procedural device, through which a State espoused a claim on behalf of the injured national, came to be known as diplomatic protection.[5] Pursuit of the latter was premised on the principle that, through the bond of nationality, the State was entitled to claim an interest in the treatment of its nationals abroad, and to demand their protection in the event of an injury.[6]

Initially, demands for redress were presented on the basis of international comity. But as a body of law governing the treatment of aliens gradually developed through treaty practice,[7] governments increasingly began to frame their demands under a claim of right, flowing from a breach of international law.[8] By the nineteenth century, the protection of nationals abroad came thus to be treated as a legal question, which justified interposition by appeal to principles of international law. By that time, however, their adjustment, too, became subject of legal methods. Beginning with the Jay Treaty of 1794, controversies concerning the mistreatment of foreign nationals began increasingly to be put to international adjudication. Particularly in the second half

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[3] Up until the twentieth century, suits by aggrieved investors in the courts of their home State did not provide an effective or viable remedy. In the first place, States have not held much sovereign assets abroad that could be subject to attachment (in practice, the vast majority of the cases involving States' foreign property were thus also suits in admiralty). Furthermore, following the US Supreme Court's judgment in *The Schooner Exchange v McFadden* (1812), 11 US 116 (1812), the doctrine of absolute immunity was accepted in many States, which thus prevented States from being sued in another State's courts and their assets being seized to enforce a court judgment.

[4] Some of the more conspicuous examples are described in C Dugan et al, *Investor-State Arbitration* (OUP 2008) 26-27.

[5] For the classical treatment of the subject, see EM Borchard, *Diplomatic Protection of Citizens Abroad or the Law of International Claims* (1915). A modern restatement can be found in CF Amerasinghe, *Diplomatic Protection* (OUP 2008). The substantive basis of the doctrine of diplomatic protection was the thesis advanced by Emmerich de Vattel that an injury to an individual is an injury to the state. E Vattel, *The Law of Nations*, bk II (1758) ch v. But it was only in the course of the nineteenth century that through the practice of diplomatic interpositions the doctrine fully developed. See F Dunn, *Protection of Nationals Abroad* (1932) 46ff.

[6] Borchard, ibid 25-30, 351.

[7] See (n 3).

[8] FG Dawson and IL Head, International Law, National Tribunals and the Rights of Aliens (Syracuse 1971) 9.

of the nineteenth century, the practice would thus become formalized of appointing ad-hoc tribunals (or umpires) to decide particular controversies, or else of establishing semi-permanent claims commissions to resolve a broader set of disputes which frequently followed from periods of protracted civil unrest, or in the aftermath of a war.[9] Though the establishment of these special-purpose dispute settlement bodies often still occurred under pressure by political, economic, or military threats, in the long run, the practice transformed the nature of alien protection from one determined by the vicissitudes of politics, to one that would increasingly be resolved according to the regularity of law.[10]

Apart from entailing the application of legal methodology to the determination of economic claims, these early means for adjudicating investment controversies had not much in common with investor-State arbitration as we know it today. Of course, both represented a form of consensual, third-party adjudication. Yet, the early forms of international adjudication mostly operated *ex post facto*, and often without a specific procedural framework governing such issues as the organization of proceedings, rules of evidence, or even the scope of jurisdiction.[11] Crucially, these early forms of international adjudication were still premised upon what was essentially an inter-State framework. Thus, if aggrieved by the actions of the host State, the foreign investor was not in a position to directly resort to dispute settlement on the international level. The investor's cause had to be formally espoused by his State of nationality, which then presented the claim for adjudication in the exercise of diplomatic protection. In accordance with long-established custom, however, such a claim was only admissible if the aggrieved investor first exhausted all available judicial or administrative remedies.[12] This meant that, though constituting an *international* mechanism for the adjudication of investment disputes, the use of ad hoc tribunals and international claims commissions did not yet provide a substitute of domestic judicial processes. On the contrary, it was a system where domestic courts retained a fundamental role in disputes over foreign investment.[13] The investor was bound to first seek redress for its grievances before host State's courts, so that the offending government was given an opportunity of doing justice to the injured party in its own regular way, and thus avoid, if possible, all occasion for international confrontation between States.[14] In theory, therefore, the cases brought to international adjudication were initially treated as domestic conflicts.[15]

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[9] See generally BJ Bederman, 'The glorious past and uncertain future of international claims tribunals' in MW Janis (ed), *International Courts for the Twenty-First Century* (Martinus Nijhoff 1992) 161-93.

[10] On this, see further TA Nissel, *A History of State Responsibility: The Struggle for International Standards (1870-1960)* (Dissertation submitted to Helsinki University in satisfaction of LLD degree, 2016), 131.

[11] Dugan et al (n 4), 35.

[12] See eg Borchard (n 5), at 818, explaining in a footnote that the requirement 'is so thoroughly established that the detailed citation of authorities seems hardly necessary'.

[13] See P Muchlinski, 'The Diplomatic Protection of Foreign Investors: a Tale of Judicial Caution', in C Binder et al. (ed), *International investment law for the 21st century: essays in honour of Christoph Schreuer* (OUP, 2009), 341-362, at 343, noting the contingent nature of diplomatic protection and the supplementary role that international law plays under such system in the regulation of disputes between investors and host States: 'In all cases the local law is the first point of redress for the foreign entity'.

[14] See *Interhandel Case (Switzerland v US) (Judgment)* [1959] ICJ Rep 6, at 27 ('Before resort may be had to an international court in such a situation [ie, when a State adopts the cause of its national whose rights are claimed to have been disregarded in another State in violation of international law], it has been considered necessary that the State where the violation occurred should have an opportunity to redress it by its own means, within the framework of its own domestic legal system.') There were also other, more practical rationales of the rule. See further Borchard (n 5), 817-18; AV Freeman, *The International Responsibility of States for Denial of Justice* (Longmans, Green and Company 1970), at 416-17; and CF Amerasinghe, *Local Remedies in International Law* (CUP 2004), 56-64.

[15] See S Puig, 'No Right Without a Remedy: Foundations of Investor-State Arbitration,' in Z Douglas, J Pauwelyn and JE Viñuales (eds), *The Foundations of International Investment Law: Bringing Theory Into Practice* (OUP, 2014), 235, at 241.

Albeit deemed to be a significant improvement from the forceful means for securing redress, the early legalized forms of investment protection had several shortcomings. One of them was certainly the absence of any permanent machinery to administer the adjudication of such disputes; a problem that would partly be addressed with the adoption of the 1899 Hague Convention and the establishment of the Permanent Court of Arbitration (PCA),[16] and later with the creation in 1922 of the Permanent Court of International Justice (PCIJ).[17] Another was the celerity with which property-related disputes were actually addressed by the various claims commissions and tribunals. Proceedings before these frequently suffered from considerable delays, while many of them were also prevented from properly completing their work.[18] In addition to this, the mechanism of diplomatic protection itself increasingly began to prove unsatisfactory as a device for the adjustment of investment disputes. For the state of nationality, the practice was seen as problematic because the espousal of claims inevitably led to confrontation and conflicts with the government of the host State. For the investor, reliance on diplomatic protection did not provide for sufficient security, as there was no guarantee that his State of nationality will be willing to espouse the claim, or even to submit it for adjudication before a competent international tribunal. In accordance with the traditional law of international claims, the right of diplomatic protection was namely one belonging to the State, meaning that the latter enjoys discretion as to whether or not it will take up the claim on behalf of its injured national, and how it will exercise it.[19] This even besides the more practical question, whether the home State was actually equipped with sufficient legal and factual knowledge to pursue claims in relation to what – certainly in the context of modern foreign investment operations – would usually turn out to be very complex problems.

### 2.1.2. The Rise of Individuals' Private Right of Action and the Advent of Contract-Based Arbitrations

The right of diplomatic protection was premised on the Vatelian fiction, famously endorsed by the PCIJ in the *Mavrommatis* case (1924), that "[b]y taking up the case of one of its subjects and by resorting to diplomatic action or international judicial proceedings on his behalf, a State is in reality asserting its own rights — its right to ensure, in the person of its subjects, respect for the rules of international law".[20] Reliance on this fiction was necessary since, since in accordance with traditional international law, private persons did not have standing to bring claims directly against States. Up until the twentieth century, international law was still considered primarily as the law which governed the relations among States, and which did not recognize private parties as its

[16] *Convention for the Pacific Settlement of International Disputes*, 29 July 1899, 1 Bevans 230 (entered into force 4 September 1900). The Convention provided a structure for the arbitration of inter-State disputes.

[17] *Statute of the Permanent Court of International Justice*, 16 December 1920 (entered into force on 20 August 1921), 6 LNTS 379, 390; (1923) 17 AJIL Supp. 115.

[18] See Bederman (n 9), 166ff and MO Hudson, *International Tribunals: Past and Future* (1944) 195-98. Admittedly, the delays were partly explicable by the substantial dockets of many of these commissions.

[19] On these limitations, see Borchard (n 5), 356, 363-80. See also *Barcelona Traction, Light and Power Company, Limited (Belgium v Spain) (Second Phase Judgment)* [1970] ICJ Rep 3 [78]-[79] ('…within the limits prescribed by international law, a State may exercise diplomatic protection by whatever means and to whatever extent it thinks fit, for it is its own right that the State is asserting. Should the natural or legal persons on whose behalf it is acting consider that their rights are not adequately protected, they have no remedy in international law. […] The State must be viewed as the sole judge to decide whether its protection will be granted, to what extent it is granted, and when it will cease. It retains in this respect a discretionary power the exercise of which may be determined by considerations of a political or other nature, unrelated to the particular case. Since the claim of the State is not identical with that of the individual or corporate person whose cause is espoused, the State enjoys complete freedom of action.…'). The discretionary nature of diplomatic protection continues to be seen as the main reason for its ineffectiveness in the context of investment dispute settlement. See eg Muchlinski (n 13), 342-344.

[20] *Mavrommatis Palestine Concessions (Jurisdiction) (Judgment)* PCIJ (ser A) No 2 (30 August 1924) 12. cf A Pellet 'The Second Death of Euripides Mavrommatis' (2008) 7 LPICT 33.

proper subjects.[21] Such was the general position in international law; undoubtedly, there were certain limited instances of individuals having been granted the right of direct action on the international plane already in the nineteenth century, but these were essentially exceptions confirming the rule.[22]

This situation began to change in the course of the twentieth century, as the practice gradually became more common of conferring *locus standi* upon private persons in proceedings before international (adjudicatory) bodies,[23] including for the purpose of bringing claims[24] against States with respect to measures affecting the individuals' economic interests. Mention could be made here of the International Prize Court envisioned by The Hague Convention (1907), which – though never established – foresaw in the possibility for individuals from neutral or enemy powers to bring an appeal before such Court in the event that "the judgment of a national court injuriously affects his property".[25] But even more so of the Central American Court of Justice, which actually operated from 1907 to 1917 and which had competence to deal with questions that individuals of the five Central American States "may raise against any of the other contracting Governments, because of the violation of treaties or conventions, and other cases of an international character".[26] Specific mention should further be made of various arrangements for post-conflict reparations, such as the various Mixed Arbitral Tribunals established in the aftermath of WWI to decide claims for war-related losses that nationals of the Allied Powers could bring against the governments of enemy states;[27] the Arbitral Tribunal of Upper Silesia created to decide claims arising out of the "suppression or diminution of vested rights" resulting

[21] cf *SS Lotus (France v Turkey) (Judgment)* PCIJ (ser A) No 10 (7 September 1927) 18 ('International law governs relations between independent States'). For a general discussion, see K Parlett, *Individual in the international legal system: Continuity and Change in International Law* (CUP 2011).

[22] cf Court belonging to the Commission for the Navigation of the Rhine. On this, see HAM Klemann, 'The Central Commission for Navigation on the Rhine, 1815-1914. Nineteenth Century European Integration' in B Wubs & R Banken (eds), *The Rhine: A Transnational Economic History* (Nomos, 2017), 1-26.

[23] The trend was noticeable in different areas of international law and part of it was also the growing practice of affording private persons the capacity to institute proceedings before international adjudicatory bodies in relation to disputes between them and international organizations. Mention can be made eg of the Administrative Tribunal of the League of Nations established in 1927 to hear complaints against the Secretariat of the League of Nations and against the International Labour Office; the United Nations Administrative Tribunal established in 1949 for the purpose of resolving disputes between UN staff members and the UN organization; or the Court of Justice created by the Treaty Establishing the European Coal and Steel Community of 1951, before which private industrial enterprises or associations of enterprises could appeal against acts of the Community's organs.

[24] Increasingly, private parties have also been given standing to complain before international bodies about a State's purported non-observance of specific obligations in non-contentious procedures. Mention could be made of the right of individual 'representations' to the International Labour Office by an industrial association of employers or of workers (cf art 409 of the Treaty of Versailles); the right of individual 'communications' to the Council of the League of Nations in the context of the Minority Protection system; or the right of petition granted to communities or sections of the populations of mandated territories under the League of Nations' mandates system (cf *International status of South-West Africa (Advisory Opinion)* [1950] ICJ Rep 128, at 137-38).

[25] Convention (XII) relative to the Creation of an International Prize Court, signed in The Hague on 18 October 1907 (reproduced in The Hague Conventions and Declarations of 1899 and 1907 (OUP 1915) 189-90), arts 4(2) and (3). None of the signatories ever ratified the Convention. The Court's failure was primarily attributable to the uncertainty as to the law that it was supposed to apply. Hudson (n 18), 166.

[26] Convention between Costa Rica, Guatemala, Honduras, Nicaragua, and El Salvador for the Establishment of a Central American Court of Justice, signed at Washington on 20 December 1907, 206 CTS 78 (reproduced in (1908) 2 AJIL Supp 231), art 2.

[27] See eg *Treaty of Peace with Germany (Treaty of Versailles),* signed 28 June 1919, 225 CTS 188 (entered into force 10 January 1920) art 304(b). Similar provisions could be found in the peace treaties with Austria, Hungary, and Bulgaria. For their text and analysis, see PF Simonson, *Private Property and Rights in Enemy Countries* (E Wilson 1921) 281-87.

from the passing of sovereignty over Upper Silesia from Germany to Poland;[28] or the special Arbitral Commission on Property Rights and Interests established after WWII to decide on property-related and other matters arising out of the WWII and the occupation of Germany.[29] Last but not least, reference must be made to the various mechanisms that would eventually become increasingly common in the post-WWII era and which would allow private parties to bring claims against their own States of nationality in respect of alleged breaches of their human rights – starting with the possibility of individual petition under the European Convention of Human Rights (1950) that has allowed parties to bring claims before the European Commission on Human Rights with respect to *inter alia* the right to peaceful enjoyment of property.[30]

Thus, what in the nineteenth century still appeared an inconceivable proposition – that a State would permit itself to be sued before an international court by a private party – significantly changed in the course of the twentieth century. The bringing of claims by private persons in their own name, and without the interposition of the State of nationality, became an option contingent upon a State's consent. In most cases, though, the granting of individual *locus standi* on the international plane did not entail a full internationalization of dispute settlement procedures. Access to these remained often conditioned upon some form of initial recourse to domestic (judicial) remedies. In the context of some of the postwar arrangements discussed above (including with regard to the proposed International Prize Court), access to international adjudication was open only by way of appeal from domestic courts.[31] While access to the Central American Court of Justice[32] and the European Commission for Human Rights[33] was even conditioned with the strict exhaustion of local remedies.

The transition in international adjudication from a predominantly inter-State model, to one that increasingly accommodated "mixity", began to be noticeable also in relation to the settlement of investment disputes. At least initially, however, changes were not brought about through international law. The suggestion to extend the competence of the PCIJ to disputes based on economic relations between a State and an individual failed to attract proper support,[34]

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[28] See chiefly Convention between Germany and Poland relating to Upper Silesia, 15 May 1922, entered into force 3 June 1922, 9 LNTS 465, art 5. The Tribunal had competence over other matters. See further, G Kaeckenbeeck, 'The Character and Work of the Arbitral Tribunal of Upper Silesia' (1935) 21 Transactions of the Grotius Society 27.

[29] Convention on the Settlement of Matters Arising out of the War and the Occupation Between the UK, France, US, and Germany (FRG), signed at Bonn 26 May 1952, entered into force 5 May 1955, 332 UNTS 3, art 7 of ch 5, art 12 of ch 10, and art 6 of Annex.

[30] *European Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR),* signed at Rome 4 November 1950, ETS 5 (entered into force 3 September 1953) art 25. See <www.echr.coe.int/Documents/Collection_Convention_1950_ENG.pdf> accessed 14 June 2018.

[31] cf Convention (XII) relative to the Creation of an International Prize Court (n 25), art 4(2) and (3); or Convention on the Settlement of Matters Arising out of the War and the Occupation Between the UK, France, US, and Germany (n 29), art 7(2). However, German-Polish Convention regarding Upper Silesia (n 28), art 5, where direct recourse was allowed. See also Treaty of Versailles (n 27), art 297(e).

[32] See *Convention for the Establishment of a Central American Court of Justice* (n 26), art 2 ('… provided that the remedies which laws of the respective country provide against such violation shall have been exhausted or that denial of justice shall have been shown'). All of the five cases that were brought before the Court by individuals were dismissed or declared to be inadmissible, in part on account of the failure to exhaust local remedies. See MO Hudson, 'The Central American Court of Justice' (1932) 26 AJIL 759.

[33] See ECHR (n 30), art 26. ('The Commission may only deal with the matter after all domestic remedies have been exhausted, according to the generally recognized rules of international law…').

[34] See Permanent Court of International Justice: Advisory Committee of Jurists, 9th Meeting (Private) of 25 June 1920, *Procès-verbaux of the Proceedings of the Committee* (1920), at 205-15. On the drafts presented to the Committee of Jurists, see further LB Sohn, 'Proposals for the Establishment of a System of International Tribunals' in M Domke (ed), *International trade arbitration: a road to world-wide cooperation* (American Arbitration Association 1958) 63, at 67ff. Later proposals to permit private persons, including corporate ones, to appear before the International Court of Justice similarly failed to attract support. See SM Schwebel, 'Judge Sir Hersch Lauterpacht's Report on the Revision of the Statute of the International

while the proposals to establish, on a conventional basis, a special machinery dedicated to the adjustment of investment dispute were not put forward until after WWII.[35] In the early part of the twentieth century, provisions for the direct adjustment of investment-related disputes began to appear, instead, first in contracts that foreign investors directly negotiated with host State governments.[36] These provisions mostly took the form of arbitration clauses providing for either *ad hoc* or institutional arbitration, generally with some form of third party designation of a neutral arbitrator.[37] A notable element in these contractual arrangements was the absence of the usual requirement of submission to local courts, which the host State governments were apparently prepared to waive in their desire to attract foreign capital.[38] This appeared as a departure from the practice generally established under international law, but was of course fully in conformity with then emerging system of "private" international arbitration, which was conceived precisely as an alternative to litigation in any particular State judicial system.[39]

In the early part of the twentieth century, contract-based arbitration progressively began to establish itself as a viable,[40] even if not widely available, nor entirely effective mechanism for the settlement of investment disputes. In practice, it was mostly the larger investors, such as oil producing companies, that actually possessed sufficient bargaining power to succeed with the inclusion of arbitration clauses in their concession contracts. Even where such procedures were available, investors often experienced difficulties in their operation. Some of the shortcomings of such a contract-based system became manifest as early as with the seminal *Lena Goldfields* arbitration of 1930, one of the first instances of direct arbitration of a dispute between a host State and a foreign investor,[41] where the company never succeeded in enforcing the massive

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Court of Justice' in DD Caron, SW Schill, A Cohen Smutny & EE Triantafilou, *Practising virtue: inside international arbitration* (OUP, 2015), 158, at 164-165.

[35] See *infra* 2.1.3.

[36] Arrangements of this type occasionally gave rise to further litigation before the PCIJ. See eg *Losinger (Switzerland v Yugoslavia) (Order of 27 June 1936) (Preliminary Objection)* [1936] PCIJ (ser A/B) No 67, case concerning the non-observance of the arbitration clause contained in a contract between the Yugoslav Government and the firm of Losinger & Co; or *Société Commerciale de Belgique (Belgium v Greece) (Judgment)* PCIJ (ser A/B) No 78 (15 June 1939), concerning two awards rendered in an arbitration between the Government of Greece and the Societe commerciale de Belgique based on the arbitration clause provided for under a 1925 contract concerning the construction of railway lines.

[37] For examples, see FV Garcia-Amador, Special Rapporteur, *Fifth Report on International Responsibility* UN Doc A/CN.4/125 and Corr 1 (in (1960) II Ybk ILC), at paras 50-53.

[38] See on this O Schachter, 'Private Foreign Investment and International Organization' (1960) 45 Cornell L Q 415, at 427.

[39] Two important developments in this field were the adoption under the League of Nations of the 1923 Geneva Protocol on Arbitration Clauses, which effectively eliminated difficulties in regard to the non-recognition of non-domestic arbitration agreements, and of the 1927 *Geneva Convention for the Execution of Foreign Arbitral Awards*, which resolved difficulties in regard to the recognition and enforcement of foreign arbitral awards. In 1922, the International Chamber of Commerce also adopted its first rules of arbitration and in 1923 established the Court of Arbitration (EcoSoc Council Res 708 (XXVII) (April 17 1959)).

[40] One must bear in mind that the alternative to litigation before the courts of the host State, or the submission of investment disputes to international adjudication, was to seek relief in the courts of the investor's home State or some third-State where host States' assets were present. Before WWII, however, the plea of sovereign immunity generally prevented litigants from suing foreign governments or government agencies. See eg *Von Hellfeld v Russian Government (Anhalt Case)*, Decision of the Royal Prussian Court for the Determination of Jurisdictional

Conflicts of 25 June 1910 (reproduced in (1911) 5 Am J Int'l L 490, at 497) ('the property of a sovereign state in another state is not subject to the writs of execution of the law courts of the latter state because that property is not subject to the political power of the harboring state'). After WWII, the doctrine of absolute immunity gradually gave way to the restrictive theory of sovereign immunity, pursuant to which States could be sued for acts performed in a commercial capacity. In the United States, this policy changed was introduced in 1952. See WW Bishop, 'New United States Policy Limiting Sovereign Immunity' (1953) 47 Am J Int'l L 93.

[41] The *Suez Canal Company* case, decided by the French Emperor as early as in 1864, is considered by some as the earliest instance of a direct investor-State arbitration. On this episode, see J Webb Yackee, 'The First Investor-State Arbitration: *The Suez Canal Company v Egypt* (1864)' (2016) 17 The Journal of World Investment & Trade 401.

monetary award which it had obtained in its favor on account of the repudiation of its mining concession.[42] But it was particularly the recurring problem of host States denying the validity of arbitration agreements or otherwise attempting to repudiate them that would soon begin to undermine the effectiveness of contract-based system of investor-State arbitration. Facing such problems, foreign investors were, once again, left to rely on the protection of their own governments,[43] which might have been neither able, nor willing to provide. Indeed, unlike in the past, with the advent of the UN Charter, military interventions to compel the enforcement of awards, or the submission to further adjudication, became outlawed.[44]

Last but not least, there were also impediments arising from the absence of adequate facilities that could administer such arbitration. Arbitral institutions established by private organizations, such as the Court of Arbitration of the International Chambers of Commerce, were frequently not acceptable to governments of capital-importing States, in view of the private, commercial orientation of such institutions.[45] On the other hand, the Permanent Court of Arbitration, the only permanent arbitral institution then organized under international law, was essentially not open to private claimants, nor commanding large membership of capital-importing States.[46]

### 2.1.3. The Establishment of ICSID as a Decisive Step in the De-Politicization of Investment Disputes

A decisive step in improving the access of foreign investors to international dispute settlement mechanisms and overcoming the limitations imposed by the mechanism of diplomatic protection was taken with the establishment of the International Centre for the Settlement of Investment Disputes (ICSID) in 1965.[47] The push for its creation did not come directly from States, as in the case of the arbitration mechanism envisioned under the 1962 OECD Draft Convention on the

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[42] See on this episode VV Veeder, 'The *Lena Goldfields* Arbitration: The Historical Roots of Three Ideas' (1998) 47 ICLQ 747.

[43] A well-known example were the proceedings brought before the ICJ by the United Kingdom on behalf of the Anglo-Iranian Oil Company, following the nationalization of the Iranian oil industry. The submission to the Court was the consequence of the refusal, by Iran, to submit to arbitration, as provided for in the concession contract entered into between the Company and Iran. See Application Instituting Proceedings, reproduced in *Anglo-Iranian Oil Co Case (United Kingdom v Iran)* ICJ Pleadings, 12, available at <https://www.icj-cij.org/files/case-related/16/016-19510526-APP-1-00-EN.pdf >.

[44] cf O Schachter, 'The Enforcement of International Judicial and Arbitral Decisions' (1960) 54 AJIL 1, 14ff.

[45] PC Szasz, 'Using the New International Centre for Settlement of Investment Disputes' (1971) 7 E Afr LJ 128, at 128-29. This is not to say that these private institutions have not been administering arbitrations involving States and foreign private enterprises. Such mixed disputes have been submitted to the ICC since 1922. But these were largely disputes arising out of various supply / sale contracts. See further, KH Böckstiegel, 'Arbitration of Disputes between States and Private Enterprises in the International Chamber of Commerce' (1965) 59 AJIL 579.

[46] Szasz, ibid at 128-29. Admittedly, the PCA's founding Conventions authorized the Bureau to place its offices and staff at the disposal of the Contracting Parties 'for the use of any special Board of Arbitration' (*Convention for the Pacific Settlement of International Disputes* (n 16), art 47). As early as in the 1930s, the PCA provided services under this provision in a dispute between a US private company and China, concerning a contractual claim relating to the provision of radio services. See *Radio Corporation of America v Republic of China* (III UNRIAA 1621, 13 April 1935). But this arrangement was made pursuant to personal request of the umpire to the Secretary General of the PCA, and PCA's Administrative Council expressly agreed to art 47 being applied to the case. See 'Permanent Court of Arbitration. Circular Noted on the Secretary General' (1960) 54 AJIL 933, 937. In 1962, PCA's normal inter-governmental jurisdiction was formally extended through the adoption of the Rules of arbitration and conciliation for settlement of international disputes between two parties of which only one is a state. Until 1970, only a single attempt was made to use this procedure. See *Government of Sudan v Turrif Construction (Sudan), Limited* (reproduced in (1970) 16 Nederlands Tijdschrift voor Internationaal Recht 200).

[47] Convention on the settlement of investment disputes between States and nationals of other States (ICSID Convention), 18 March 1965, 575 UNTS 159 (entered into force 14 October 1966).

Protection of Foreign Property.[48] Nor as a result of private initiatives,[49] such as the Draft Statutes of the Arbitral Tribunal for Foreign Investment proposed by the International Law Association in 1948,[50] or the arbitration mechanisms proposed under the 1959 Abs-Shawcross Draft Convention on Investments Abroad.[51] Instead, the founding of the ICSID Centre occurred on the initiative of the World Bank, which – being at the same time a financing as well as a developmental institution – explored ways to stimulate the flow of private foreign capital to developing countries so as to supplement the limited volume of public development finance otherwise provided for by the Bank. As Aron Broches, the then General Counsel of the Bank and intellectual father of the ICSID Convention, would later explain, the Bank considered it necessary to contribute to the improvement in the investment climate "by reducing the likelihood of unresolved conflicts between host countries and investors, and in particular by doing so in a manner which would eliminate the risk of a confrontation of the host country and the national State of the investor".[52] The ICSID Convention, concluded after only some three years of drafting in 1965, succeeded on both counts.[53]

With a view to reducing the likelihood of unresolved conflicts, the Convention provided an effective machinery dedicated to the resolution of investment disputes, based on either conciliation or arbitration. This entailed not only the provision of detailed rules pertaining to the selection of arbitrators and to the conduct of arbitral proceedings. The Convention also directly addressed two of the most fundamental weaknesses that, at that time, were considered to undermine the effectiveness of concession-based arbitrations. First, it provided the necessary treaty basis for ensuring that arbitration agreements voluntarily entered into between private investors and host States would ultimately be implemented (Article 25(1) ICSID). And second, it provided the necessary framework to enable that the resulting arbitral decisions could be enforced in the national legal systems without any further review by domestic courts (Article 54 ICSID Convention).

Equally important, by granting private investors direct access to the Centre, the ICSID Convention succeeded in introducing a treaty-based mechanism through which direct confrontations between the host State and the investor's national State could be avoided. The foreign investor has been granted the ability to directly proceed against the host State in an international forum, in its own name, without having to call upon the power of its home State for protection. Indeed, the Convention went as far as expressly prohibiting interventions on the part of the home State in circumstances where an investor and the host State have consented to submit an investment dispute to arbitration before the ICSID Centre.[54] Procedurally, the Convention was thus a major improvement from the traditional remedial procedures, as the investor could now itself remain in charge of the process. At the broader level, however, the Convention was also claimed to be a significant step in the "de-politicization" of investment

[48] Reprinted in (1963) 2 ILM 241. Art 7(b) of the Draft Convention envisioned the possibility that nationals of the Parties submit disputes to an Arbitral Tribunal in the event that they have been injured by measures in breach of the Convention.

[49] For a survey of the principal proposals, see Hudson (n 18), 213-19; and Sohn (n 34) 68-75.

[50] Reproduced in UNCTAD International Investment Instruments: A Compendium vol III (2003) 259.

[51] 'The Proposed Convention to Protect Private Foreign Investment', (1960) 9 *J Pub L* 115. Art 7(2) of the Draft Convention envisioned the possibility for an investor 'injured by measures in breach of this Convention' to institute proceedings 'against the Party responsible for such measures' before an Arbitral Tribunal.

[52] A Broches, 'The Convention on the Settlement of Investment Disputes between States and Nationals of Other States', (1972/II) 136 Recueil des cours, 331, at 343.

[53] For an extensive account of this history, see AR Parra, *The History of ICSID* (OUP 2012).

[54] The exercise of diplomatic protection with respect to a dispute is solely permitted if the host State fails to comply with an award rendered in such dispute (ICSID Convention, art 27).

disputes, insofar as it purported to create conditions that ought to prevent an investment dispute from escalating into a direct confrontation between the home State and the host State.[55]

There is little doubt that, as originally conceived, ICSID was not itself intended to operate as an alternative to, but only as a *complement* of, domestic judicial procedures. As Broches would emphasize on several occasions throughout the Convention's drafting process, the proposed machinery was not intended as a substitute for local courts and local law, nor was it to be seen as "a one-sided attempt to create a new sort of extra-territoriality for foreign private investment."[56] Rather, the machinery

> "became important in the abnormal case, where the normal ways of dealing with disputes proved unsatisfactory, perhaps because of a lack of governmental or judicial stability; perhaps because new legal relationships were being created for which there was as yet no appropriate or competent local forum. Implicit in the convention was the thought that it would be used only in these and other 'appropriate cases'."[57]

This idea is ultimately also reflected in the Convention's preamble, which recognizes that disputes arising in connection with an investment "would usually be subject to national legal processes", though adding that "international methods of settlement may be appropriate in certain cases". In accordance with the drafter's intentions, those cases were supposed to constitute the exception, rather than the rule.

### 2.1.4. Investor-State Arbitration as an Exclusive Remedy

Nevertheless, by setting out a procedural and institutional machinery anchored in international law, the ICSID Convention ended up providing precisely such kind of mechanism for the settlement of investment disputes that, in practice, was effectively capable of providing a viable alternative to domestic courts. Inadvertently, the ICSID Convention itself offered the conjecture that investor-State arbitration could operate as a substitute of other dispute settlement mechanisms, by expressly stipulating in Article 26 that "[c]onsent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy" (even if nonetheless adding that "[a] Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention"). Included already in the first drafts of the Convention,[58] this

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[55] See eg DA Soley, 'ICSID Implementation: An Effective Alternative to International Conflict' (1985) 19 Int'l L 521, at 543; or IFI Shihata, 'Towards a Greater Depoliticization of Investment Disputes: The Roles of ICSID and MIGA' (1986) 1 ICSID Review - Foreign Investment Law Journal 1, 3-4. Most textbooks on investment law adhere to this canon of 'depoliticization'. But for a realistic assessment of the depoliticizaion argument, see M Paparinskis, 'The Limits of Depoliticisation in Contemporary Investor-State Arbitration' (2010) 3 Select Proceedings of the European Society of International Law 271.

[56] 'Memorandum of the meeting of the Committee of the Whole, December 18, 1962' reproduced in ICSID, History of the ICSID Convention: Documents Concerning the Origin and the Formulation of the Convention on the Settlement of Investment Disputes between States and Nationals of Other Slates (vol 2, pt 1, Washington, ICSID, 1968), at 58.

[57] ibid.

[58] In the first draft of the Convention – prepared by Broches and intended to provide a basis for discussion among the Executive Directors of the Bank – one can find language to the effect that '[e]xcept as otherwise stated therein, an undertaking to have recourse to arbitration shall be deemed to be an undertaking to have recourse to arbitration in lieu of any other remedy.' (Art II, Section 4, Working Paper of 5 June 1962, reproduced in *History* (vol 1) (n 56), 123). The provision was reformulated several times in the course of the subsequent negotiations. Following the initial round of discussions among the Bank's Executive Directors, the text was first changed to: 'Consent to have recourse to arbitration pursuant to this Convention shall, unless otherwise stated, be deemed consent to have recourse to such proceedings in lieu of any other remedy.' (Art IV, Section 16, Preliminary Draft Convention of 15 October 1963, reproduced in *History* (vol 2-1) (n 56), 219). The provision again underwent modifications after the regional consultative meetings; the text subsequently presented to the Legal Committee provided: 'Consent to have recourse to arbitration pursuant to this Convention shall, unless otherwise stated, be deemed consent to have recourse to such proceedings to the exclusion of any other remedy.'

stipulation had a two-fold purpose – to remove doubts that States or investors could generally have (1) as to whether the parties to a dispute intended to reserve the right to pursue other remedies, and (2) as to whether they intended to require that other remedies be exhausted prior to recourse to arbitration.[59] The latter aspect ended up generating most discussion in the Convention's drafting process.

Most questions in this respect were raised by the implication that an undertaking to arbitrate disputes between the ICSID Centre would automatically be regarded as dispensing with the need of exhausting local remedies. This proposition was one that was not lightly accepted and thus generated much opposition throughout the drafting process. Already during the initial discussions on the proposed Convention by the World Bank's Executive Directors, apprehensions were expressed about the way this presumption was formulated. Several Executive Directors considered it namely to derogate from the established principle of international law which conditioned the admissibility of an international claim with the exhaustion of local remedies, or deemed it to be generally impertinent to national judicial procedures which were thought to be the normal avenue for resolving investment disputes.[60] Similar objections were later raised at the various regional consultative meetings that were held with national legal experts (but were particularly pronounced at the meeting in Latin America),[61] and in the formal observations submitted by some States on the proposed draft.[62] They eventually resurfaced during the final

(Art 27(1) of Draft Convention of 11 September 1964, reproduced in ibid, 622). The text further redrafted in the course of the discussions by the Legal Committee into: 'Consent of the parties to arbitration pursuant to this Convention shall, unless otherwise stated, be deemed consent to such proceedings to the exclusion of any other remedy. A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration pursuant to this Convention.' (Art 27(1) of 'Summary proceedings of the Legal Committee Meeting of 28 December 1964', reproduced in *History* (vol 2-2) (n 56), 792). Before being submitted back to the Executive Directors for adoption, the text underwent some final modifications, so that it then read: 'Consent of the parties to arbitration pursuant to this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration pursuant to this Convention.' (Art 26(1), Revised Draft of the Convention, 11 December 1964, reproduced in *History* (vol 2-2) (n 56), 919).

[59] *History* (vol 2-1) (n 56), 23.

[60] See eg statement of CS Krishna-Moorthi (Executive Director for India) at the meeting of 18 December 1962, noting how it was 'extremely important … that the convention and the Center not appear to derogate form the respect owed to national laws and national courts' and thus observing how the provision on the exclusiveness of arbitration as a remedy reinforced his argument for the need to define the actual ambit of operation of the center (reproduced in *History* (vol 2-1) (n 56), 58); statement of F Illanes (Executive Director for Argentina, Chile, Bolivia, Uruguay and Paraguay) at the meeting of 27 December 1962, noting that '[n]ormally, disputes between a government and a foreign investor were dealt with first in the national courts' and suggesting that the presumption be therefore redrafted to the effect that the national of the other contracting party would have 'the right to present a claim according to international law' (ibid, 62); or similar statements by the same Illanes, by L Mejia-Palacio (Executive Director for Brazil, the Philippines, Columbia, Ecuador, and the Dominican Republic), by RC Chen (Executive Director from China), by AK Ghosh (Alternative Director from India), by M Mirza (Executive Director from Pakistan), and by I Khelil (Alternative Director from Tunisia) at the meeting of 28 May 1963 (reproduced in ibid, 86-97).

[61] Opposition to the proposed provision was particularly strong among the experts of the Latin American States. See eg the general statements made at the Consultative Meeting of 3-7 February 1964 at Santiago by F da Cunha Ribeiro (Brazil), J Barboza (Argentina), J Escobar (Bolivia), A Espinosa (Venezuela), T Bustamante (Ecuador), or A del Castillo (Colombia), who were more or less all critical about the curtailment of the authority of their national courts that was considered to necessarily follow from the use of the proposed Centre, and about the privileged position in which the foreign investors would be placed if they could avoid recourse to domestic judicial systems (reproduced in *History* (vol 2-1) (n 56), 306-26). Nonetheless, similar reservations were also expressed at other regional meetings. See eg statement of S Bilgen (Turkey) at the Consultative Meeting in Geneva on 20 February 1964 (reproduced in ibid, 431), or the statements of Ghanem (Lebanon), Dajani (Jordan), Wanasundera (Ceylon), Heth (Israel), as well as Pant (Nepal) at the Consultative Meeting in Bangkok in April 1964 (reproduced in ibid, 524-26, and 543 respectively).

[62] See observations by Turkey (suggesting that the presumption be inverted, so that consent to arbitration would not be deemed to exclude the necessity of prior exhaustion of local remedies), or Austria (wondering whether it would not be

discussions on the Convention's text by the Bank's Legal Committee, where several legal experts insisted that the provision be inverted, so that an express agreement would rather be required to rule out the requirement of exhaustion of local remedies. The argument was namely made that, since the usual method for the settlement of investment disputes was through national legal processes, the proposed provision "expressed a presumption of the unusual".[63]

Throughout these discussions, Broches defended the presumption by arguing that the provision was "not intended to elevate arbitration procedures over local law", but was solely designed "to avoid any question whether, once there was an agreement to arbitrate, that avenue was immediately available or whether it was necessary to pursue other remedies first."[64] As Broches would often emphasize throughout the preparatory works, the presumption was thus not stating a rule of "substance", but represented merely a "rule of interpretation".[65] In Broches' view, such rule of interpretation "would seem to be in accordance with the *most likely intention of the parties* in cases where they have entered into an agreement containing an arbitration clause",[66] it "reflected the *position of most modern jurists* on the problem of waiving the competence of local courts where a dispute between a private individual and a State was referred by agreement to an international tribunal",[67] and at the same time also "reflected the position *supported by State practice*"[68] – a proposition eventually shared by legal experts from several capital-exporting states.[69] In short, the presumption was merely meant to represent "what was the *normal* interpretation of consent to arbitration".[70]

Broches' arguments certainly had merit. In doctrinal writings, the proposition was well-accepted that, whenever contracts or concessions provided for international jurisdiction without reference to the exhaustion of local remedies, this could be construed as a tacit waiver, by the State making the contract with the alien, of the right to require the exhaustion of local remedies.[71] The same presumption seemingly did not apply, however, in the situation where States themselves created some arbitration machinery for the settlement of disputes concerning private claims. In such cases, the conclusion of a convention providing for adjudication of individual claims was not, in itself, deemed to involve an abandonment of the claim to exhaust local remedies. [72] Indeed, Broches conceded that what he considered to be the "the normal

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more practical to submit an investment dispute before local courts). Reproduced in *History* (vol 2-2) (n 56), at 663 and 670-71, respectively.

[63] See statement by the legal expert of Philippines, in *History* (vol 2-2) (n 56), 756. The legal experts of Turkey, Panama, Israel, as well as Ghana, associated themselves with these objections, ibid 756-57, 761.

[64] *History* (vol 2-1) (n 56), 59.

[65] See 'Paper prepared by the General Counsel and transmitted to the members of the Committee of the Whole' (reproduced in *History* (vol 2-1) (n 56), 84); Comment on Section 16 in Preliminary Draft (ibid, 220); Comment on Article 26(1) in 'Report of the Chairman of the Legal Committee on Settlement of Investment Disputes' (23 December 1964) (ibid (vol 2-2), 936; or 'Memorandum from the General Counsel and Draft Report of the Executive Directors to accompany the Convention' (19 January 1965) (ibid (vol 2-2), 952, 958-959).

[66] *History* (vol 2-1) (n 56), 84-85.

[67] ibid (vol 2-2), 756.

[68] ibid (vol 2-2), 973.

[69] See statements of legal experts of the Netherlands, United States, United Kingdom, Germany, and Spain, at Legal Committee Meeting of 28 December 1964, which considered that the language of the proposed provision was declaratory of existing practice. ibid (vol 2-2), 758-61.

[70] ibid (vol 2-1), 431.

[71] See Garcia-Amador (n 37) 57, para 64. See further SM Schwebel and JG Wetter, 'Arbitration and the Exhaustion of Local Remedies' (1966) 60 AJIL 484 (confirming the practice under contracts between states and investors to treat arbitral remedies provided under such contracts as exclusive).

[72] See *Salem Case (Egypt, USA)* (8 June 1932) II UNRIAA 1161, at 1189. A waiver of the local remedies requirement was possible, though, but had to be made expressly. See eg *US-Mexico General Claims Convention*, signed on 8 September 1923, 68 LNTS 459, art 5.

interpretation" of consent to arbitration may not be applicable outside the context of contractual arbitration clauses. In the paper he prepared in 1963 for the Executive Directors, Broches took the view that

> "[t]he situation would be different if a government made a unilateral declaration… by which it gave aggrieved investors the right to have recourse against it before an arbitral tribunal under the auspices of the Centre. In such a case the government might be willing to waive the local remedies requirement, or it might regard the arbitration procedure as an appellate procedure to be resorted to only after the exhaustion of local remedies."[73]

At a later meeting with the Committee of the Whole, Broches again reiterated that

> "The only exceptional case might arise where a government, by statute or proclamation, undertook unilaterally to place disputes before the Center. In that case the intention might well be to have recourse to the Center only if all other means to settlement, including local remedies, had failed."[74]

As a matter of "normal interpretation", the proposition that arbitration dispensed with the requirement of exhausting local remedies was thus not automatically applicable to the situation where consent to arbitration was expressed through unilateral provisions included in investment legislation. In fact, as Broches would end up admitting in the later course of negotiations, it was "for this reason chiefly" that the interpretative presumption was expressly included in the proposed Convention.[75]

Insofar as it merely set out an interpretative presumption, the proposed provision was not supposed to have any bearing on the local remedies rule. As claimed by Broches, in fact, the provision "was emphatically not designed to introduce any change in accepted rules of international law."[76] The presumption was namely intended to apply "*not* to the case of a private investor approaching a government with a claim that he had a moral right to ask it to resort to arbitration, but to that where consent to arbitration had already been given, and the only question at issue was to determine whether that consent had been tacitly qualified by requiring the prior exhaustion of local remedies"; in the view of Broches, "[i]t seemed wise to assume that such a reservation did not exist unless expressly stated."[77] In Broches' understanding, the interpretative presumption therefore in no way prevented the host State from demanding the exhaustion of local remedies as a condition precedent for bringing a case before an arbitral tribunal. Nonetheless, with a view not to casting any doubt on the right of States to require such exhaustion, the second sentence was eventually added to the provision, stipulating that "[a] Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention."[78]

### 2.1.5. The Onset of Bilateral Investment Treaties and the Entrenching of Direct Recourse to Treaty-Based Investment Arbitration

Article 26 of the ICSID may not have been meant to introduce any change into the traditional law applicable to the presentation of international claims. It did, however, depart from the approach adopted in some of the other contemporaneous proposals that likewise envisioned the

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[73] *History* (vol 2-1) (n 56), 85.

[74] cf 'Memorandum of the meeting of the Committee of the Whole, May 28, 1963' reproduced in ibid, 97.

[75] *History* (vol 2-2) (n 56), 758.

[76] *History* (vol 2-1) (n 56), 431.

[77] ibid.

[78] See *History* (vol 2-2) (n 56), 973.

creation of some arbitration machinery for the settlement of investment disputes between States and private individuals. Both the ILA Draft Statutes of the Arbitral Tribunal for Foreign Investment (1948) and the OECD Draft Convention on the Protection of Foreign Property (1962), for example, envisioned that the presentation of claims by injured nationals would be subject to the normal operation of the local remedies rule.[79]

Nor was Article 26 ICSID purportedly intended – at least in Broches' view – to "express any view with regard to the desirability or undesirability of exhausting local remedies."[80] But by laying down a *general* presumption against the requirement of exhaustion of local remedies (a presumption which was thus to apply not only to typical situation of a contractual undertaking to arbitrate, but also to situations where consent to arbitration is expressed unilaterally), Article 26 ICSID provided the basis on which investment arbitration would later effectively establish itself as a powerful and preferred *alternative* to domestic courts. Article 26 ICSID namely deferred the question of local remedies to the will of the parties and Broches was in effect convinced that the host States would have sufficient leeway to insist on the exhaustion of local remedies.

At the time of the adoption of the ICSID Convention, the expectation was that consent to arbitration before the Centre would normally be express by means of a contractual undertaking entered into directly between the foreign investor and the respondent State (including "any constituent subdivision or agency of a Contracting State designated to the Centre by that State"(Article 25, ICSID Convention) – even if the drafters did not consider it unconceivable that such consent could also be based on a unilateral offer to arbitrate expressed in domestic investment promotion code that would eventually be simply accepted by the investor in writing.[81] Either of those options seemingly left open the possibility to condition consent to the jurisdiction of the Centre with the exhaustion of local remedies if the parties so desired. As Broches would explain, "[t]he parties, *principally the host government*, had to decide whether they were willing to permit recourse to the facilities of the Center immediately and in lieu of local remedies, or whether those facilities were to be used only as an appellate Court."[82] This was not only possible in the context of contractual arbitration clauses, but the option could conceivably be exercised also in circumstances where consent to arbitrate before the ICSID Centre were to be expressed by means of a unilateral declaration; in Broches' view, "all that would be necessary under the Convention would be for the government to state the local remedies requirement in its unilateral declaration."[83]

Since the 1990s, however, the predominant method by which investment disputes have been brought before the Centre was not by means of contractual arbitration clauses, but on the

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[79] See art 4b, ILA Draft ('Access to the tribunal presupposes the exhaustion of local remedies except where other rules of international law or an agreement between the Parties provides otherwise'); and Commentary to art 7 of the *OECD Draft Convention* ('Nothing in the Convention, whether in this or any other Article, affects the normal operation of the Local Remedies rule. The rule implies that all appropriate legal remedies short of the process provided for in the Convention must be exhausted – local remedies or others') (1963) 2 ILM 241 at 261. However, see Council of Europe, Consultative Assembly, Opinion No 39 (1963) on the OECD Draft Convention on the Protection of Foreign Property (1964) 3 ILM 133, para 15, suggesting that such prerequisite of the exhaustion of local remedies be rather considered to be waived, unless a Party has made an express declaration to the contrary. See further art 18(1) of the Revised Draft on International Responsibility of the State for Injuries Caused in its Territory to the Person or Property of Aliens, proposed by the Special Rapporteur to the ILC, Garcia Amador ('An international claim brought for the purpose of obtaining reparation for injuries sustained by an alien […] shall not be admissible until, in respect of each one of the grounds of the said claim, all the remedies and proceedings established by municipal law have been exhausted.') FV Garcia Amador, Special Rapporteur *Sixth Report on International Responsibility* UN Doc A/CN.4/134 and Add.1 (in (1961) II Ybk ILC) at 48.

[80] *History* (vol 2-2) (n 56), 756-757.

[81] IBRD, 'Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States' (18 March 1965) [24].

[82] *History* (vol 2-1) (n 56), 97; emphasis mine.

[83] ibid, 85.

basis of mutually reciprocated offers to arbitrate expressed in dispute settlement provisions of bilateral investment treaties (BITs).[84] The beginnings of such treaties can be traced back to the 1960s; though, it was predominantly in the 1990s that they would become the primary vehicle through which capital-exporting States have sought to protect the investments of their nationals abroad. Unlike the earlier Friendship, Commerce, and Navigation treaties that dealt with the protection of investments in addition to other commercial matters, the BITs were concluded with a single objective in mind: the promotion and protection of foreign investment. To that end, the BITs not only set out standards of treatment that investors were expected to enjoy as a matter of international law, but at the same time also allowed aggrieved investors to invoke international arbitration when a host State has failed to respect its treaty obligations. In the course of the years, this procedural innovation eventually resulted in an "epochal extension of compulsory arbitral jurisdiction over States, at the behest of private litigants",[85] and gradually lead the ICSID to become a principal institution for the resolution of international investment disputes.

To be sure, in terms of procedure, expressing consent to ICSID arbitration through a dispute settlement clause in a BIT is not fundamentally different from it being expressed through domestic investment legislation. In both cases, the State offers to submit disputes arising out of certain classes of investments to the jurisdiction of the Centre, which can then be accepted by potentially any number of qualifying (existing or future) investors. Both options provide for a system of arbitration where the claimant need not have a direct contractual relationship with the defendant State, nor in fact any pre-existing undertaking to arbitrate until the dispute has arisen. Instead, the required consent to arbitration is established through a multi-stepped process, whereby the arbitration agreement is perfected only once the investor announces its intention to avail itself of the State's offer to arbitrate.[86] Where both options differ, however, is in the nature of the instrument in which the offer to arbitrate is embodied. Unlike domestic foreign investment codes, which are solely the product of the host State legislative will, investment treaties are the outcome of negotiations between sovereign States, meaning that their contents depend on the agreement of the contracting State parties. Nominally, of course, the parties to such treaties are equally sovereign States. In practice, however, these treaties have typically been concluded between countries with such different levels of outward foreign investment that the bargaining power of the two sides has in reality been markedly unequal.[87] Eager to attract foreign investments, the capital-importing States have mostly not been in a position to dictate the terms of the treaty and rarely have they been successful in demanding the exhaustion of local remedies as condition to investor-State arbitration.[88] Gradually but steadily, the onset of investment treaties

[84] cf *Asian Agricultural Products Ltd. v. Republic of Sri Lanka (Final Award)* (ICSID Case No ARB/87/3, 27 June 1990), the first case in which the Centre has been seized by an arbitration request exclusively based on a dispute settlement provision of a treaty.

[85] J Paulsson, 'Arbitration Without Privity' 10 ICSID Rev–Foreign Investment LJ 232, at 256.

[86] The system has been described by some as 'arbitration without privity'; see Paulsson (n 85). But such description is somewhat inaccurate: while the investor is not privy to the investment treaty containing the offer to arbitrate, it becomes privy to an agreement to arbitrate by accepting the State's offer.

[87] On this, see AT Guzman, 'Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties' (1997-1998) 38 Va J Int'l L 639, at 680 ('Without a BIT, a particular developing country will have a much lower level of investment than otherwise. Investment in a developed country, on the other hand, is much less likely to be sensitive to the presence of such treaties. Developing countries, therefore, are more eager than developed countries to reach an agreement on investment with a major capital-exporting country and the capital-exporting countries can, in turn, demand strong protections for their foreign investors.' Footnotes omitted).

[88] cf P Peters, 'Exhaustion of Local Remedies: ignored in most bilateral investment treaties' (1997) 44 Netherlands International Law Review 233.

has thus led to the entrenchment of investor-State arbitration as a proper alternative to litigation before domestic courts.[89]

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As I intend to demonstrate in the subsequent chapters of this book, the functional shift that occurred with the advent of investor-State arbitration and its establishment as an alternative to domestic litigation continues to inform investment tribunals' attitude towards domestic courts. Particularly on issues pertaining to jurisdictional matters, the presumption that investor-State arbitration dispenses with the local remedies requirement is recurrently invoked as a reason for not according deference to domestic judicial procedures, and as a general argument for downplaying the relevance of domestic courts.

## 2.2. The Substantive Shift: The Rise of International Standards of Treatment and Domestic Law's Declining Importance to the Adjustment of Investment Disputes

The onset of international investment arbitration has not, in itself, been determinative to the declining significance of domestic courts as a means for resolving investment disputes, however. Such a development also precipitated from the development of substantive rules of international law pertaining to the treatment of foreigner subjects. These rules have provided an alternative set of standards by which the propriety of the conduct of State authorities could now be appraised – standards independent from those set out in domestic law. Once this appraisal was no longer dependent on domestic standards, domestic courts effectively lost then their claim to exclusivity in resolving investment disputes. For, unlike in relation to domestic law, with regard to which domestic courts could traditionally claim epistemic superiority, the same is not the case with standards based on international law. It is worth examining, therefore, the process through which these international standards of treatment began to take shape, and their progressive development, which ensued in a full-fledged internationalization of investor-State relations by the end of the twentieth century.

### 2.2.1. Initial Standard-Setting through Early Treaties of Commerce

Prior to the sixteenth century, the situation of the foreigner who acquired legal interests in the territory of a foreign state, as resident or only as merchant, very much depended on local idiosyncrasies. By the general rules of the law of nations, the government of the host state was essentially entitled to treat the foreigner and his property with unimpeded discretion, and whatever substantive rights the foreigner enjoyed abroad, these existed solely by virtue of national regulations.[90] The only duty incumbent upon the host state by the law of nations was to accord justice to the foreigner on an equal footing with the nationals in the local courts; a duty

[89] For a recent restatement of this view, see U Kriebaum, 'Local Remedies and the Standards for the Protection of Foreign Investment', in C Binder et al. (ed), *International investment law for the 21st century: essays in honour of Christoph Schreuer* (OUP, 2009), 417-462, at 460, explaining how '[t]he ICSID Convention was intended to replace the vagaries of adjudication of investment claims against States by their own courts' and how '[t]he dispute settlement system provided for in the ICSID Convention is designed as an alternative to litigation in domestic courts, not as a subsidiary remedy'. See also A Ehsassi, 'Cain and Abel: Congrulence and Conflict in the Application of the Denial of Justice Principle' in S Schill (eds), *International Investment Law and Comparative Public Law* (2010), 213, at 241, noting how ICSID tribunals provide an 'alternative' mechanism for obtaining remedies available in the domestic legal system, as opposed to international human rights courts which represent a 'subsidiary system' to domestic remedies.

[90] Freeman (n 14), 500-501; H Neufeld, The International Protection of Private Creditors from the Treaties of Westphalia to the Congress of Vienna (1648-1815): A Contribution to the History of the Law of Nations (Sijthoff 1971) 94-95; also RB Lillich, The Human Rights of Aliens in Contemporary International Law (Manchester, 1984) 5-7.

which, if failed to be respected, amounted to a denial of justice, which provided then grounds for the exercise of reprisals.[91] Essentially, however, the standard of treatment was one contingent upon the local situation, and the legal condition of the foreigner therefore varied widely as between different communities and during different periods.

This began to change from the sixteenth century onwards when conventional rules pertaining to the treatment of aliens gradually began to emerge from the practice of the major European powers of that period.[92] It was thus particularly Britain, France, Holland, and Spain – and to a lesser extent the German Empire, Sweden, and Russia – that proceeded to gradually secure, on a reciprocal basis, particular rights for their subjects abroad.[93] Most of these treaties would contain stipulations pertaining to the freedom and security of the foreigner's person and property, as well as to the freedom of trade (in some cases already based on most-favoured-nations basis[94]), further supplemented by stipulations recognizing foreigners' rights of access to the local courts.[95] The latter stipulations were premised on three essential principles: (1) the foreigner had the right of access to court (and was thus entitled to purse his rights as plaintiff or defendant in the ordinary way of procedure and to use all remedies available under municipal law), (2) on equal footing with the host country's own nationals (which meant that justice was to be administered to him in a non-discriminatory way), and (3) where he was to be assured the application of national laws in a just way.[96] The relevant treaties of the period did not otherwise postulate that the legal system of the foreign State had to adhere to any particular standard. Some of them, however, did supply certain safeguards against shortcomings of the judiciary.[97]

In the course of the eighteenth century, some of the protections originally conceded to each other's nationals by the European Powers began gradually to be employed in other contexts. Important in this respect is especially the practice of the United States, which soon upon its independence embarked upon securing protection to its commercial interests abroad – first, through treaties of amity and commerce with the European Powers,[98] followed by treaties with the countries of Latin America, and later with other states. Although their primary purpose was

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[91] The 'commission of injustice or the denial of justice' have been recognized as conditions justifying reprisals as early as in the work of G da Legnano, *Tractatus De Bello, De Reprasaliis et De Duello* (1383), Ch CLVI, 326. cf HW Spiegel, 'Origin and Development of Denial of Justice' (1938) 32 AJIL 63, 63-66.

[92] Characteristic of this practice was the conclusion of commercial treaties, usually in tandem with peace treaties, which were aimed at the resumption of economic relations after periods of war. The practice became so ubiquitous that these treaties came to be in virtually standard form. SC Neff, 'Peace and Prosperity: Commercial Aspects of Peacemaking' (CUP 2004) 365, 367-70.

[93] See C Lipson, *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries* (University of California Press, 1985), 12, explaining that it was essentially the benefits of continuous international commercial intercourse that provided a powerful incentive for observation of these rules.

[94] See further on this SW Schill, The Multilateralization of International Investment Law (CUP 2009) 129ff.

[95] Neufeld (n 90), 94-100.

[96] See eg Art VIII of the *Peace Treaty of Utrecht between Britain and France* (1713), which stipulated '[t]hat the ordinary distribution of justice be revived, and open again, through the kingdoms and dominions of each of their Royal Majesties, so that it may be free for all the subjects on both sides to sue for and obtain their rights, pretentions, and actions, according to the laws, constitutions, and statutes of each kingdom'; reproduced in G Chalmers, *A Collection of Treaties Between Great Britain and Other Powers* (1790) at 378. Similar stipulations can be found in Article VII of the Peace Treaty between Britain and Spain, art XXX of the *1725 Peace Treaty between France and Holland, and Spain and the German Emperor* (Tr, Tm art XXX).

[97] First, some of the treaties contained detailed rules for securing the foreigner's position in court proceedings, relating to *inter alia* the engagement of attorneys, the conduct or duration of proceedings, or even in relation to the enforcement of the thus obtained judgments. Second, some of the treaties provided for the referral of disputes connected with commerce to special commissions, allowed for the exercise of consular jurisdiction, or provided for the institution of special judges. Finally, many of the treaties expressly permitted the issuing of letters of marque or reprisals in the event that justice was denied to the foreigner. Neufeld (n 90), 103-09.

[98] Soon after its declaration of independence, the US concluded a Treaty of Amity and Commerce with France (1778), which was then followed by similar treaties with the Netherlands (1782), Sweden (1783), and Prussia (1785).

to facilitate trade and navigation (usually on the basis of MFN treatment and mutual guarantees against discrimination), these treaties often contained provisions that were also relevant to the protection of investments.[99] Most significant among these were general provisions governing the treatment of persons and property of the other contracting party, which in most cases had to be accorded "special protection" or "full and perfect protection", frequently in combination with the requirement of national and/or MFN treatment.[100] Many of these treaties would further contain provisions against seizures or detentions, and, from the mid-nineteenth century onwards, also specific stipulations concerning the payment of compensation in the event of expropriation. Last but not least, in most of these treaties, stipulations were made with regard to the foreigner's access to courts – initially only in relation to suits against foreigners for debt, but later in the form of general access-to-courts provisions.[101]

A different kind of commercial treaties were, in the meanwhile, employed in other parts of the globe. From the sixteenth century onwards, the European Powers, acting initially through chartered companies such as the British or Dutch East India Companies, increasingly expanded their economic interests in Asia and Africa. The primary vehicle for this expansion were the numerous commercial treaties that the trading companies would have the habit of concluding with the local rulers.[102] These commercial treaties significantly differed from those concluded among the Western States. For one, the privileges granted in them did not require national treatment, but were premised on the principle of extraterritoriality: foreign traders were granted exemptions from customs duties, freedom from the jurisdiction of local courts, as well as the general right to be governed by the law of their country of origin, under the jurisdiction of their own consuls. Furthermore, the exercise of free trade was not conceded on the basis of most-favoured-nations treatment, but of preferential (or even exclusive) treatment. While formally concluded on a footing of equality and mutuality, these commercial treaties therefore soon digressed into instruments of economic domination, as the ones favouring from them were solely the European nationals.[103] Before long, the extensive privileges granted by these treaties degenerated into situations derogatory to the sovereignty of the non-European contract party, establishing either suzerain-vassal relations that, by the end of the eighteenth century, would ultimately give way to colonial administrations.[104]

By the end of the nineteenth century, the treaty practice therefore developed in two directions. On the one hand, the commercial treaties of the kind concluded by the European Powers *inter se*, or by the United States in general, led to the formation of certain basic standards of treatment, which, though initially devised to protect primarily merchants and long-distance trade, would later provide an effective framework for the global expansion of industrial and financial capital,[105] and ultimately provide the basis for the development of contemporary rules of investment protection. The commercial treaties of the kind underpinning the European colonial expansion, on the other hand, had lesser of a role in the development of such standards. Implicitly, of course, such treaties were essential to the protection of foreign investment, which in the eighteenth and nineteenth centuries was mostly occurring in the context of colonial

[99] On the content of these treaties, see RR Wilson, 'Property-Protection Provisions in United States Commercial Treaties' (1951) 45 Am J Int'l L 83, 90-97; and KJ Vandevelde, 'The Bilateral Investment Treaty Program of the United States' (1988) 21 Cornell Int'l LJ 201, 203-06.

[100] ibid 94-96.

[101] On this issue specifically, see RR Wilson, 'Access-to-Courts Provisions in United States Commercial Treaties' (1953) 47 AJIL 20, at 33-43.

[102] On content of the commercial treaties thus concluded in Asia and Africa, see CH Alexandrowicz, 'The Afro-Asian World and the Law of Nations (Historical Aspects)' (1968) 123 Recueil des Cours 121, 152-57, and 172-88.

[103] Lillich (n 90), 18

[104] See *infra* 2.3.2.

[105] Lipson (n 93), at 9.

expansion. This protection, however, was not one flowing from the standards of treatment prescribed by these treaties but from the powers derived from these treaties by the European imperial powers, which allowed them to effectively control the actions of their colonies and protectorates.[106]

### 2.2.2. The Emergence of Minimum Standard(s) of Treatment under Customary International Law

By the middle of the eighteenth century, some of the rights that had recurrently been granted in the commercial treaty practice of the European powers became so well entrenched that legal publicists considered them binding as a matter of general obligation under the law of nations.[107] Chief among these was the duty to protect foreigners and their property against injuries ensuing from either the State's own authorities or its inhabitants.[108] This was a duty that did not extend solely to the provision of physical safety.[109] Since, by then, the principle found recognition that foreigners were subject to laws of the local sovereign, it was also through the application of this law that the local sovereign was to guarantee the required protection to the foreigner, including by way of granting the latter access to justice.[110] Though complementary to the duty of protection and security, the administration of justice in relation to the foreigner was also a separate duty incumbent upon the sovereign according to custom. By then, the duty extended beyond the mere granting of access to justice, as the courts were required to treat the foreigner on equal footing with the nationals and to apply justice in treating the foreigner's case.[111] The following needs to be kept in mind, however. While being the necessary, national treatment was also the sufficient condition for compliance with the obligations under the law of nations, meaning that a State could still excuse itself by stating that its own nationals were subject to the same deficient standard of judicature. Furthermore, the justice to which the foreigner was entitled was not a promise of an abstract conception of justice, but justice in accordance with municipal law, meaning that there was no rule requiring the courts to administer in the case of the foreigner domestic law differently from the law of the land of the court.[112] The right of judicial access

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[106] See M Sornarajah, *The International Law on Foreign Investment* (CUP 2010) 19-20. See also the outcome in PCIJ, *Oscar Chinn (United Kingdom v Belgium) (Judgment)* PCIJ (ser A/B) No 63 (12 December 1934), attesting to the absence of any concrete duties relating to the treatment of aliens in colonies beyond a general prohibition of discrimination and respect for acquired rights.

[107] cf G Schwarzenberger, 'The Province and Standards of International Economic Law' (1948) 2 Int'l L Q 402, 407.

[108] See E de Vattel, *Droit des Gens ou Principes de la Loi Naturelle*, bk II (1758, English translation 1916), ch VIII, s 104 ('A sovereign may not allow the right of entrance into his territory granted to foreigners to prove detrimental to them; in receiving them he agrees to protect them as his own subjects and to see that they enjoy, as far as depends on him, perfect security.'); or C Wolff, *Jus Gentium Methodo Scientifica Pertractatum* (1764, English translation 1934), ch IX, s 1063 ('Foreigners, as long as they live in alien territory, ought to be safe from every injury, and the ruler of the state is bound to defend them against it, that is, security is to be assured to foreigners living in alien territory.'). See Neufeld (n 90), 48.

[109] See T Weiler, The Interpretation of International Investment Law (2013) 103ff.

[110] See de Vattel (n 108), ch VIII, ss 102-03 ('Being thus subject to the laws, foreigners who violate them should be punished accordingly. […] For the same reason, any disputes which may arise between foreigners, or between a foreigner and a citizen, should be settled by the local judge and according to the local laws').

[111] See eg A Gentili, *De Jure Belli Libri Tres,* vol I (1612, edn 1933) ch XXI, 101 (referring to 'refusal to do justice'); de Vattel (n 108), ch VII, s 84 (a State was entitled to interfere in the causes of its subjects in foreign countries and to grant them protection 'in the cases of a refusal of justice, palpable and evident injustice, a manifest violation of rules and forms; or, in short, an odious distinction made to the prejudice of his subjects, or of foreigners in general.'); or C van Bynkershoek, *Quaestionum Juris Publici Libri Duo,* vol 1 (1737, edn 1930), ch 24, 135-36 ('The law uses the phrase "by an unjust judgement", so that it does not suffice merely to pronounce judgement, it must also be just').

[112] See eg H Grotius, *De Jure Belli ac Pacis,* bk III (1625, edn 1925) ch II, V, 627 (referring to the situation where 'judgement has been rendered in a way manifestly contrary to law'); or Wolff (n 108), s 587 ('the right is denied […] also if in a matter not doubtful a decision has been made plainly contrary to law, which is assumed to be clear of itself'). See generally Neufeld (n 90), 102-03.

protected investment only to the extent that local law provided the investor with a remedy for injury to its investment.

Perceptions began to change in the course of the nineteenth century, when the rules pertaining to the treatment of aliens began gradually to be imposed on a global basis from China to Latin America. Rudimentary as they were, the rules at once operated as an element of the "standard of civilization" – the primary legal mechanism through which polities in that period had been admitted into, or barred from, the international society of States – and concurrently as positive obligations, for the breach of which the State incurred responsibility under international law.[113] When used in this latter sense, the obligations were commonly presented as the "standard of justice" under international law,[114] or simply the "minimum standard" of international law.[115] The standard at that stage was still not concerned specifically with the protection of investments, but was supposed to govern a broad range of relations arising from the status of aliens in foreign states, relating, both, to their personal security and the protection of their property. Though representing a normative floor against which any State purportedly had to measure up, the exact content of this standard was never a settled one.[116]

The starting point was the existence of the obligation – by then considered universal – that required States to accord protection and security for the person and property of aliens. The exact scope of that obligation was subject to differing interpretations, however. Probably the least contested components of the minimum standard were the duty to provide equal protection of the law to foreigners and citizens alike, and the duty to afford aliens adequate means for vindicating their rights and redressing their wrongs.[117] What was contested, however, was the operationalization of these duties. Equality of treatment was now claimed to be only the starting point – for, the treatment also had to satisfy the international standard.[118] Where the system of law and administration did not conform to this standard, the foreigner was entitled to rights and remedies that the State otherwise did not accord to its own citizens.[119] The same applied to the administration

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[113] See on this M Paparinskis, The International Minimum Standard and Fair and Equitable Treatment (OUP 2013) 20.

[114] In the seminal exposé given by then US Secretary of State Elihu Root in 1910, '[t]here is a standard of justice, very simple, very fundamental, and of such general acceptance by all civilized countries as to form a part of the international law of the world. The condition upon which any country is entitled to measure the justice due from it to an alien by the justice which it accords to its own citizens is that its system of law and administration shall conform to this general standard. If any country's system of law and administration does not conform to that standard, although the people of the country may be content or compelled to live under it, no other country can be compelled to accept it as furnishing a satisfactory measure of treatment to its citizens.' E Root, 'The Basis of Protection to Citizens Residing Abroad' (1910) 4 AJIL 517, 521-22.

[115] See eg E Borchard, 'The "Minimum Standard" of the Treatment of Aliens' (1940) 38 Mich L Rev 445.

[116] In fact, its content was never considered capable of precise definition. cf C Eagleton, *The Responsibility of States in International Law* (NYU Press 1928), at 86, claiming that '[a]s a matter of fact, the standard is not susceptible of complete and definitive statement'; or Borchard, ibid 458, pointing to the 'erroneous inference that it is definite and definable'; or Freeman (n 14), 568, explaining that 'the content of the international standard is not fixed with anything like mathematical precision.'

[117] See Paparinskis (n 113), 46-54.

[118] As Root would explain: 'Each country is bound to give to the nationals of another country in its territory the benefit of the same laws, the same administration, the same protection, and the same redress for injury which it gives to its own citizens, and neither more nor less: provided the protection which the country gives to its own citizens conforms to the established standard of civilization.' E Root, 'The Basis of Protection of Citizens Residing Abroad' (1910) 4 ASIL Proceedings 16, 20. See also *Harry Roberts (USA) v United Mexican States* (IV UNRIAA 77, 2 November 1926) 80 ('equality is not the ultimate test of the propriety of the acts of authorities in the light of international law. That test is, broadly speaking, whether aliens are treated in accordance with ordinary standards of civilization.'). Freeman (n 14), 504-07.

[119] Root, ibid, 21: 'any country's system of law and administration does not conform to that standard, although the people of the country may be content or compelled to live under it, no other country can be compelled to accept it'.
See eg *George W Hopkins (USA) v United Mexican States* (IV UNRIAA 41, 31 March 1926) at 47 ('it not infrequently happens that under the rules of international law applied to controversies of an international aspect a nation is required to accord to aliens broader and more liberal treatment than it accords to its own citizens under its municipal laws.').

of justice. The adequacy of the host State's judicial system was not determined by reference to the treatment accorded to the nationals of the host State, but was supposed to be adjudged against the ideals of justice as hypothetically available in the more "civilized" Western countries.[120]

The exact scope of the general duty of protection and security was not clearly spelled out in relation to other activities in which an alien could be engaged – in spite of the fact that the minimum standard of treatment was intended to encompass every facet of the official exercise of State authority.[121] As to the police protection that the State was expected to ensure to the person and property of aliens, for example, this was supposed to be an "effective" one,[122] or of a "certain level" that was not an "illusory" one.[123] Perhaps the most controversial aspect of the minimum standard, however, was the extent to which international law accorded protection to acquired proprietary interests of aliens additional to those that would normally be accorded to citizens under domestic law. The question, specifically, was whether international law proscribed the taking of foreign property without the payment of some form of compensation.[124] Up until the end of the nineteenth century, this aspect of the standard did not attract much discussion. In the course of the twentieth century, and particularly after the events such as the Soviet Revolution, the Eastern European agrarian reforms, and the Mexican expropriations of 1938, however, the conditions under which the right of property could be withdrawn from aliens would become fraught with disagreement, with capital-exporting States insisting on the existence of an obligation to provide "prompt, adequate, and effective" compensation (the Hull formula), and capital-importing States insisting that the maximum it could be expected was the treatment on equal footing with the nationals of the host State.[125]

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[120] Root, ibid, at 25. Weiler (n 109), 117

[121] cf FS Dunn, *The Diplomatic Protection of Americans in Mexico* (Columbia University Press 1933) 3-4. The case of *LFH Neer and Pauline Neer (USA) v United Mexican States* (IV UNRIAA 60, 15 October 1926) where treatment falling below the minimum standard was described as that which amounts to 'an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency' (61-62), is frequently taken as setting out a standard pertaining to the general treatment to which the alien was purportedly entitled from governmental authorities. See eg I Brownlie, *System of the Law of Nations: State Responsibility* (OUP 1983) pt I, 74, describing *Neer* as a 'useful and classical' formulation of a minimum standard of treatment, or Paparinskis (n 113), 53-54 considering *Neer* to operate as the 'default rule'. But as the case was one arising out of the failure to prevent the occurrence of injury caused by private actors, it has been doubted whether that precedent really set forth a standard universally applicable to all types of state conduct, and not merely restated the standard of due diligence required in providing the degree of police protection under international law. See generally, J Paulsson and G Petrochilos, '*Neer*-ly Misled' (2007) 22(1) ICSID Rev–Foreign Investment LJ 242.

[122] See eg *Montijo Case (US v Colombia)* (26 July 1875) 2 Moore's Arbitrations 1421, 1444 ('The first duty of every government is to make itself respected both at home and abroad. Protection is promised to those whom the Government has consented to admit to its territory, and means must be found to render said protection effective.').

[123] See eg *Affaire des biens britanniques au Maroc espagnol (Spain v Great Britain)* (II UNRIAA 615, 1 May 1925) 642 ('présuppose que la sécurité générale dans les pays de résidence de ceux-ci ne tombe pas au-dessous d'un certain niveau, et qu'au moins leur protection par la justice ne devienne pas purement illusoire.').

[124] See generally Paparinskis (n 113), 54-63.

[125] Illustrative in this respect is, for example, the correspondence between the then Minister of Foreign Affairs of Mexico, Eduardo Hay, and the US Secretary of State, Cordell Hull, reprinted in (1938) 32 Am J Int'l L Sup 181. The former maintained that 'there does not exist, in international law, any principle universally accepted by countries, nor by the writers of treatises on this subject, that would render obligatory the giving of adequate compensation for expropriations of a general and impersonal character', and though acknowledging that Mexico may have an obligation to indemnify under its own laws, he insisted that 'the time and manner of such payment must be determined by her own laws' (ibid 187). The latter adverted, in turn, to 'a self-evident fact when it notes that the applicable precedents and recognized authorities on international law support its declaration that, under every rule of law and equity, no government is entitled to expropriate private property, for whatever purpose, without provision for prompt, adequate, and effective payment therefor.' (ibid 193).

The legal source of the international minimum standard was never clearly stated.[126] In their relations with capital-importing States, the Western States typically presented it as a matter of settled practice.[127] Particularly in the course of the twentieth century, the content of the standard therefore became subject of major contestation between capital-exporting and capital-importing States, and its precise contours remain unsettled even in the jurisprudence of today. Nonetheless, the emergence itself of an international minimum standard has brought about an important shift in the development of investor-State relations. Not in that it provided an external measure for determining the propriety of State actions, but because it purported to furnish a measure that operated independently from domestic standards (and therefore from domestic law).[128] In spite of its indefinite nature, crucial in the emergence of the international minimum standard was its non-contingent nature.

### 2.2.3. The Challenges to International Standards: From Calvo to CERDS

The attempts to internationalize investor-State relations were not met without resistance on the part of the capital-importing States. Most vocal in this respect were initially the Latin American States, which – finding themselves as respondents in many of the international arbitrations of the late nineteenth and early twentieth century – considered the purported minimum standard of treatment, as well as its intrusive enforcement through the institution of diplomatic protection, to be nothing but tools of economic or political imperialism. Unable to resist this by force, the Latin American States mounted resistance primary through the writings of their publicists, whose arguments would then be adopted as a matter of policy, and – with varying degrees of success – eventually translated into legislative, contract-drafting, and treaty-making practice.

The person that would be eventually credited for having articulated the most famed critique of the capital-exporting States' claim that international law required a minimum, substantive duty of protection was the Argentinean jurist, Carlos Calvo (1822-1906).[129] The doctrine that Calvo developed in his attempt to narrow (if not altogether abolish) the institution of diplomatic protection was premised on two cardinal principles.[130] The first was that sovereign States, being equal in their legal rights under international law, necessarily enjoyed the right to be free from "interference of any sort" by other States. The second, which followed from the same principle of sovereign equality of nations, was that foreign nationals were not entitled to rights and privileges more extended than those accorded to the nationals of the State where they

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[126] In his famous speech, Elihu Root simply presented the standard as a premise of international intercourse. Borchard (n 115), 458, in turn, claimed the standard to be 'compounded of general principles recognized by the domestic law of practically every civilized country'.

[127] See eg Dunn (n 121), 3-4, claiming the existence of 'certain generally accepted standards of conduct, ascertainable by reference to past practice and applicable to new cases by logical processes.'

[128] See Borchard (n 115), 39 ('International law is concerned not with the specific provisions of the municipal legislation of states in the matter of aliens, but with the establishment of a somewhat indefinite standard of treatment which the state cannot violate without incurring international responsibility.')

[129] Influential among the Latin American publicists was also the Argentinean foreign minister Luis Drago (1859-1921), who developed the doctrine that the public debts cannot occasion armed intervention, nor occupation of territory on the part of Western Powers. See LM Drago, 'State Loans in their Relation to International Policy'
(1907) 1 AJIL 692. The ideas advanced in his writings would later lead to the adoption of the Drago-Porter Convention at the Hague Peace Conference of 1907, which prohibited the use of force for the collection of any contract debt (at least as long as the debtor state did not refuse or otherwise resist an offer to arbitrate the dispute). Yet, concerned primarily with the question of armed intervention, the Drago Doctrine was of limited import to the broader problem of diplomatic protection, or to the issue of the minimum standard of treatment as such.

[130] Calvo's doctrine was set out in his celebrated treatise, *Le Droit International Theorique et Pratique,* vol 3 (5th edn, 1896) s 1276. See generally DR Shea, *The Calvo clause: a problem of inter-American and international law and diplomacy* (University of Minnesota Press, 1955), 16-20.

reside.[131] The necessary implication of both these principles was that any pecuniary claims that the foreigner might have had against the State had to be submitted to the local courts, to be settled in accordance with local law, and only in the event of denial of justice could such claims become the subject of diplomatic interposition. At no rate was the foreigner otherwise entitled to complain to his State of nationality if accorded the application of the same conditions as the nationals of the receiving State. Rather, in entering and taking up the residence abroad, the foreigner was bound to accept the legal conditions that prevailed in the host State.[132]

By presenting national treatment as the maximum of good treatment any foreigner could ask for, Calvo attempted to restrict the influence of international law in the sphere of the State's domestic jurisdiction. For, according to his doctrine, the international obligations of the State were discharged from the moment that the foreigner has been put on a footing of complete equality with the nationals of the state. This, in turn, removed the legal grounds on which diplomatic interferences on the part of the foreigner's State of nationality could be possibly justified – save for those pertaining to a possible denial of justice that the foreigner may have experienced in pursuing her or his claims before local courts. Such grounds were, however, limited ones, particularly as Calvo – as well as other Latin American scholars –construed the doctrine of denial of justice narrowly and, at any rate, considered that any defects in domestic remedial processes had to be measured by local criteria, and not in light of an international standard.[133] Pursuant to Calvo's doctrine, domestic courts were thus expected to be the final forum to which foreigners would turn to vindicate their rights. In fact, the idea that controversies between foreigners and host States should primarily be resolved through local means of dispute settlement – and only exceptionally through international adjudication – remains associated with Calvo's doctrine until present-day.[134]

Calvo's concepts of non-intervention and foreigners' absolute equality with a State's nationals were derived from principles of international law that had long been supported by publicists and the practice of European states among themselves. These were the principle of independence of sovereign states, and the ensuing right to complete territorial jurisdiction and related right to establish the conditions under which foreigners may enter and reside in the country. Calvo considered that these should apply to Latin American States just as they did to European States in their reciprocal relations.[135] Not surprisingly, the precepts of the Calvo doctrine were never accepted by the capital-exporting States, nor by international lawyers outside Latin America, who ridiculed Calvo's theory on the ground that it ultimately signified the abolition of all state responsibility for injuries to foreigners,[136] or at least replaced international law with domestic law as the final test for establishing such responsibility.[137] Conversely, Calvo's writings did have a major impact on the practice of Latin American States, which implemented

[131] The claim that the foreigner should be placed on a footing of civil equality with the national did not originate with Calvo, but was made already earlier by the Venezuelan jurist Andrés Bello (1781-1865). cf Borchard (n 115), 450.

[132] Shea (n 130), 16-20.

[133] Dawson and Head (n 8), 21. Denial of justice was thus claimed to arise only when a State denied access to courts. cf 'The report to the League of Nation's Sub-Committee of Experts for the Progressive Codification of International Law' (Guerrero Report), reproduced in 'Questionnaire No 4: Responsibility of States for Damage done in their Territories to the Person or Property of Foreigners' (1926) 20(3) AJIL Supp 176, ch 6.

[134] See C Schreuer, 'Calvo's Grandchildren: The Return of Local Remedies in Investment Arbitration' (2005) 4(1) LPICT 1.

[135] On this, see AB Lorca, Mestizo international Law: A Global Intellectual History 1843-1933 (CUP 2014) 62-64.

[136] See AV Freeman, 'Recent Aspects of the Calvo Doctrine and the Challenge to International Law' (1946) 40 Am J Int'l L 121, 133; AH Feller, 'Some Observations on the Calvo Clause' (1933) 27 ibid 461; AS Hershey, 'The Calvo and Drago Doctrines' (1907) 1 ibid 26.

[137] Borchard (n 115), 452.

his principles into their common international policies and reciprocal treaty relations,[138] as well as, individually, at the level of their domestic constitutions,[139] and contractual relations with foreign investors. In the case of the latter, the doctrine manifested itself in the form of the Calvo Clause – a contractual stipulation entailing an undertaking on the part of the foreign investor to resort to local remedies, as well as to waive any right that the latter may have to the diplomatic protection of his government in connection with matters arising under the contract. Insofar as such clauses attempted to vitiate the State's own right of protection, their validity has generally been disputed; but there were nonetheless cases where such clauses were found to bar international claims.[140]

Resistance against the international minimum standard never withered away, and got a renewed impetus with the process of decolonization in the second part of the twentieth century. The newly independent States that emerged from colonial rule in Africa and Asia increasingly began to question whether the customary international law rules of State responsibility towards foreign investors could bind nations that have not partaken in their creation.[141] This took place alongside the broader discussions on the rules of State succession, as part of which the newly independent States also disputed the continuity of obligations arising out of concession contracts previously granted by the colonial powers, challenging thereby the "traditional" doctrine of "acquired" rights.[142] While the conceptual problems pertaining to State succession remained primarily the subject of discussions in the International Law Commission, it was chiefly through the newly-provided forum of the General Assembly (GA) of the United Nations that newly independent States began to formally challenge the various rules of international law that they deemed prejudicial to their own economic interests.[143]

This began with the inception of the principle of permanent sovereignty over natural wealth and resources (PSNR), which was gradually asserted through a string of GA resolutions, and officially proclaimed in the 1962 Declaration on Permanent Sovereignty over Natural Resources.[144] Declared to be "a basic constituent" of the right to self-determination, the principle was to provide a legal basis for the newly-independent States to reclaim control over natural resources that at that time continued to be exploited by Western companies pursuant to oil and mineral concessions acquired in the colonial era – even if, in its initial formulation, not necessarily intended to undo the traditional rules of international law applicable to the protection of foreign

[138] See eg Convention relative to the Rights of Aliens, 29 January 1902, reproduced in J Brown Scott, The International Conferences of American States, 1889–1928 (OUP, 1931), 91, arts 2 and 3; or Montevideo Convention on Rights and Duties of States, 26 December 1933, (1936) 165 LNTS 19 (entered into force on 26 December 1934), arts 8 and 9. These instruments were not widely ratified, and to the extent that the US participated in them, were subject to reservations. See Freeman (n 136), 139ff.

[139] See generally MR Garcia-Mora, 'The Calvo Clause in Latin American Constitutions and International Law' (1950) 33 Marquette Law Review 205.

[140] See eg North American Dredging Company of Texas (USA) v United Mexican States (4 UNRIAA 26, 31 March 1926).

[141] For example of this critique, see eg SN Guha Roy, 'Is the Law of Responsibility of States for Injuries to Aliens a Part of Universal International Law?' (1961) 55 Am J Int'l L 863; or G Abi-Saab, 'The Newly Independent States and the Rules of International Law' (1962) 8 Howard Law Journal 95, at 113-16. For an overview, see further P Dumberry, *The Formation and Identification of Rules of Customary International Law in International Investment Law* (CUP 2016) 70-77.

[142] An exposition of this critique can be found in M Bedjaoui, 'Second report on succession of States in respect of matters other than treaties by Mr. Mohammed Bedjaoui, Special Rapporteur – Economic and financial acquired rights and State succession' UN Doc A/CN.4/216/Rev.1 (in ILC Ybk 1969, vol II). On the conceptual struggles in this field of law, see generally M Craven, *The Decolonization of International Law: State Succession and the Law of Treaties* (OUP 2007) 80-90.

[143] On this, see especially M Bedjaoui, Towards a New International Economic Order (Unesco, 1979) 123ff; and futher A Anghie, Imperialism, Sovereignty and the Making of International Law (CUP 2005) 196-244.

[144] *Permanent Sovereignty over Natural Resources,* UN GA Res 1803 (XVII) (14 December 1962). For a detailed account on the 'birth' of the PSNR principle, see N Schrijver, *Sovereignty Over Natural Resources: Balancing Rights and Duties* (CUP 1997) 33-164.

economic interests.[145] However, a new bid to denounce the international minimum standard was made in the following decade already, as part of the effort to inaugurate a New International Economic Order (NIEO). Using their majority in the General Assembly, the developing countries eventually succeeded in the adoption of the 1974 Charter of Economic Rights and Duties of States (CERDS), which asserted each State's "right" to nationalize foreign property subject to the payment of compensation that was to be determined, not by reference to international law, but to each State's own domestic law.[146] In a classic restatement of the Calvo doctrine, the CERDS further resolved that controversies concerning the question of compensation "shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely and mutually agreed by all States concerned that other peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principle of free choice of means."[147]

Less than a year later, the legal significance of the CERDS would be considered in the seminal *Texaco v. Libya* arbitration, with sole Arbitrator Dupuy finding it a "political rather than a legal declaration", and not one that could be binding on the capital-exporting States, which opposed it.[148] It soon become clear that the CERDS would be unable to achieve the desired effect of subjecting foreign investors exclusively to the domestic law and the jurisdiction of the courts of the host State. Indeed, it soon became clear that even the concerted opposition of developing States to the international standards of treatment could not end up loosening core aspects of the established rules. On the contrary, it eventually led to their further strengthening through the conclusion of numerous bilateral investment treaties in the second part of the twentieth century. Before discussing that process, however, it is necessary to briefly touch on another aspect of the internationalization of investment protection standards that was in the meantime unfolding in the context of investment contracts.

### 2.2.4. The Move Towards the Internationalization of Investment Contracts

Efforts to internationalize Investor-State relations were not only pursued through international law instruments. Before present-day treaty-based protections would become widely available to investors, a trend had already been set in motion in international arbitral practice which had as its object a partial (if not complete) emancipation of investor-State contracts from the ambit of the host State's domestic law. In the *Serbian Loans* case (1929), the Permanent Court of International Justice may still have taken the principled view – in what was nominally an inter-State dispute – that "[a]ny contract which is not a contract between States in their capacity as subjects of international law is based on the municipal law of some country".[149] But already a year later, the arbitrators deciding the dispute between a British corporation and the government of the Soviet Union in the *Lena Goldfields* arbitration (1930) accepted the possibility that "general principles of

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[145] For example, the UN GA Res 1803 stipulated that, in the event of expropriation, 'appropriate compensation' were to be paid 'in accordance with international law' (para 4), and further recognized that '[f]oreign investment agreements freely entered into by or between sovereign States shall be observed in good faith' (para 8). On this aspect of the Resolution, see Schrijver, ibid 66-68, 180.

[146] 'Charter of Economic Rights and Duties of States' UN GA Res 3281 (XXIX) (12 December 1974), art 2(2) ('Each State has the right: […] (c) To nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent').

[147] ibid.

[148] Texaco Overseas Petroleum Co (Topco) & California Asiatic Oil Co (Calasiatic) v Government of the Libyan Arab Republic (Award) (1978) 17 ILM 1 (19 January 1977), [88].

[149] Case Concerning the Payment of Various Serbian Loans Issued in France (France v Yugoslavia) (Judgment) PCIJ (ser A) No 14 (12 July 1929), 41.

law recognized by civilized nations" could be regarded as the proper law of the contract.[150] In spite of the absence of an express provision on applicable law in the concession agreement, the arbitrators applied the principle of "unjust enrichment" in awarding compensation for the Soviet Union's breaches of Lena's mining concession.[151]

This move was one that would later be heralded as a "gigantic first step for international commercial arbitration, almost equivalent to the caveman's discovery of fire."[152] Not only because it has significantly influenced the drafting of choice-of-law provisions in concession agreements,[153] but also in view of the precedential effect it had on subsequent practice. In several important arbitrations concerning concession contracts, arbitral tribunals would later have no hesitation accepting the possibility of a choice for the application of general principles of international law– such as those requiring the observance of commitments in good faith (*pacta sunt servanda*) and respect for acquired rights, or that prohibiting unjust enrichment – to a concession contract entered into between a State and an investor. This process of "internationalization" took place in various ways. In many of the earlier cases, it was essentially the outcome of interpretative technique.[154] Despite the absence of an explicit choice-of-law provision, tribunals would namely see fit to apply general principles of law by way of implication. Support for such an approach would usually be found in the circumstances of a contract's conclusion, in specific terms of the contract (such as the presence of a stabilization clause, or of a clause referring disputes to international arbitration), or simply in the "special nature" of the contract in question (i.e. being a contract concluded between a sovereign State and private party).[155] Concurrently, however, the process of internationalization found underpinning in the drafting practice, as choice-of-law clauses would be inserted in concession contracts explicitly providing for the application of (general) principles of (international) law in addition to the domestic law of the host State.[156]

Initially, the move towards introducing an international element into investor-State contracts was seemingly based on the perception that the domestic legal system of the host State was simply inadequate, if not outright deficient, to deal with such type of agreements. Particularly Islamic law was frequently considered to lack sophistication purportedly required to deal with the complex matters regulated by the concession contract in question.[157] In later cases, the need to

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[150] *Lena Goldfields Arbitration, Lena Goldfields Ltd v USSR (Award)* (1936) ILR 3 (3 September 1930), [22]. The text of the Award is reproduced as an annex to the award's commentary by A Nussbaum, 'The Arbitration between the Lena Goldfields, Ltd. and the Soviet Government' (1950-1951) 36 Cornell Law Quarterly 31.

[151] ibid [23]-[25].

[152] Veeder (n 42), 772.

[153] cf FA Mann, 'The Proper Law of Contracts Concluded by International Persons' (1959) 35 BYIL 34, at 51ff.

[154] The basis for such an approach was usually found in the general principles governing the conflict of laws in private international law, pursuant to which the proper law of the contract was that by which the parties to a contract intended, or may fairly be presumed to have intended, the contract to be governed. cf A McNair, 'The General Principles of Law Recognized by Civilized Nations' (1957) 33 BYBIL 1, 4-6.

[155] For an overview, see H Kjos, *Applicable Law in Investor-State Arbitration* (OUP 2013), 217-21.

[156] The validity of such clauses was upheld in the three Libyan oil arbitrations of the 1970s. See *BP Exploration Company (Libya) Limited v Government of the Libyan Arab Republic* (Awards of 10 October 1973 and 1 August 1974) 53 ILR 297; *Topco/Calasiatic v Libya* (n 148), [25]-[35]; and *Libyan American Oil Co (LIAMCO) v Libya (Award)* (1981) 20 ILM 1 (12 April 1988), 63-66.

[157] See eg the remarks of Lord Asquith of Bishopstone, as umpire, in *Petroleum Development Ltd v Sheikh of Abu Dhabi* (1951) 18 ILR 144, 149 ('If any municipal system of law were applicable, it would *prima facie* be that of Abu Dhabi. But no such law can reasonably be said to exist. The Sheikh administers a purely discretionary justice with the assistance of the Koran; and it would be fanciful to suggest that in this very primitive region there is any settled body of legal principles applicable to the construction of modern commercial instruments.'); or that of Sir Alfred Bucknill, as referee, in *Ruler of Qatar v International Marine Oil Company Ltd* (1953) 20 ILR 534, at 545 ('I am satisfied that Qatari law does not contain any principles which would be sufficient to interpret this particular contract.'); or that of the Tribunal in *Saudi Arabia v. Arabian American Oil Company (Aramco)* (1958) 27 ILR 117, at 169 ('The regime of mining concessions and consequently also of oil

insulate the contract from the application of domestic law was chiefly justified by reference to the special position of the host State as both contractor and legislator. Removing certain core contractual provisions from the ambit of domestic law and subjecting interferences with the contractual relationship to the international legal order provided an expedient way to protect the investor against potential legislative abuses by the host State.[158]

The concept of "internationalization", as developed in various nuances in arbitral practice, was not seen as unproblematic in international legal doctrine. The applicability of international law to State contracts has long remained and still remains a contested proposition.[159] Nonetheless, the conceptual device was one necessary to achieve a degree of protection for investment contracts at a time when investors could not yet rely upon conventional instruments. The acceptance, in practice, of the possibility that a contract be withdrawn from the municipal law of the host State concerned found ultimately underpinning in Article 42 of the ICSID Convention, which makes express provision for the applicability of international law to individual investor-State disputes. With the growth of investment treaties, however, the problem of contract internationalization would eventually lose its significance. As a result of the "treatification"[160] of investment law, contractual relationships between the investor and the host State enjoy the protection of investment treaties, under which investors' contractual rights are invariably treated as one of the many types of protected assets.

## 2.2.5. The "Treatification" of Investment Law in the Twentieth century

In the meantime, the practice of guaranteeing protection to nationals and their interests abroad by means of conventional instruments continued apace, and eventually intensified in the second part of the twentieth century. As in the previous centuries, investment rule-making continued to be pursued primarily at the bilateral level. Due to continuous disagreements between the capital-exporting and capital-importing States on the appropriate level of investment protection, several attempts at multilateral rule-making – beginning with the efforts at codification of rules pertaining to the treatment of aliens under the auspices of the League of Nations in the late 1920s, and continuing with the subsequent attempts at regulating investment in the framework of the Havana Charter for an International Trade Organization (1948), and the various post-WWII proposals for a multilateral code on foreign investment, such as the ICC's International Code of Fair Treatment of Foreign Investment (1949), the Abs-Shawcross International Convention for the Mutual Protection of Private Property Rights in Foreign Countries (1957), and the OECD Draft Convention on Foreign Property (1963/1967) – ultimately failed to receive the required support.[161]

In the earlier part of the twentieth century, the primary driver behind bilateral rule-making remained the United States, as the European investment still favoured their colonial and

concessions has remained embryonic in Muslim law and it is not the same in the different schools ... *Hanbali* law contains no precise rule about mining concessions and is silent a fortiori about oil concessions').

[158] See eg *Sapphire International Petroleums Co v Natioanl Iranian Oil Company (Arbitral Award)* (1967) 35 ILR 136 (15 March 1963), 171 (finding that the substantive law applicable to the interpretation and performance of the concession agreement had to be the principles of law generally recognized by civilized nations, *inter alia* because the legal security of the investor's interests 'could not be guaranteed … by the outright application of Iranian law, which it is within the power of the Iranian state to change.'); or *Topco/Calasiatic v Libya* (n 156), [42] ('The recourse to general principles is to be explained not only by the lack of adequate legislation in the State considered […]. It is also justified by the need for the private contracting party to be protected against unilateral and abrupt modifications of the legislation in the contracting State: it plays, therefore, an important role in the contractual equilibrium intended by the parties.')

[159] For an exhaustive overview of the various doctrinal positions, as well as their critique, see I Alvik, *Contracting with Sovereignty* (Hart Publishing 2011) 47-58.

[160] The notion of 'treatification' has been applied to describe the enormous growth of investment treaties by JW Salacuse, *The Law of Investment Treaties* (OUP 2010) 78.

[161] cf Schill (n 94), 31-40.

dependant territories, which obviated the need for treaty protection. Until WWII, the FCN treaties concluded by the US were still commercial treaties in the broadest sense, dealing with matters pertaining to trade and shipping, but also consular relations, and the treatment of nationals in general (including, for instance, matters pertaining to the freedom of worship and travel within the host State). Novel, however, was a uniform provision on property protection, which guaranteed "the most constant protection and security" and protection "required by international law", and prohibited the taking of property "without due process of law and without payment of just compensation." Moreover, the nationals of the other contracting party were guaranteed national and MFN treatment with respect to commercial work and other listed activities.[162] In the post-WWII era, however, the US FCN treaties became increasingly investment-oriented (even if their provisions were still phrased to cover protection of property in general, rather than investment *per se*), with their benefits now extended to corporate activities, including those of local subsidiaries.[163] The guarantees concerning the treatment of foreign property expanded, as the parties were required to afford "equitable" or "fair and equitable" treatment and "most constant protection and security", and, in the event of expropriation, "prompt, adequate and effective compensation" was to be provided. Furthermore, these treaties prohibited "unreasonable or discriminatory measures" that would impair the property rights, and guaranteed nationals national and MFN treatment with regard to commercial and non-commercial activities, as well as limited the rights of parties to restrict the repatriation of earnings.[164] Significantly, these US FCN treaties provided for mandatory State-to-State dispute resolution, guaranteeing to each parry the right of adjudication before the ICJ of any dispute concerning its interpretation or application.[165]

From the 1960s onwards, the European capital-exporting States, too, embarked upon creating their own networks of bilateral instruments aimed at securing the protection of investments in the developing world. Unlike the US treaty instruments, which were directed towards developed States, the European BITs targeted primarily developing countries. Taking the lead on this was Germany, which concluded the first modern bilateral investment treaty (BIT) with Pakistan in 1959,[166] with other European capital-exporting states soon following suit. While in the case of Germany, the move towards bilateral treaty-making was largely informed by the still fresh recollection of private property confiscation in the context of post-WWII reparations, several of the former European colonial empires, such as the United Kingdom, Belgium, France, and the Netherlands, originally pursued their BIT programmes primarily with a view to safeguarding the existing investments of their nationals in the newly independent States. Not before long, however, other capital-exporters from Europe (e.g. Austria, Switzerland, and Italy), as well as from other parts of the world would be joining the BIT movement as well.

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[162] KJ Vandevelde, *Bilateral Investment Treaties* (OUP 2010), 22.

[163] Traditionally, FCN treaties were commercial in in the broadest sense of the word, as they applied not only to investors, but also to merchants. In their origins, they were essentially market access instruments, through which both foreign investment and trade were bargained for. Yet, from the 1940s onwards, a paradigm shift occurred as a result of the GATT (1947). As trade regulation increasingly too place on a multilateral basis, FCN treaties began to be more narrowly oriented towards the protection of investments. On this development, see ME Footer, 'International Investment Law and Trade: the Relationship That Never Went Away' in F Baetens (ed), *Investment Law within International Law: Integrationist Perspectives* (CUP 2013), 259-297, 264ff.

[164] ibid 23-24. A Benton, 'The Protection of Property Rights in Commercial Treaties of the US' (1965) 25 ZaORV 50, 60ff.

[165] These frequently became subject of litigation before the ICJ. See eg United States Diplomatic and Consular Staff in Tehran (United States of America v Iran) (Judgment) [1980] ICJ Rep 3 (24 May 1980); Military and Paramilitary Activities in and against Nicaragua (Nicaragua v United States of America) (Judgment) [1986] ICJ Rep 14 (27 June 1986); Elettronica Sicula SpA (ELSI) (United States of America v Italy) (Judgment) [1989] ICJ Rep 15 (20 July 1989); or Oil Platforms (Islamic Republic of Iran v United States of America) (Judgment) [2003] ICJ Rep 161 (6 November 2003).

[166] C Brown, Commentaries on Selected Model Investment Treaties (OUP 2013) 293.

Differently from the US FCN treaties, the European BITs focused exclusively on the protection of foreign investment, which was usually broadly defined as comprising not only tangible property, contractual rights, and shareholding interests, but also rights granted under public law and intellectual property rights. Though concluded by different States, many BITs happened to be very similar in nature, content and structure.[167] Building on the principles and rules developed in the context of the earlier unsuccessful attempts at multilateral rule-making, and particularly on the clauses devised in the 1959 Abs-Shawcross Draft and the 1967 OECD Draft Convention, most BITs provided investors with the guarantees of fair and equitable treatment, full protection and security, and national and/or MFN treatment, coupled with provisions proscribing expropriations others than those that were non-discriminatory, for a public purpose, against payment of prompt, adequate and effective compensation, and with respect for the due process of law. Often, the BITs would also contain stipulations concerning damage in times of war and civil disturbance, the free transfer of funds, and not infrequently a stipulations concerning the observance of commitments. The most important innovation introduced by BITs, however, was the granting of concomitant procedural means for the enforcement of the prescribed standards of treatment in the form of provisions allowing aggrieved investors to bring claims directly against the host State in international arbitration. Facilitating this development, of course, was the establishment in 1965 of the ICSID, which provided the appropriate forum for hearing such claims.

Within a few decades, the number of such BITs has grown exponentially. If there were reportedly 385 BITs concluded by 1990, their numbers reached already 1,857 by 2000, and 2,750 by 2010.[168] While the sudden surge in treaty-making coincided with the end of communism and the new era of globalization, the initial impetus for the conclusion of BITs were chiefly the uncertainties pertaining to the rules of customary international law in the field of investment protection. Not only did the BIT, as a conventional instrument, provide the means for reaffirming some of the norms that the developed states long advanced as being part of customary international law, but at the same time also offered the opportunity for the further development of the customary international law standards which in many ways have been falling short of providing adequate protection to modern business practices, and especially the growing role of the corporation in investment making.[169] It is, of course, ironical that prompting this further internationalization of investment rules through this process of "treatification" were precisely the challenges mounted against traditional investment protection standards by developing countries in the context of their quest for a New International Economic Order. Paradoxical, thereby, is the fact that the same States that purported to reject those standards have later accepted them in conventional form, not only in their relations with the capital-exporting States, but also in the treaties that they concluded among themselves.[170]

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The argument that I intend to defend in this study is that the ascendance of international rules pertaining to the protection of foreign investors significantly weakened the position of domestic courts. If the availability of direct investor-State arbitration provided a functional alternative to dispute resolution before domestic courts, the process of internationalization of the

[167] On the content, see UNCTAD, Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking (2007) (UNCTAD/ITE/IIA/2006/5).

[168] For these figures, see UNCTAD, *Bilateral Investment Treaties: 1959-1999* (2000) (UNCTAD/ITE/IIA/2); UNCTAD, *Investment Policy Monitor* (No 1, 4 December 2009) <www.unctad.org/en/docs/webdiaeia200911_en.pdf> accessed 14 June 2018.

[169] *Barcelona Traction* (n 19), 46-47.

[170] On the treaty-making practice up until the 1990s, see P Peters, 'Dispute Settlement Arrangements in Investment Treaties' (1991) Netherlands Yearbook of International Law 150ff.

applicable standards of treatment disposed, at the same time, of any material need for investment disputes to be dealt with at the level of the domestic legal system. Once it was international law that supplied the standards necessary for assessing the propriety of conduct of host State's organs, domestic law – and domestic courts applying it – lost in relevance. In fact, as I intend to show in the present study, this substantive shift has provided international adjudicatory bodies with both a sword and a shield. By relying on the principle of supremacy of international law, it has now become not only possible for investment tribunals to leave aside any unfavourable domestic judicial pronouncements in determining the State's liability for damages incurred by the investor. But inasmuch as they were applying a materially different standard, investment tribunals could conceive themselves as operating in a different legal sphere than domestic courts, and thereby resolving the instances of jurisdictional competition in their favour.

## 2.3. Reasons for Avoiding Domestic Courts: From the Standard of Civilization to the Problem of Impartiality and Efficiency of Domestic Procedures

This leads to the more fundamental question, as to why capital-exporting States historically deemed it necessary to provide foreign investors with the power to sue and have a choice with regard not only as to the forum but also as to the applicable law. It has not been uncommon to explain the rise of investment arbitration as the necessary, functional complement to the substantive standards of treatment (the "no rights without remedies" argument).[171] I argue, however, that the functional and substantive shifts described above cannot be seen in isolation from each other. They are part of one and the same process of de-localization and internationalization of investor-State relations that has been going on, at least intensively, since the nineteenth century.

The premise of my inquiry is that this process is ultimately driven by a deep-rooted skepticism, as well as a fundamental lack of trust and confidence on the part of the capital-exporting States towards the legal systems of States of non-European origin. As I intend to demonstrate in the following parts, one of the key rationales for the introduction of investor-State arbitration was the perception that the capital-importing States possessed weak judicial systems that did not match up to that of developed states, and therefore could not administer justice in an adequate way. What I also intend to show, however, is that such a perception is not of recent vintage, but that is one that developed, capital-exporting States have traditionally nurtured about the legal systems of countries of non-European origin ever since the beginning of the colonial expansion.

### 2.3.1. Measuring Legal Systems through the Lens of Civilization

The colonial expansion had brought European nations, invariably sharing a common Christian tradition, in contact with peoples and societies whose social and cultural (and therefore also legal) practices were largely at variance with those of their own.[172] The Europeans did not embrace these cultural differences as a *fact*, as a necessary consequence of differing beliefs and values that different peoples in different parts of the world may hold. They rather considered them as backward, primitive, and generally aberrant – as opposed to their own social and cultural

[171] On this, see generally Puig (n 15).

[172] See eg D Kennedy, 'Three Globalizations of Law and Legal Thought: 1850-2000' in DM Trubek and A Santos (ed) *The New Law and Economic Development: A Critical Appraisal* (CUP 2006) 193 at 29-30, explaining that '[i]n the Ottoman lands and across Asia, there were highly developed preexisting modes of legal consciousness (Islamic, Hindu, Confucian, Shinto) that had at least a chance of resisting or transforming themselves into local competitors [of Western Classical Legal Thought]'.

practices, which they believed to be universal.[173] Not only – Europeans came to regard themselves as uniquely "civilized", as opposed to the "barbaric", "savage", and "uncivilized" peoples that occupied most of the non-European world.[174] The practice of distinguishing societies along "civilizational" lines was not without significance. In the course of the nineteenth century, Western jurists began to advance the proposition that international law was a product of the special civilization of modern Europe and remained as such only the province of civilized states. Demoted to the "uncivilized", non-European people were hence debarred from the realm of international law. Of the many legal (and political) implications that this has had, the most important was certainly the fact their sovereignty could not be recognized under international law, which meant that they became suitable objects of conquest by the Western Powers, in their pursuit of the "civilizing mission".[175]

The legal mechanism through which peoples had accordingly been admitted into (though, more frequently been barred from) the universal civilization of Europe was that of the "standard of civilization".[176] This was a set of requirements that, though never clearly defined, were deemed to include the following. First, a "civilized" State was taken to be one that was capable of guaranteeing certain basic rights (essentially, those relating to dignity, to the protection of life and property, and to freedom of travel, commerce and religion), and such rights were in principle to be guaranteed to all peoples within its jurisdiction, though in particular to foreigners, which invariably meant the citizens of "civilized states".[177] Second, a "civilized" State was one that possessed an effective government and maintained a State machinery that operated with a certain degree of efficiency. Third, it was one that adhered to the precepts of law, not only in the sense of compliance with international law, but also in relation to the capacity to guarantee legal justice to all within the domestic jurisdiction, foreigners and natives alike. Fourth, a "civilized" State maintained permanent diplomatic relations with other States. Whereas fifth, and finally, a State meeting the "standard of civilization" was one that generally adhered to cultural practices that were deemed "acceptable" to European views (e.g. monogamy).[178] In practice, of course, the standards to which non-European peoples were expected to conform were nothing but idealized European standards, for only States meeting such standards, as the nineteenth century lawyer John Westlake explained, would have enabled "people of a European race" to "carry on the complex life to which they have been accustomed in their homes".[179]

The maintenance of an adequate legal system – one that not only substantively recognizes certain basic rights, but also procedurally guarantees such rights through a functioning judicial system – was thus an important element of the "standard of civilization". In practice, however, it was also an element that was habitually difficult to meet by non-European States. As between civilized states, Westlake wrote in his treatise, there may be "differences of detail, but no one who has had a liberal education feels himself a stranger in […] law courts […] of another country" and

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[173] This notwithstanding the fact that eg up until 1850, the family law of Western States still looked quite similar to the then existing regimes of Muslim, Hindu, or Confucian family law. ibid at 33.

[174] J Lorimer, Institutes of International Law: A Treaties of the Jural Relations of Separate Political Communities (1883) 101-3.

[175] See G Simpson, *Great Powers and Outlaw States: Unequal Sovereigns in the International Legal Order* (CUP 2004) 227ff; and Anghie (n 143), 32-114.

[176] See generally B Bowden, 'The Colonial Origins of International Law, European Expansion and the Classical Standard of Civilization' (2005) 7 Journal of the History of International Law 1.

[177] cf G Schwarzenberger, 'The Standard of Civilisation in International Law' (1955) 8(1) Current Legal Problems 212, 220, observing many years later that the test of the standard of civilization was 'as a rule, merely whether its government was sufficiently stable to undertake binding commitments under international law and whether it was able and willing to protect adequately the life, liberty and property of foreigners.'

[178] GW Gong, The Standard of 'Civilization' in International Society (Clarendon 1984) 14-21.

[179] J Westlake, Chapters on the Principles of International Law (CUP 1894) 141.

"the native subjects of one state travelling or resident in another […] usually feel themselves safe under the local administration of justice."[180] In countries having "civilizations differing from the European", in contrast, Western nationals "would not feel safe under the local administration of justice which, even were they assured of its integrity, could not have the machinery necessary for giving adequate protection to the unfamiliar interests arising out of a foreign civilisation."[181] There were a number of reasons why local legal systems were deemed unsuitable for extension to Europeans. For one, concerns were raised about the local law itself which, to the extent that it was actually contained in written codes, was often considered to be contradictory, harsh, and still resting on doctrines long eliminated from Western legal thought (such as the application of the law of retaliation or the principle of collective responsibility). With equal apprehension, though, Western commentators took issue with the abuses in the way that the laws were administered, with the inadequacies of local procedures as such (such as the fact that torture would normally be resorted to in order to secure confessions, or the idiosyncratic treatment of evidence), and with the apparent lack of independent judiciaries (where these were considered to exist at all), which were notoriously prone to bribery and corruption.[182]

The "standard of civilization" was not only determinative of whether non-European states as such would obtain equal recognition under international law, but also of whether their domestic legal systems were to obtain such recognition. As between "civilized" states, the question of mutual acceptance and recognition of domestic legal systems was never an issue. As Westlake explained:

> "The common civilisation then […] contains the principle that the institutions, whether of government or of justice, which the inhabitants of a state find suitable to themselves, must normally be accepted as sufficient for the protection of foreigners among them. Those foreigners are subject to the local courts and authorities, and not to separate jurisdictions, and their own governments will not, normally, interfere for their protection so long as they enjoy equal treatment with natives."[183]

Indeed, this principle of mutual acceptance was well-reflected in the practice of Western states in relation to the commercial treaties that they had been concluding *inter se* from the sixteenth century onwards. As discussed above, in most of these treaties, the granting of access to domestic courts on equal footing with the state's nationals and the nondiscriminatory and fair application of the national laws were considered sufficient to ensure protection to the life and property of foreigners. Significantly, these treaties did not postulate that the legal system of the

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[180] ibid 101-02.

[181] ibid 102.

[182] See eg the analysis of the Chinese law in GW Keeton, *The Development of Extraterritoriality in China* (Longmans 1928) 96-136. Of particular interest is Keeton's assessment of the Chinese judicial system, of which he noted as follows: 'It must be remembered, moreover, that China until 1911 had no judges in the Western sense of the word at all. Her magistrates were appointed in the first place, as a result of successful competition in the state examinations, for proficiency in the classics. They exercised at once legislative, administrative, and judicial functions. They were not bound by the provisions of the code, for they had the power at all times of creating new offences and punishing for their breach. There was no regular legal procedure, and the magistrate adopted whatever methods seemed to him best fitted for ascertaining the truth. Furthermore, there was no legal profession in China, trained to watch over the interests of its clients. The person accused of an offence was entirely at the mercy of the examining magistrate, who might even detain him for years without deigning to investigate the nature of his offence. It should not be forgotten, moreover, that until the compilation of the new Chinese codes at the beginning of the present century Chinese law designated many things as penal which in Western systems are either civil offences or no wrong at all in law. Lastly, the meagre salaries paid to even the highest magistrates rendered them an easy prey to wealthy and unscrupulous law-breakers, and encouraged irregular taxation.' ibid 99-100.

[183] Westlake (n 179), 103.

foreign state would have to adhere to any supposed minimum standards accepted by civilized nations.[184]

In relation to legal systems of non-European states, in contrast, no such principle of unconditional mutual acceptance was applied. Instead, three different strategies were pursued by the Western states in dealing with those legal systems. Two of them effectively entailed the expansion of the jurisdiction of Western legal systems at the cost of the native ones. In the more brutal form, such expansion resulted in the displacement of native (legal) institutions, and their replacement with legal and judicial systems that resembled those of the European states. In the less brutal, though, not any less condescending form, the expansion materialized through the imposition of regimes of extraterritoriality that resulted in the removal of European residents from the jurisdiction of local courts and their submission to the authority of their own consuls. The third strategy pursued, in turn, ensued in the acceptance of local forms of administration of justice; but unlike the case of intra-European regimes, this acceptance was not an unconditional one, but one that was subject to the meeting by the state in question of minimum standards deemed prescribed by international law, and which also resulted in frequent interventions – not only be means of diplomatic interposition but even by (threats of) use of force – as soon as the local administration of justice did not appear to accord with those standards. It is worth examining these strategies in greater detail now.

### 2.3.2. Colonial Rule and the Introduction of Western Systems of Administration of Justice

The imposition of colonial rule,[185] to which great parts of Africa and Asia were subjected, invariably led to the introduction of new structures of governance. The techniques of administration varied, depending on the colonial power involved. While some of the territories were ruled directly by the colonial offices; in others, the administration was exercised indirectly through local rulers. What colonial expansion invariably led to, however, was the introduction of new systems of laws and courts, invariably modeled upon the metropolitan legal systems of the European Powers, though rarely representing their precise replications. Namely, when Europeans conquered Africa and parts of Asia, they frequently encountered populations with well-established indigenous and Islamic systems of law. But instead of displacing these systems, they rather subordinated them to metropolitan legal traditions, creating thus a form of hybrid, *sui generis* colonial legal system.[186] Many of the colonial powers had thus the habit of retaining native

[184] Neufeld (n 90), 103.

[185] The methods used to bring non-European societies under colonial rule differed in time and per region. In some cases, subjugation resulted from outright occupation of what was perceived and claimed to be *terrae nullius*. A case at hand is Australia, which had been found to consist 'of a tract of territory practically unoccupied without settled inhabitants or settled law' that could thus be lawfully occupied and annexed to the British Dominions. See *Cooper v Stewart* (1889) 14 AC 291 (Judicial Committee of the Privy Council). Another way was through the institution of 'colonial' protectorates, by which the European Powers obtained initially the possibility to interfere with internal sovereignty rights of the protected entities, and later to acquire full and comprehensive sovereignty over the territory and the native peoples. These protectorates were typically established by means of transactions with the native rulers and chiefs, through which the latter surrendered to the protecting power so much sovereignty as it was necessary for giving effect to the protection granted. Such practice was one that was frequently employed in Africa and in some parts of Asia, where the European Powers encountered native communities permanently occupying defined tracts of land and displaying some form of political organization. On colonial protectorates, see further Alexandrowicz (n 102), 189ff.

[186] See R Roberts and K Mann, 'Law in Colonial Africa' in K Mann and R Roberts (eds), *Law in Colonial Africa* (James Currey 1991) 3, 8-9. As Benton explains: 'Colonialism shaped a framework for the politics of legal pluralism, though particular patterns and outcomes varied. Wherever a group imposed law on newly acquired territories and subordinate peoples, strategic decisions were made about the extent and nature of legal control. The strategies of rule included aggressive attempts to impose legal systems intact. More common, though, were conscious efforts to retain elements of existing institutions and limit legal change as a way of sustaining social order.' L Benton, *Law and Colonial Cultures: Legal Regimes in World History, 1400–1900* (CUP 2001) 2-3.

law and custom for decision of disputes in which natives were involved (although, only to the extent that those native rules could "be tolerated by a civilized power"[187]). To administer this native law, they also found it opportune to establish special "native courts", which operated with various degree of integration with the "regular", European-type colonial courts.[188] These native courts, however, were designed to deal with cases between natives only and their jurisdiction did not extend to the Western subjects.

The introduction of colonial legal systems formed one of the essential elements in the European efforts to establish and maintain colonial domination. Quite conveniently, however, their putting into place also obviated the need for recourse to international legal processes to protect the flows of foreign investment into the colonies. Through the introduction of their own laws and courts, and backed their own police and prisons, European Powers were now themselves capable of guaranteeing in their colonial possession respect for certain basic rights and the orderly administration of justice to their own subjects, as well as to the subjects of other European Powers. So much so that, where a European Power assumed jurisdiction over territories that had previously been subject to capitulatory regimes, other Powers gradually gave up their claims to extraterritorial rights. With time, the assumption of a protectorate over "uncivilized" people would therefore automatically be deemed to entitle the protecting state to exercise jurisdiction over all subjects in the territory,[189] and in fact, would be held to provide the colonial power with the exclusive right to deal with the colonial possession outside the sphere of international law.[190]

### 2.3.3. Regimes of Extraterritoriality and the Administration of Justice by Means of Consular and Mixed Courts

Not everywhere did the colonial encounter result in complete subjugation of non-European peoples. In contrast to the purportedly "savage" societies that were held to require administration in the hands of one or another European power, there was also a category of entities that displayed sufficient social and political organization to obtain recognition as sovereigns, and to retain thus their nominal independence, whilst at the same time being considered not "civilized" enough to engage in intercourse with the Western powers on the basis of equal footing. These entities, characterized by contemporary lawyers as "semi-civilized" states, were not yet entitled to have their sovereignty fully recognized and were therefore subjected to regimes of extraterritoriality.[191] Although not an invention of the colonial era,[192] extraterritoriality acquired

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[187] AN Allott, 'The Extent of the Operation of Native Customary Law: Applicability and Repugnancy' (1950) 2(3) Journal of African Administration 4. In British controlled territories, the applicability of native law usually depended on whether or not the rule in questions was 'not repugnant to justice and morality.' ibid 8. In some German colonies, in contrast, the natives were only subject to native law, insofar as they were considered to be 'insufficiently advanced to come under German law'. JP Moffett, 'Native Courts in Tanganyika' (1952) 4(1) Journal of African Administration 17, 17-18.

[188] See RE Robinson, 'The Administration of African Customary Law' (1949) 1(4) Journal of African Administration 158.

[189] At one point, a difference of opinion existed between European Powers as to the jurisdictional rights that the protecting powers enjoyed over subjects of other powers. In particular, the British maintained the view that international law did not permit them to exercise criminal and civil jurisdiction over subjects of foreign powers in the territory, except with the consent of these powers. Subsequently, however, the British assimilated its position with that of the other European governments, such as France and Germany, that such jurisdiction extended to all subjects. See on this, J Mugambwa, 'Treaties or Scraps of Paper – A Second Look at the Legal Character of the Nineteenth century British/African Colonial Agreements' (1987) 20 Comparative and International Law Journal of Southern Africa 79, 85-86.

[190] Alexandrowicz (n 102) 194.

[191] cf Keeton (n 182), 100.

[192] As a legal institution, regimes of extraterritoriality stretch back to much earlier periods, when legal systems were dominated by the principle of the personality of the law. The latter dictated that the law applicable to particular individuals be determined on the basis of their origin or ethnical/tribal affiliation. Hence, it was normal for foreigners to be exempted from local jurisdiction and being granted the right to live according to their own laws. See HJ Liebesny, 'The Development

new meaning during the colonial expansion of the nineteenth century, as it provided a convenient tool for the commercial penetration of economically (and militarily) weaker States, without the assumption of colonial administration. This was a tool, of course, that was firmly grounded in international law. By the nineteenth century, extraterritorial regimes were invariably imposed by what were commonly known as treaties of "capitulation",[193] sometimes also referred to as "unequal treaties",[194] which were particularly ubiquitous in the Western relations with the States of the Middle East (Turkey, Egypt) and Asia (China, Japan, Korea).

By virtue of such regimes, the Western residents in those countries were not only granted far-reaching privileges, such as the right to trade and establish residence, or the exemption from the payment local taxes and customs duties (privileges which could even be further extended pursuant to MFN clauses). Most significantly, perhaps, they were entitled to remain under the jurisdiction of their own State of nationality. In practice, this meant that they continued to be governed by their own law and judged by their own courts, instead of having to subject themselves to the "less civilized" local systems of law, which were considered inadequate in the eyes of the Western powers. This obviously provided an important mechanism for securing also the protection of investment flows. The security of investments did not depend on particular guarantees applicable as a matter of international law, but was effectively guaranteed by the extraterritorial application of the laws of Western powers.[195] In some cases, for example, foreign companies were even entitled to establish themselves and organize according to the laws of their own countries, and freely transact and conduct business in the host State, without being subject to the authority of the local government.[196]

Of great significance in this respect was also the possibility for foreign subjects to be administrated justice in accordance with Western standards, by courts that operated almost in isolation of the local judicial systems. Local variations notwithstanding, such extraterritorial administration of justice was generally performed by two types of institutions. In case of differences between subjects of different foreign nationalities, the case was always tried before a

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of Western Judicial Privileges' in M Khadduri and HJ Liebesny (eds), *Law in the Middle East: Origin and Development of Islamic Law,* vol I (Middle East Institute 1955) 309, 309. Historically, the granting of extraterritorial rights was already widely practiced in the Mediterranean basin prior to the conquest of Constantinople by the Ottomans in 1453. Some consider the earliest example of such practice to be found in the treaty concluded in 911 between the Varangians and Emperor Leo VI of the Byzantine Empire. See G Bie Ravndal, 'Capitulations' in EG Mears (ed), *Modern Turkey* (Macmillan 1924) 430, at 435-36. But the practice found its full development and systematization in the intercourse between Christian nations and the Ottoman Empire, where the granting of extraterritorial rights to foreign, predominantly European merchants has since the Middle Ages been a practical solution to the problem of jurisdiction over non-believers, as well as a convenient way to obtain scarce goods and win political allies in Christendom. For similar reasons, extraterritorial arrangements were brought in existence between the European States and other Islamic nations, such as the 'Barbary Powers' of Algiers, Tunis, and Tripolis. See JM Mössner, 'The Barbary Powers in International Law (Doctrinal and Practical Aspects)' in *Grotian Society Papers* (Brill 1972) 197, 214-215. Reportedly, the tradition of granting extraterritorial privileges was also customary between the rulers of Asia. See Alexandrowicz (n 102), 151-52.

[193] So named after a category of instruments, subdivided into chapters (*capitula*), through which early Ottomans had granted extraterritorial privileges to subjects of non-Muslim nations. In those times, however, such privileges were granted on the footing of equality, or had even been conceded unilaterally by Ottoman rules. In the nineteenth century, in contrast, the earlier capitulatory arrangements were replaced by new treaty arrangements, which compelled much further reaching privileges from the then weakening Ottoman Empire, so as to enable the opening up of the latter to Western foreign capital.

[194] The notion refers to treaties such as those imposed upon China, Japan, or Korea, following their military defeat at the hand of Western powers, or else obtained through threat of military action on account of those countries' refusal to open to foreign capital and commerce. The lack of reciprocity in such arrangements has usually warranted the description of 'unequal treaties'.

[195] The state of exemption from local laws meant that foreign nationals were effectively immunized from regulatory measures adopted by the local sovereigns, obviating the need to have special procedures put in place for investor-State disputes. In case disputes of that kind nonetheless emerged, the matter would be resolved through diplomatic means.

[196] Ravndal (n 192), 431.

*consular court* instituted in each consulate, which usually happened to be the court of the defendant. In case of differences between foreign and local subjects, on the other hand, the trial was conducted instead before *mixed courts*, composed of local judges and foreign delegates, usually accompanied by translators (dragomen) from the consulate of the foreigner. In the latter courts, an official delegate from the consulate of the nationality of the foreign subject or firm had always to be present, for the court proceedings were not considered valid unless ultimately approved by the said delegate. The latter could namely refuse to approve the proceedings if these were not deemed consistent with legality. The ensuing sentences were then executed by the local competent authorities under the supervision of the respective consulates.[197] The system of mixed courts was developed most fully in the arrangements between the Western Powers and the countries of the Far East.

By the end of the nineteenth century, expectedly, the countries that were subject to regimes of extraterritoriality began to resent Western Powers' interference with their domestic legal systems. Restrictions on their exercise of jurisdiction over foreign residents were increasingly found as humiliating, as they were derogatory to the sovereignty of the territorial ruler.[198] Besides, given that the privileges enjoyed by the foreigners were denied to their own nationals, they also considered them hurtful to their own subjects. Yet, the various extraterritorial regimes could not be abrogated unilaterally, for even where these were initially conceded on a unilateral basis (such as in the case of the Ottoman Empire), they had by then been gradually formalized and entrenched in treaties. This, notwithstanding the fact that, as a legal institution, extraterritoriality has grown into an anomaly that was opposed to the modern conception of territorial sovereignty, and was also at variance with the practice of Western states that had already restricted the exercise of extraterritorial jurisdiction among themselves. Expectedly, states subject to extraterritorial regimes claimed these to be contrary to the principle of sovereign equality of states. But Western lawyers defended extraterritoriality with the proposition that the "semi-civilized" states had lower "standards" of justice than the "fully civilized" states of Europe, which arguably prevented foreigners with an allegedly superior civilization from being subjected to the local systems of law. As maintained by Keeton, for example, extraterritoriality was thus "…not an exception to the general principles of international law, but a condition of intercourse […] between states of different degrees of civilisation, where that difference is clearly and fundamentally reflected in the legal institutions of the states concerned."[199]

Given that the Western Powers were only ready to give up extraterritorial arrangements if states subject to them could provide Western subjects with the same treatment that they would expect to receive in their home states, many of the purportedly "semi-civilized" States embarked upon judicial reforms, in order to prove that such arrangements were no longer necessary to protect Western residents. Yet, apart from the case of Japan, which modernized its government and reformed its judicial system to the extent that the capitulatory regime had definitely been abolished in 1899, legal reform projects in most other states were frequently deemed insufficient.[200] After all, meeting the "standards of civilization" entailed complying with the

[197] This is how the system operated in Turkey, ibid 431-32.

[198] Anghie (n 143), 85.

[199] Keeton (n 182), 104.

[200] The Ottoman Empire, for example, had been attempting to obtain abolition of the capitulations since the Congress of Paris of 1956. But it was only by the terms of the 1923 Treaty of Lausanne that foreigners became for the first time subject to Turkish law. Even then, some Western commentators expressed doubts as to the appropriateness of such a move. See eg Ravndal, writing that 'If we judge the future by the past, the outlook is not encouraging. The personnel of the judicial system has been woefully lacking in training, the judges underpaid, and the courts notoriously corrupt. The judicial system, in spite of many reforms, is an almost hopeless jumble of several coexisting systems of jurisprudence. Moreover, there is great confusion between so-called religious and civil law court procedure, although by the reform movements of 1908, this confusion was supposed to have been removed. The Ottoman civil code has its foundation in the religious law and is therefore inadequate for modern social and commercial usages.' Ravndal (n 192), 434.

idealized European standards, which presupposed the execution of wide ranging judicial reforms. In the case of the Ottoman Empire, for example, the extinction of capitulatory regimes was held to be possible "only through the complete secularization and nationalization of the Islamic law and through the further habilitation of the Ottoman courts".[201] It is not surprising, therefore, that Western Powers continued to insist on extraterritorial regimes until well into the twentieth century, sometimes relinquishing them for reason of strategic calculations other than those related to the administration of justice.[202]

### 2.3.4. Governance through International Law: Minimum Standards of Administration of Justice and the Doctrine of Denial of Justice

Western economic expansion resulted in a different type of confrontation in Latin America. Contrary to the situation in other parts of the world, in the first part of the nineteenth century, and after almost three centuries of colonial rule, most of the region achieved political independence. The newly independent States, of course, did not revert to the systems of political and legal organization existing prior to their subjugation by the Spanish and Portuguese empires. Instead, the forms of government they adopted were largely borrowed from European sources, and so were the legal systems they introduced, which largely embodied the Western notions of individual liberty, the sacredness of private property, and the sanctity of contracts.[203] This notwithstanding, in many of those countries, the conditions of order and stability otherwise necessary to make the European system work had not yet been fully established – a problem which manifested itself, among others, in the frequent outbreaks of disorder (taking the form of mob violence and civil strife), as well as recurrent changes of government.[204] This did not leave unaffected the many foreigners that were present in those countries. Dissatisfied with the local means available for redressing the injuries sustained during many of the Latin American revolutions, they recurrently called upon the assistance of their own governments to secure reclamation.

Unlike in the case of non-European societies in other parts of the world, the ensuing confrontations between capital-export States and the countries of Latin America did not result in the imposition of extraterritorial regimes. After all, the legal and political systems of Latin America were of European origin so that in accordance with the legal doctrines of the nineteenth century, they could hardly be considered as inferior in civilization.[205] Instead, the protection of the life and property of the foreign nationals was increasingly pursued through the utilization of international law and diplomacy. If, procedurally, the mechanism employed for that purpose was that of diplomatic protection, substantively, it was the doctrine of denial of justice that now provided the essential legal basis for diplomatic interposition.

The doctrine has been premised on the assumption that international law requires each State to provide a system of justice that treats aliens fairly and impartially, and that generally affords adequate judicial protection to their rights.[206] Not only was the availability of such a system one of the defining characteristics of the "civilized" state, but – as already mentioned above – at the same time a concrete obligation comprised under the minimum standard of

[201] ibid 445.

[202] In the case of China, for example, the United States and Great Britain were only willing to relinquish extraterritorial privileges once it appeared advantageous to securing China as an ally during WWII.

[203] Dawson and Head (n 8), 5-7.

[204] Dunn (n 5), 53-54; Lipson (n 93), 17; Borchard (n 5), 836-837.

[205] Shea (n 130), 5, argues that this was not the only reason why extraterritoriality was not imposed. Of relevance was, purportedly, also the sensitiveness of those States to the prerogatives of sovereignty, as well as the better bargaining position of those states as a result of the United States Monroe doctrine.

[206] See *infra* 6.1.

treatment under customary international law. Hence, even where unable to directly secure the operation of a judicial system that would fully cater to the needs of their citizens abroad, the capital-exporting States could at least ensure that their nationals could be indemnified where the judicial system would not appear to perform according to the desired standard. This was possible since, in view of the non-exacting nature of the standard of denial of justice, the capital-exporting States often reserved for themselves the right to determine whether justice had been denied to their nationals. The operation of the system was aptly explained by Borchard in the following way:

> "The attitude of the exploiting countries in the matter embodies the view that the political organization of many Latin-American countries is so weak, that judges depend so thoroughly upon executive favor, that, in the light of their experience, they must conclude that their citizens cannot secure from the courts that impartiality to which they are entitled, and that they cannot leave the rights of their citizens unreservedly to the determination of the local courts. Even where the South American states have succeeded by treaty and diplomacy in securing a recognition of the principle that claims of foreigners can only be diplomatically pressed where, after an exhaustion of local remedies, there has been a denial of justice, the exploiting countries undertake to judge for themselves what they will consider a denial of justice, so that the principle, while in conformity with the international law applied among the European states themselves, is, in its application to Latin-America, extremely flexible. A judgment, they say, may in spite of the observance of forms be nevertheless prejudicial to the interests of their citizens and they reserve the right to determine whether in each particular case justice has been in any degree denied."[207]

Expectedly, many of the capital-importing States considered the rules and practices thus imposed on them as constituting non-colonial forms of imperialism, and thus insisted on a narrow construction of the doctrine of denial of justice.[208]

### 2.3.5. From the Problem of Civilization to the Quest for a Neutral and Efficient Forum

Towards the middle of the twentieth century, the test of "civilization" gradually fell into disfavor, and with the commitment to formal equality of States following the adoption of the UN Charter, also definitely ceased to be used as a criterion for assessing the suitability of domestic legal systems.[209] By then, of course, any arguments pertaining to the purported inadequacy of domestic legal systems would have been difficult to sustain along "civilizational" lines, as many of the newly independent states that emerged from the process of decolonization possessed judicial systems that were modelled upon those of their former colonial powers.[210] But this did not imply that domestic judicial systems other than those of the developed world had become any less an object of distrust than they were before. What changed was only the language through which the opposition to the use of host States' judicial systems was now presented. Whereas an early report prepared by the UN Secretariat for the ECOSOC in 1960 would still associate the investors' reservations towards reliance on host State courts with their "foreign" nature and the resulting

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[207] Borchard (n 5), 837.

[208] See *infra* 6.1.

[209] cf Simpson (n 175), 256ff.

[210] See Dawson and Head (n 8), 306, noting for example how 'most Commonwealth countries include in their laws a procedural system almost identical to the English mode, a model which is as fair as any in the world' and how therefore '[t]he courts in these countries can be criticized for much the same reasons all courts are criticized, i.e., it is their inefficiency, not their unfairness, which is of concern'.

investors' "unfamiliarity" therewith,[211] the argumentation in the academic literature of the 1950s and 1960s progressively got enveloped in a more technical narrative: the purported lack of independence and efficiency of domestic courts were now identified as the main shortcomings of local litigation of investment disputes, and as the key factors justifying the introduction of direct investor-State arbitration.[212]

In the literature of the time, it was primarily the *independence* of domestic courts that was seriously questioned. This was presented either as a problem of integrity of domestic judicial procedures, or as a problem of the courts' non-independence from the host State itself. In the former case, what was called into question was the ability of the local judiciary to deliver justice impartially. Domestic courts were presented as being biased against the foreign investor, whereby the risk of governmental interference in judicial procedures and the presence of local prejudice were generally mentioned as the main obstacles for the foreign investor to securing impartial justice through local litigation.[213] This was, of course, a continuation of the arguments that had traditionally been raised in the nineteenth century in support of the claim that non-European judiciaries failed to meet the required "standard of civilization". What was further doubted, on the other hand, was the courts capacity to provide effective relief to the investor in vindicating its rights. This was not so much a question of the courts' actual bias, as it was one of systemic bias, associated with the domestic courts' embeddedness within the host State's legal order.[214] Given that courts, as organs of that order, were bound to apply the host State's legislation, and given that the host State could freely interfere with such legislation through executive or legislative action, domestic litigation of investment disputes was claimed to be potentially futile even where the integrity of the judiciary was not questionable.[215] More often than not, however, the claims of

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[211] ECOSOC *The Promotion of the International Flow of Private Capital: Progress Report by the Secretary-General* UN Doc E/3325 (26 February 1960), para 200 ('it is widely felt that what is lacking is […] an effective forum in which to enforce them [i.e. the investor's rights]. This lack springs chiefly from the reservations which the investor might feel toward reliance *either on foreign courts and agencies with which he is not familiar*, or on the support of his government…' (emphasis added)).

[212] Resort to such technical narratives has also been a common way for propagating the use of international commercial arbitration to resolve trade/commercial disputes. See on this, AA Shalakany, 'Arbitration and the Third World: A Plea for Reassessing Bias Under the Specter of Neoliberalism' (2000) 41 Harv Int'l LJ 419, 434ff.

[213] See eg M Domke, 'The Settlement of International Investment Disputes' (1957) 12 Bus Law 264, 265, arguing how the 'investor, dissatisfied with an investment situation in a foreign country, will not be inclined to go before the courts of that country. He will be fearful of the nationalistic trend in those courts, especially when a vital question of the country's interest is involved. Rightly or wrongly, the mere suspicion is enough to make one look for other means of relief'; or WE Albrecht, 'Some Legal Questions Concerning the Convention on the Settlement of Investment Disputes between States and Nationals of Other States' (1968) 12 St Louis U LJ 679, 682, describing domestic courts as 'too often prejudiced and susceptible to executive and legislative influence.' See also See eg ILA, *Report of the 40th Conference* (1938) 174-75: 'Experience has taught that . . . the indispensable objectivity and impartiality [of national courts] are sometimes jeopardized by considerations of national interest; this occurs especially in cases in which considerable interests are at stake.'

[214] The argument at that time had much to do with the changed nature of host States' interferences with the investors' property, which by the mid-twentieth century began to take less the form of individual instances of mistreatment, but more the shape of impersonal takings effected through legislative decrees that, as such, had to be given effect by domestic courts. On this shift, see Dawson and Head (n 8), 51ff.

[215] See eg A Broches, 'The Convention on the Settlement of Investment Disputes' (1965) 9 Sec Int'l & Comp L Bull 11, at 14 claiming that '[i]f there is a lack of confidence among investors it is not a lack of confidence in the integrity of the national courts but a fear that the executive and legislative branches will take politically motivated actions which the courts are powerless to deal with. This is a fact that has to be faced and one, moreover, that is not surprising in a world that is in political ferment'; or MM Moore, 'International Arbitration between States and Foreign Investors-The World Bank Convention' (1966) 18 Stan L Rev 1359, 1368, noting how '[t]he municipal courts may be hampered by the executive and legislative powers in that country, […] making an impartial decision unlikely.' See also O Schachter, 'Private Foreign Investment and International Organization' (1959-1960) 45 Cornell L Q 415, 427-28, observing that 'While it cannot be demonstrated that the absence of arbitration procedures constitutes a decisive obstacle to the flow of investment generally, there is reason to believe that many enterprises, especially those operating on a large scale, will be concerned about the risk of a government relying on its 'sovereign' power to over-ride or cancel contractual arrangements. For such firms, the

non-impartiality were not even concretized. The mere fact that redress would have to be sought before the courts of the same State whose actions formed the object of the investor's challenge was seen as sufficient reason to doubt about the impartiality of domestic litigation.[216] Indeed, investor-State arbitration was simply presumed to provide the "impartial" and "neutral" forum,[217] or even – as argued by some – to be "practically the only forum available for litigating with a foreign government."[218] Ultimately, such claims were then coupled with arguments pertaining to the purported *inefficiency* domestic judicial procedures. As opposed to the pursuit of local remedies, international arbitration supposedly provided the possibility for investment disputes to be heard rapidly, expeditiously, with dispatch.[219]

The arguments against domestic litigation of investment disputes were rarely, if ever based on empirical evidence demonstrating bias on the part of domestic courts.[220] Most of the evidence was anecdotal.[221] In fact, a study published 1971, which surveyed the legal systems of 25

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willingness of a government to contract for neutral arbitration in case of dispute is itself a significant symptom that the investment climate is favorable, and may be an important element in deciding to proceed with the investment.'

[216] See eg E Snyder, 'Foreign Investment Protection: The Dispute Solving Aspect' (1964) 3 Colum J Transnat'l L 127, 131, claiming that '[i]t does not appear realistic to expect a foreign investor to allow adjudication of his grievance before a tribunal of the nation in which the grievance arises, or before a tribunal of a nation allegedly causing the grievance. The reasons for this commend themselves without elaboration'; PC Szasz, 'A Practical Guide to the Convention on Settlement of Investment Disputes' (1968) 1 Cornell Int'l LJ 1, 9-10, noting 'the understandable suspicion of a foreign investor when asked to leave the final definition of his rights and obligations to the courts of the very government with which he is proposing to litigate'; or PK O'Hare, 'The Convention on the Settlement of Investment Disputes' (1971) 6 Stan J Int'l Stud 146, 146, finding that 'investors have been understandably diffident about their chances in the courts of a nation whose policy they are resisting.' See also DM Sassoon, 'The Convention on the Settlement of Investment Disputes between States and Nationals of Other States' (1966) 1 Isr L Rev 27, 27.

[217] See eg the Commentary to the 1959 Abs-Shawcross Draft Convention on Investments Abroad, in 'The Proposed Convention to Protect Private Foreign Investment' (1960) 9 J Pub L 115, 123, stating that '[t]here must, at the heart of any instrument dedicated to the creation of an atmosphere of confidence, always lie a provision for the effective adjudication by *an impartial body* of all disputes which may arise' (emphasis added); E Snyder, 'Protection of Private Foreign Investment: Examination and Appraisal' (1961) 10 Int'l & Comp LQ 469, 491, underlying the importance of the 'certainty that disputes involving foreign investments will be submitted to *impartial* arbitration' (emphasis added); CM Spofford, 'Third party judgement and international economic transactions' (1964) 113 Recueil des Cours 117, 148, speaking of the 'natural apprehension on the part of all parties that in transactions which may have a great impact on the national economy, municipal courts of one party could not be perfectly *impartial*' (emphasis added); P Szasz, 'Arbitration under the Auspices of the World Bank' (1969) 3 Int'l Lawyer 312, 312-13, speaking of the problem of attracting 'investors otherwise fearful of entering a foreign jurisdiction without having access to an *impartial*, assured forum to settle any disputes that might arise with the host Government' (emphasis added); or C Yun, 'The Convention on the Settlement of Investment Disputes - Commentary and Forecast' (1969) 11 Malaya L Rev 287, 292 noting how '[o]ne of the main factors influencing foreign investment decisions is the sense of assured security that in the case of disputes arising out of the investment the investor would be able to seek redress from an *impartial* neutral body.' (Emphasis added).

[218] Szasz (n 45), 140.

[219] See eg M Brandon, 'Recent Measures to Improve the International Investment Climate' (1960) 9 J Pub L 125, 128, speaking of the essentiality of establishing 'a system of international arbitration which would ensure the *rapid and final settlement* of disputes between sovereign states and private parties' (emphasis added); or AN Farley, 'Commentary: The Convention on the Settlement of Investment Disputes between States and Nationals of Other States' (1966) 5 Duq U L Rev 19, 26, noting how the ICSID Convention 'meets the characteristics traditionally propounded in favor of conciliation and arbitration: international investment disputes may be *heard with dispatch* by impartial or disinterested parties in accordance with a prior defined procedure.' (Emphasis added). See also C Hurst, 'Wanted! An International Court of Piepowder' (1925) 6 Brit. YB Int'l L 61, complaining on the 'evil consequences' resulting from delay in the settlement of international claims on behalf of individuals, and propounding the creation of some form of international jurisdiction which could expeditiously hear claims for injuries suffered by individuals at the hands of foreign governments.

[220] An exception is Snyder (n 216), 131, citing several judicial decisions purportedly biased against the investor. Interestingly, most of them, were decisions of courts from developed countries, where an attempt was made to recover damages from the host State that adversely affected the investor's interests.

[221] See eg 'Foreign Seizure of Investments Remedies and Protection' (1960) 12 Stan L Rev 606, 616-17, discussing the limited possibilities of judicial redress with respect to injuries sustained by foreign property on account of Mexican nationalizations, the Cuban agrarian reform of 1959, and the Indonesian nationalizations of 1958. See also IBRD, 'Report

jurisdictions, including those of many Latin American, African, and Asian countries, concluded that, in spite of areas where formal procedural inadequacies were found to exist, "the evidence indicates that, in the main, aliens' fears of foreign legal systems are groundless and founded more upon ignorance than on fact".[222] This notwithstanding, the study concluded that due to "post-World War II events which undermined faith in […] the Local Remedies Rule", the ICSID system "may be, at least for the time being, the most effective device for obtaining prompt, impartial decisions politically more acceptable to both host and protecting States."[223] In much the same way, the argument of inefficiency of domestic litigation usually did not rest on much factual substantiation. The fact that arbitration could be conducted directly between the investor and the host State was in itself deemed to provide an advantage over domestic litigation.

Today, the argumentation has not changed much. The narratives of neutrality of arbitration and local judicial bias continue to dominate contemporary writings, supported by claims pertaining to investment arbitration's technical superiority over domestic litigation. While local judicial bias continues to be more or less presumed,[224] reference is nonetheless made to certain concrete shortcomings of local litigation, such as to domestic constitutional limitations preventing direct application of international law within the host State's legal order, or conversely, treaty limitations precluding local claims that are based on the treaty; [225] to statutory immunities preventing suits against State organs or governmental agencies;[226] but also to the purportedly weak judicial organization causing excessive delays in many countries, and/or the lack of technical expertise on the part of domestic courts.[227]

It is not the intention here to further explore the validity of such claims. There is little doubt that considerable differences may exist in relation to the independence and/or effectiveness of domestic judiciaries around the world.[228] What is curious, however, is that the discussion has usually been framed in the most generic of terms – i.e., the problems of independence and ineffectiveness are presented as issues of purported concern to just *any* investor seeking redress in the courts of the State recipient of its investment – whereas in reality,

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of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States' (18 March 1965) [10] (mentioning that 'experience shows' that disputes may arise which the parties wish to settle by other methods than through domestic judicial procedures).

[222] Dawson and Head (n 8), 311.

[223] ibid 245.

[224] See eg C Schreuer (et al), *The ICSID Convention: A Commentary* (2nd edn, CUP 2009) 5 ('Rightly or wrongly, the national courts of one of the disputing parties are not perceived as sufficiently impartial.'); M Sornarajah, *The International Law on Foreign Investment* (CUP 2010) 217 ('[a] foreign investor, justifiably in many instances, will not have confidence in the impartiality of local tribunals and courts […] Arbitration, in a neutral state before a neutral tribunal, has traditionally been seen as the best method of securing impartial justice for him'); or JE Alvarez, *The Public International Law Regime Governing International Investment* (Martinus Nijhoff 2011) 68-69 (speaking of the 'risk of biased local courts' and 'the deep suspicion – often justified – of local courts'). But see SW Schill, 'Private Enforcement of International Investment Law: Why We Need Investor Standing in BIT Dispute Settlement' in M Waibel et al (eds), *The Backlash against Investment Arbitration* (Kluwer 2010) 29, 33-36, identifying a number of causes that may prevent domestic judges from adjudicating investment disputes independently.

[225] See M Bronckers, 'Is Investor-State Dispute Settlement (ISDS) Superior to Litigation Before Domestic Courts? An EU View on Bilateral Trade Agreements', (2015) 18 Journal of International Economic Law 655, 660ff; and also European Commission, 'Investment in TTIP and Beyond - the Path for Reform,' Concept Paper, 2015, <http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153408.PDF>, last accessed on 18 February 2019, at 9-10. For a contrary view, see T Jardim, 'The Authority of Domestic Courts in Investment Disputes: Beyond the Distinction Between Treaty and Contract Claims' (2013) 4(1) JIDS 175.

[226] See eg Dugan et al (n 4), 14-15; R Dolzer and C Schreuer *Principles of International Investment Law* (OUP 2008) 214-15; or Schreuer (n 224), 5.

[227] See eg Schreuer (n 224), 5; Bronckers (n 225), 671-672.

[228] See eg World Justice Project, *Rule of Law Index 2016* (2016) <https://worldjusticeproject.org/sites/default/ files/documents/RoLI_Final-Digital_0.pdf> accessed 14 June 2018.

the faith in the prospect of local litigation has essentially beenone concerning the operation ofthe legal systems of developing countries.[229] Attesting to this most clearly is the fact that up until recently, there were practically no bilateral investment treaties providing for direct investor-States arbitration in existence between capital-exporting States. Admittedly, this situation began to change in recent years, as advanced economies have started to conclude, or are in the process of concluding investment protection treaties *inter se*; treaties which now also provide for investor-State arbitration. But as the discussions attending the negotiations of these treaties have shown – especially those concerning the Comprehensive Economic and Trade Agreement (CETA) with Canada and the Transatlantic Trade and Investment Partnership (TTIP) with the US – the question of trust more than ever continues to play a role. On the one hand, with the many voices now questioning the actual need for investor-State arbitration in these treaties,[230] the impression gets confirmed that the current mechanism may never have been intended to operate on a truly reciprocal basis, as a means for avoiding the legal systems of developed and developing States alike. On the other hand, it is precisely by reference to trust (or lack thereof) that argments for retaining the current mechanism are being articulated. Wheras in the context of intra-EU BITs, the existence of investor-State arbitration is seen as unjustified because of the "existence of mutual trust between the Member States" that the common values on which the EU is founded will be recognized and that the law that implements them will be respected,[231] in the context of treaties between EU Members and Third States, the system must arguably be retained precisely because the relations between these States are "*not* based on mutual trust".[232] As ECJ Advocate General Bot recently observed:

> "It is *clear* that an investor from a third State who wishes to invest in a Member State will have at his disposal a body of law protecting that investment as well as legal remedies to assert his claims. Without preaching to or making groundless accusations about the commercial partners of the European Union, it cannot however be *taken for granted* that, in the third States with which the European Union wishes to develop relations in terms of investment, EU investors will enjoy an equivalent level of protection from a substantive and procedural point of view."[233]

* * *

As I intend to show in the present study, the problem of distrust in domestic judicial procedures continues to inform the present-day approach of investment tribunals in their dealing with domestic courts. Not only are arguments pertaining to the futility of domestic judicial procedures, and conversely, to the technical superiority of investment-arbitration, continuously invoked and relied upon in dealing with jurisdictional conflicts. But so is also the acceptance of domestic judicial pronouncements frequently called into question on account of the courts' embeddedness in the legal systems of the respondent States.

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[229] On this, see further M Sattorova, 'Return to the Local Remedies Rule in European BITs? Power (Inequalities), Dispute Settlement, and Change in Investment Treaty Law', (2012) 39 Legal Issues of Economic Integration 223

[230] For general discussion, see A de Mestral (ed), *Second Thoughts: Investor State Arbitration between Developed Democracies* (McGill-Queen's University Press 2017); for an example from policy circles, see European Parliament, 'Report containing the European Parliament's recommendations to the European Commission on the negotiations for the Transatlantic Trade and Investment Partnership (TTIP)', A8-0175/2015 (1 June 2015), at 74, 84, suggesting that domestic judicial procedures are the most appropriate tools for addressing investment disputes in TTIP.

[231] ECJ, *Slovakische Republik (Slovak Republic) v. Achmea BV*, C-284/16, Judgment of 6 March 2018, [34] and [58]. The ECJ thus endorsed the arguments previously advanced by the European Commission, which consistently claimed that resort to outside dispute settlement mechanisms by EU subjects revealed a 'mistrust in the courts of EU Member States' which had 'no place' in the European legal order. See *Achmea BV v The Slovak Republic (Award on Jurisdiction, Arbitrability and Suspension)* (UNCITRAL, PCA Case No 2008-13, 26 October 2010) (formerly *Eureko BV v The Slovak Republic*) [185].

[232] See ECJ, *Opinion 1/17 (on CETA)*, Opinion of Advocate General Bot of 29 January 2019, [81]; emphasis mine.

[233] Ibid, [73]; emphasis mine.

## 2.4. Conclusions

To recapitulate, what I suggest in this study is that the investment tribunals' present attitude towards domestic courts has been shaped by three factors. First, the fact that investor-State arbitration has succeeded to progressively establish itself as a fully-fledged alternative to local litigation of investment disputes, which led to a perception of functional redundancy of local courts (a development which I call the *functional* shift). Second, the fact that the standards by which the propriety of host States' dealings with foreign investors is measured are now predominantly provided by international law, as a result of which domestic courts have also become substantively redundant (a development which I call the *substantive* shift). Third, and finally, that at the end of the day, both of these developments are nothing but the consequence of the long prevailing distrust among capital-exporting/Western States towards the ability of foreign, non-Western courts to adequately adjust controversies between foreign investors and the host States of their investments (the problem of *distrust*). The following chapters shall demonstrate how these three factors continuously find their way into present day jurisprudence.