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The Role of the Domestic Law of the Host State in Determining the *ratione materiae* Jurisdiction of Investment Treaty Tribunals: The Partial Revival of the Localisation Theory

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Chapter 5: The Localisation Theory: Roots, Contents, and Its Legal Destiny

Introduction

1. I will open this Chapter by reviewing the roots, contents, and the fate of the domestic-centric theories of ‘Calvo Doctrine’ and the ‘Localisation Theory’ (**Section One**), followed by a consideration of the advent of bilateral investment treaties and the impact of such treaties on the theories put forward by developing states in the 1960s-1970s to safeguard the position of their laws and courts in resolving foreign investment disputes (**Section Two**).

Section One: Classical Domestic-Centric Theories: The Calvo Doctrine and the Localisation Theory

2. Approximately two hundred years ago, almost the whole world was reigned by a few European countries which either colonised other countries and areas or had substantial economic, political, and military dominance over them. The first wave of decolonisation took place in Latin America.¹ Unsurprisingly, the historical distrust of international arbitration, as an apparatus devised by West European countries to protect their interests, seems to have stemmed from South America.² In fact, before the vast decolonisation of the 1955-1965 period which culminated in the formation of another powerful group of developing countries, the Latin American countries were the vanguards of what more than a century later would be called the ‘localisation theory’.
3. Dissatisfied with the outcome of foreign investment arbitration and diplomatic protection cases, these countries were urged by Carlos Calvo, an Argentinian national, to localise foreign investment contracts by making them subject to the jurisdiction of the courts and the laws of the host state.³ Besides, in accordance with this theory – which was later called the ‘Calvo Doctrine’ – foreign investors were required to waive the right to call for diplomatic protection by their government at the time of the conclusion of the investment

¹ The dates of independence and the then world powers from which these Latin American countries became independent are as follows: Argentina (1816, from Spain); Bolivia (1825, from Spain); Brazil (1822, from Portugal); Chile (1810, from Spain); Colombia (1810, from Spain); Costa Rica (1821, from Spain); Cuba (1898, from Spain and 1902 from the US); Dominican Republic (1844, from Haiti); El Salvador (1821, from Spain); Guatemala (1821, from Spain); Haiti (1803, from France); Honduras (1821, from Spain); Mexico (1810, from Spain); Nicaragua (1821, from Spain); Panama (1821, from Spain and later from Colombia); Paraguay (1811, from Spain); Peru (1821, from Spain); Uruguay (1825, from Brazil); Venezuela (1811, from Spain). As can be seen, most of these countries went through decolonisation in the 1810s-1820s and became independent from Spain, with the eminent exception of Brazil which became independent from Portugal and Haiti which became independent from France.

² L Atsegbua, ‘International Arbitration of Oil Investment Disputes: The Severability Doctrine and Applicable Law Issues Revisited’ (1993) 5 *African Journal of International & Comparative Law* 634, 638.

³ On some scholars’ accounts, there was another eminent jurist from the Latin American region, namely Mr. Andres Bello from Venezuela, who was actually the first person to advance the Latin American version of ‘localisation’. See FG Dawson, ‘The Influence of Andres Bello on Latin-American Perceptions of Non-Intervention and State Responsibility’ (1987) 57 *BYIL* 253, 273; S Montt, *State Liability in Investment Treaty Arbitration: Global Constitutional and Administrative Law in the BIT Generation* (Hart Publishers 2009) 42.

contract.^{4 5} The aim of the formulation of the Calvo doctrine was to assert the Latin American countries' right to economic self-determination and territorial jurisdiction.⁶

4. Although it did not sell globally, the doctrine received a very warm welcome in Latin American countries. They sought to implement the essential ideas inherent in the Doctrine by inserting coherent provisions in their treaties, constitutions, municipal laws, and in the contracts they concluded with western investors.⁷ Indeed, the most obvious manifestation of this doctrine can be tracked down to the inclusion of certain contractual clauses in a number of foreign investment contracts concluded between the governments of Latin American countries and foreign investors pursuant to which foreign investors agreed to waive their right to seek diplomatic protection from their national government in connection with disputes arising out of the investment contract. This type of provision became famous as 'Calvo Clause'.⁸ This so-called Calvo Clause was inserted, to simply give one single example, in a contract for completion of the most important railroad line in Chile in 1861.⁹
5. Going approximately one century forwards in the history, with the vast extinguishment of colonialism across Asia and Africa in the second half of the 20th century, like the Latin American countries, the new independent states as well as other older independent – but previously ill-influenced by colonial powers – countries also began to design and implement laws, policies, and strategies to gain legal control over foreign investment contracts and disputes.¹⁰ These localisation efforts were either made individually or collectively.

⁴ J Paulsson, 'Third World Participation in International Investment Arbitration' (1987) 2(1) ICSID Rev-FILJ 19-20.

⁵ The conditions prescribed by the Calvo Doctrine have been usefully distilled by certain commentators: "... the inference drawn from the whole text, read together with the general principle that foreigners are subject to the local law and must submit their disputes to local courts, has given the Spanish-American countries a basis to assert the doctrine that in his private litigation the alien must exhaust his local remedies before invoking diplomatic interposition and that in his claims against the state he must make the local courts his final forum." See EM Borchard, *The Diplomatic Protection of Citizens Abroad or the Law of International Claims* (The Banks Law Publishing Company 1915) 793. Another commentator has also usefully extracted the main pillars of the Doctrine: "Calvo, basing his theories on the generally accepted rules of national sovereignty, equality of states, and territorial jurisdiction, set forth two cardinal principles which constitute the core ideas of his doctrine: First, that sovereign states, being free and independent, enjoy the right, on the basis of equality, to freedom from "interference of any sort" [...] by other states, whether it be by force or diplomacy, and second, that aliens are not entitled to rights and privileges not accorded to nationals, and that therefore they may seek redress for grievances only before the local authorities. These two concepts of nonintervention and absolute equality of foreigners with nationals are the essence of the Calvo Doctrine." See DR Shea, *The Calvo Clause: A Problem of Inter-American and International Law and Diplomacy* (University of Minnesota Press 1955) 19-20.

⁶ M Sornarajah, 'The Climate of International Arbitration' (1991) 8(2) J Int'l Arb 47, 71; DR Shea (n 5) 19-20.

⁷ DR Shea (n 5) 20-21.

⁸ See RP Lazo, 'The No of Tokyo Revisited: Or How Developed Countries Learned to Start Worrying and Love the Calvo Doctrine' (2015) 30(1) ICSID Rev-FILJ 176.

⁹ See RP Lazo (n 8) 176; S Montt (n 3) 46.

¹⁰ See M Sornarajah, 'Power and Justice in Foreign Investment Arbitration' (1997) 14(3) J Int'l Arb 103, 111-112. For an economic analysis of such strategies and policies in a legal context, see JW Salacuse, *The Three Laws of International Investment: National, Contractual, and International Frameworks for Foreign Capital* (OUP 2013) 59 *et seq*; T Wälde, 'A Requiem for the 'New International Economic Order': The Rise and Fall of Paradigms in International Economic Law' in G Hafner, G Loibl, A Rest, L Sucharipa-Behrmann & K Zemanek (eds) *Liber Amicorum Professor Ignaz Seidl-Hohenveldern in Honour of his 80th Birthday* (Kluwer Law International 1998) 778 *et seq*.

6. On an individual level, certain countries revised their laws and regulations to stipulate that the applicable law to investment contracts is the law of the state contracting party to such contracts. For instance, Article 23 of the Petroleum Act of Iran (1974) provided that: “[t]he validity, interpretation and implementation of the [petroleum] contracts shall be subject to the laws of Iran.” Another example that comes to mind in this regard is Article 74 of Decree No. 222 (1987) of Colombia which provided that contracts to which the state or a state entity is a party are governed by the laws of Colombia and subject to the jurisdiction of Colombian courts.¹¹
7. In addition to amendments of their laws, many of the developing countries with rich natural resources moved to explicitly mention in their investment contracts with aliens that their laws, and not any other law, govern the substance of their foreign investment contractual relationships. In particular, in a series of petroleum investment contracts concluded by certain Members of the Organization of the Petroleum Exporting Countries (“OPEC”) with foreign investors, the laws of the host state were chosen as the applicable law of the contract.¹²
8. On a collective level, the efforts of the developing countries in localising foreign investment contracts were principally manifested in a series of resolutions adopted by the UN General Assembly where the developing countries had a numerical majority. The most salient of these resolutions are the following: General Assembly Resolution No. 1803

¹¹ See HAG Naon, ‘Arbitration in Latin America: Overcoming Traditional Hostility’ (1989) 5(2) *Arb Int’l* 164, fn 39.

¹² See L Atsegbua (n 2) 655-656; VC Igboke, ‘Developing Countries and the Law Applicable to International Arbitration of Oil Investment Disputes: Has the Last Word been Said?’ (1997) 14(1) *J Int’l Arb* 99, 116-118 (referring to the Production Sharing Contract between the Nigerian National Petroleum Corporation (“NNPC”) and Ashland Oil Nigeria Limited (“AON”) dated 12 June 1973, the Service Contract dated 07 August 1978 between the National Iranian Company (“NIOC”) and Ultramar Company and, the contract between Saudi Arabia and ENI). See also AS El-Kosheri and TF Riad, ‘The Law Governing A New Generation of Petroleum Agreements: Changes in the Arbitration Process’ (1986) 2 *ICSID Rev-FILJ* 270-271 (referring to the 1971 Joint Structure Agreement concluded between the “NIOC” and Amerada Hess Corp; 1974 Service Contract concluded between the “NIOC” and Ultramar Co. Ltd., and the 1980 contract between Indonesia and P.T. Anggi Chemallay).

More broadly, in a comprehensive survey conducted by Martin Bartels, 29 investment contracts concluded by developing countries with foreign investors in the mining sector from the 1950s-1980s have been identified which expressly provide for the application of the laws of the host state to the contract: (1) the contract between Indonesia and Anggi Chemallay (1980); (2) the contract between Bukit Asam and Indonesia (1973); (3) the contract between Sulawesi and Indonesia (1977); (4) the contract between Rennell Island and Solomon Islands (1972); (5) the contract between Sierra Rutile and Sierra Leone (1972); (6) the contract between Gove and Australia (1968); (7) the contract between Petaquilla and Panama (1971); (8) the contract between Cuajone and Peru (1969); (9) the contract between Alcan Queensland and Australia (1965); (10) the contract between Wittenom and Australia (1972); (11) the contract between Selebi Phikwe and Botswana (1959); (12) the contract between Amalgamated Diamond and Ghana (1976); (13) the contract between Metalsazmeh and Iran (1970); (14) the contract between Cerro Matoso and Colombia (1970); (15) the contract between Las Brisas and Colombia (1975); (16) the contract between IAN/TOTAL and Colombia (1980); (17) the contract between Vaupes Y Guyana and Colombia (1978); (18) the contract between O’OKIEP Copper and Lesotho (1970); (19) the contract between Lesteng-La-Trai and Lesotho (1974); (20) the contract between Cerro Colorado and Panama (1980); (21) the contract between OK Tedi and Papua New Guinea (year not identified); (22) the contract between Moyamba & Bonthe and Sierra Leone (1961); (23) the contract between Brokopondo and Surinam (1958); (24) the contract between Quebrada Blanca and Chile (1977); (25) the contract between Finan and Jordan (1974); (26) the contract between JPCM and Jordan (1975); (27) the contract between Aquaba and Jordan (1978); (28) the contract between Kerio Valley and Kenya (1971); (29) the contract between Kinangoni and Kenya (1971). See M Bartels, *Contractual Adaptation and Conflict Resolution* (Kluwer Law and Taxation Publishers 1985) 106-107.

(XVII) of 14 December 1962 on “Permanent Sovereignty over Natural Resources”,¹³ the General Assembly Resolution No. 3201 (S-VI) on 01 May 1974 on “Declaration on the Establishment of a New International Economic Order”,¹⁴ and the General Assembly Resolution No. 3281 (XXIX) on 12 December 1974 on “Charter of Economic Rights and Duties of States”.¹⁵

9. Article 2(2)(C) of the “Declaration on the Establishment of a New International Economic Order” is the most notable resemblance of the efforts of developing countries to localise foreign investment contracts.¹⁶ This provision, *inter alia*, confirms the right of each sovereign state to:

... nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely 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.¹⁷

¹³ ‘Permanent Sovereignty over Natural Resources’ GA Res 1803, XVII, 14 December 1962.

¹⁴ ‘Declaration on the Establishment of a New International Economic Order’ GA Res 3201, S-VI, 01 May 1974. This Resolution entailed a number of broad economic goals for developing states: “national sovereignty over a State’s resources, sovereign equality of States, discretion of States as to the admission of foreign investment, better conditions for the economic and social development of poorer countries in international trade and investment, equal share of profits between the host states and investors, and lowering the standard of compensation for expropriated foreign companies.” See M Herdegen, *Principles of International Economic Law* (OUP 2013) 16. See also J Voss, ‘The Protection and Promotion of European Private Investment in Developing Countries-An Approach Towards A Concept For A European Policy on Foreign Investment: A German Contribution’ (1981) 18(3) Common Market Law Review 363, 371.

¹⁵ ‘Charter of Economic Rights and Duties of States’ GA Res 3281, XXIX, 12 December 1974.

¹⁶ Thomas Wälde characterises the two cited 1974 Resolutions of the General Assembly, i.e., the “Declaration on the Establishment of a New International Economic Order” and the “Charter of Economic Rights and Duties of States”, as the most ‘important’, ‘comprehensive’, ‘far-reaching’, and ‘controversial’ resolutions of the General Assembly in economic matters. T Wälde (n 10) 772.

¹⁷ To have a better picture of developing countries’ achievements in this Resolution, it is worthwhile to cite Article 2 of this Resolution in full:

1. Every State has and shall freely exercise full permanent sovereignty, including possession, use and disposal, over all its wealth, natural resources and economic activities.

2. Each State has the right:

(a). To regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities. No State shall be compelled to grant preferential treatment to foreign investment;

10. As one can see, the precious and remarkable achievement of developing countries as enshrined in this provision is a default rule pursuant to which the laws of the host state apply to the critical question of determining compensation in case of a taking which question should be decided by the courts or tribunals of the host state unless otherwise agreed.¹⁸ These two accomplishments in this very important international instrument precisely represent the two anchors of the ‘localisation theory’: foreign investment disputes should be resolved by reference to the local law of the host state, and, in principle, such disputes should be settled by the national courts and tribunal of the recipient state.
11. Another noticeable particular example that comes to mind in terms of collaborative endeavours of developing countries in the post-colonisation era is the marked opposition of the Latin American countries (supported by Iraq and Philippines) in 1964 to the resolution of finalising the draft text of the envisaged ICSID Convention. In the related meeting, Latin American countries, represented by Chile, voiced vehement opposition to the idea of resolution of foreign investment disputes by international arbitration rather than by the national courts of the host state.¹⁹
12. Additionally, as an allied sectoral move, in 1968, at the XVIth Conference of OPEC, the Members of the Organisation put forward a unified position concerning the competent forum for the resolution of foreign investment disputes in the petroleum sector by adopting Resolution XVI.90. The Member States declared that:

Except as otherwise provided in the legal system of a Member Country, all disputes arising between the Government and operators shall fall

(b). To regulate and supervise the activities of transnational corporations within its national jurisdiction and take measures to ensure that such activities comply with its laws, rules and regulations and conform with its economic and social policies. Transnational corporations shall not intervene in the internal affairs of a host State. Every State should, with full regard for its sovereign rights, cooperate with other States in the exercise of the right set forth in this subparagraph;

(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. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely 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.

Given the contents of this provision and other rules contained in this Resolution, it is unsurprising that a number of developed countries voted against this Resolution (namely, Belgium, Denmark, Germany, Luxembourg, the United Kingdom, and the United States) or abstained (e.g. Austria, Canada, France, Ireland, Italy, Japan, the Netherlands, Norway, and Spain).

¹⁸ Another collective UN-oriented attempt by developing countries at this juncture was the “Code of Conduct on Transnational Corporations”, which aimed at regulating the conduct of transnational corporations. See Draft United Nations Code of Conduct on Transnational Corporations (1984) 23(3) ILM 626-640. This Code was drafted by the United Nations Commission on Transnational Corporations, a subcommittee of the Economic and Social Council of the United Nations. Due to substantial disagreement over the contents of the Draft Code, the negotiations were suspended in 1992. See P Muchlinski, *Multinational Enterprises and the Law* (OUP 2007) 660-662.

¹⁹ International Centre for Settlement of Investment Disputes (ICSID), *History of the ICSID Convention* (Vol. 2, ICSID 1968) 606; RP Lazo (n 8) 181-182.

exclusively within the jurisdiction of the competent national courts or the specialized regional courts, as and when established.²⁰

13. As can be clearly observed, a common denominator of all these collaborative and individual efforts by developing countries is that they try to determine the local courts of the recipient state as competent forums to decide foreign investment cases and/or to designate the law of the host state as the governing law to investor-state controversies.
14. Pursuant to the above-mentioned unilateral measures and collaborative endeavours by developing countries, some scholars, particularly from the so-called Third World countries, contended that, even absent any stipulation, the internal law of the host state is the law applicable to the substance of investment contract disputes and that the court of the host state is the competent forum for adjudicating disputes arising out of such contractual relationships.²¹ Indeed, from the lens of these commentators, all these measures, resolutions, and doctrines purported to 'localise' investment contracts with foreign investors, thereby subjecting them to the control and the jurisdiction of host state law and host state judicial system.²²
15. However, these efforts received strong reactions from the countries of the North, i.e. capital-exporting countries. The mindset was that subjecting the foreign investment contract to the national law and national courts of the host state would leave the investor at the whim of its co-contractor.²³ These reactions were represented either in the guise of legal doctrines or in the form of arbitral awards rendered in favour of western investors by ignoring the laws of the host state. These western responses are frequently referred to as the 'internationalisation'²⁴ of foreign investment contracts. In Sornarajah's view, pursuant to the so-called theory of internationalisation, investment contracts concluded between foreign investors and host states are "by nature international contracts subject to some supranational system".²⁵
16. In terms of doctrinal support, according to Sornarajah, several theoretical solutions were offered by publicists of capital-exporting countries to internationalise state contracts with foreign investors. In his view, these theories are: (i) 'the assimilation of international contracts to international treaties'; (ii) insertion of 'stabilisation' clauses immunising contracts from future legislative changes; (iii) choosing 'general principles of law',

²⁰ Declaratory Statement of Petroleum Policy in Member Countries, Resolution No. xvr.90, 1968 OPEC Conference, Vienna: Austria, reprinted in OPEC Official Resolutions and Press Releases, 1960-1990, at p 63.

²¹ See, for example, AS El-Kosheri and TF Riad (n 12) 257-258; M Sornarajah, 'The Climate of International Arbitration' (n 6) 47; L Atsegbua (n 2) 634, 636-637 (referring the above-cited UN Resolutions and stating that they "have given a strong impetus to developing countries and these countries now claim that foreign investment contracts are governed by the domestic law of the nationalising State." [footnote omitted]).

²² The term 'localisation' was used, *inter alia*, by Sornarajah. See Sornarajah, *The International Law on Foreign Investment* (4th edn, CUP 2017) 116. Another commentator uses the term "relocalisation" for the same theory put forward by developing countries in the 1970s-1980s. See VC Igboke, 'Developing Countries and the Law Applicable to International Arbitration of Oil Investment Disputes: Has the Last Word been Said?' (n 12) 116-123.

²³ O Spiermann, 'Applicable Law' in P Muchlinski, F Ortino, and C Schreuer (eds), *The Oxford Handbook of International Investment Law* (OUP 2008) 94; C Leben, 'La Théorie Du Contrat d'Etat Et L'évolution Du Droit International Des Investissements' (2004) 302 *Collected Courses of the Hague Academy of International Law* 221-222.

²⁴ M Sornarajah, *The International Law on Foreign Investment* (n 22) 339 *et seq.* El-Kosheri and Riad alternatively term this concept as 'delocalization' or 'transnationalization'. See AS El-Kosheri and TF Riad (n 12) 257-258.

²⁵ M Sornarajah, 'Power and Justice in Foreign Investment Arbitration' (n 10) 103, 107.

‘transnational law’ or ‘public international law’ as the substantive law applicable to disputes arising from the investor-state contract; (iv) including arbitration clauses in investment contracts pursuant to which disputes arising from investment contracts must be settled by an arbitral tribunal rather than by the state party’s courts.²⁶

17. In Sornarajah’s opinion, these theories were bolstered by a series of international arbitral awards rendered in favour of foreign investors, which for him were ‘charades’.²⁷ Indeed, in a series of arbitral awards rendered in the period of the 1950s-1980s, several arbitral tribunals refused the application of domestic law of the host state to the so-called ‘economic development agreements’²⁸ and went on to apply international law or general principles of law to the substance of the investment contract disputes.²⁹ These arbitral tribunals disregarded the laws of the host state either because they considered the law of the host state to be insufficient and/or inchoate to resolve complicated issues of

²⁶ M Sornarajah, ‘The Climate of International Arbitration’ (n 6) 47, 50-69. See also HE Kjos, *Applicable Law in Investor-State Arbitration: The Interplay Between National and International Law* (OUP 2013) 215 *et seq.* For a review of the theoretical underpinnings of the ‘internationalisation’ theory, see FA Mann, ‘The Law Governing State Contracts’ (1944) 21 BYIL 11; P Jessup, *Transnational Law* (Yale University Press 1956); A Verdross, ‘The Status of Foreign Private Interests Stemming from Economic-Development Agreements with Arbitration Clauses’ in M Bender (ed) *Selected Readings on Protection by Law of Private Foreign Investment* (The Southwestern Legal Foundation, International and Comparative Law Center 1964); FA Mann, ‘State Contracts and State Responsibility’ (1960) 54 AJIL 572; A Verdross, ‘Quasi-International Agreements and International Commercial Transactions’ (1964) 18 Yearbook of World Affairs 230; J Paulsson, ‘Third World Participation in International Investment Arbitration’ (n 4) 46; SM Schwebel, ‘International Arbitration: Three Salient Problems’ (1987) 3(3) Arb Int’l 1-60; P Weil, ‘The State, the Foreign Investor, and International Law: The No Longer Stormy Relationship of a *Ménage à Trois*’ in S Schlemmer-Schulte and KY Tung (eds) *Liber Amicorum Ibrahim F.I. Shihata* (Kluwer Law International 2001).

²⁷ M Sornarajah, ‘The Climate of International Arbitration’ (n 6) 47, 50-69. See also L Atsegbua (n 2) 634, 647 *et seq.*; M Sornarajah, ‘Power and Justice in Foreign Investment Arbitration’ (n 10) 103, 107.

²⁸ This term has been used by several commentators. See, for instance, JN Hyde, ‘Economic Development Agreements’ (1962) 105 Collected Courses of the Hague Academy of International Law; A Verdross, ‘The Status of Foreign Private Interests Stemming from Economic-Development Agreements with Arbitration Clauses’ (n 26); SI Pogany, ‘Economic Development Agreements’ (1992) 7(1) ICSID Rev-FILJ; RB Lillich, ‘The Law Governing Disputes under Economic Development Agreements: Re-Examining the Concept of Internationalisation’ in RB Lillich & CN Brower (eds), *International Arbitration in the Twenty-First Century, Towards Judicialization and Uniformity* (Transnational Publishers 1994).

²⁹ See, for instance, *Petroleum Development Ltd. v. The Sheikh of Abu Dhabi* (1951) 18 ILR 144; *Ruler of Qatar v. International Maritime Oil Company* (1953) 20 ILR 534; *Saudi Arabia v. Arabian American Oil Company (Aramco)* (1963) 27 ILR 117 *et seq.*; *Sapphire International Petroleum Ltd. v. National Iranian Oil Company (NIOC)* (1964) 13 International & Comparative Law Quarterly 1011 *et seq.*; *BP Exploration Company (Libya) Limited v. Government of the Libyan Arab Republic*, 10 October 1973 and 01 August 1974 (1979) 53 ILR 297 *et seq.*; *Texaco Overseas Petroleum Company and California Asiatic Oil Company v. The Government of the Libyan Arab Republic*, Award on Merits, 19 January 1977 (1979) 53 ILR 389; *LIAMCO v. The Government of the Libyan Arab Republic*, Award of 12 April 1977 (1981) Yearbook of Commercial Arbitration 89 *et seq.*; *Revere Copper and Brass, Inc v. Overseas Private Investment Corporation*, Award, 24 August 1978, AAA Case No. 16/10/0137/76, 17 ILM 1321.

For commentary and description of these awards, see, VC Igbokwe, ‘Developing Countries and the Law Applicable to International Arbitration of Oil Investment Disputes: Has the Last Word been Said?’ (n 12) 111-114; M Sornarajah, ‘The Climate of International Arbitration’ (n 6) 47, 58-64; L Atsegbua (n 2) 634, 650-655; M Sornarajah, ‘Power and Justice in Foreign Investment Arbitration’ (n 10) 103, 107 *et seq.*; KM Al-Jumah, ‘Arab State Contract Disputes: Lessons from the Past’ (2002) 17(3) Arab Law Quarterly 215, 217-223; MB Ayad, ‘Harmonization of Custom, General Principles of Law, and Islamic Law in Oil Concessions’ (2012) 29(5) J Int’l Arb 477, 499-513.

international investment law³⁰ or because of the fact that the transnational nature of such contracts and the great economic interests at stake necessitated the application of international law rather than domestic law. In the latter group of awards, some of the arbitral tribunals reasoned that application of the host state law would be inappropriate in the context of those investment contractual disputes because the investor has assumed a substantial risk when investing in the host state and subjecting him/her to the laws of the host state would dissuade foreign investments to flow to developing countries.³¹

18. These influential doctrines and arbitral awards, backed by the significant element of political power, seriously curtailed the efforts of the capital-receiving countries to localise foreign investment contracts. Even the legal value and the law-creating effect of the biggest achievements of developing countries, i.e., the Resolutions of the General Assembly of the United Nations, were also seriously called into question by some of these arbitral awards.³²
19. The force behind these efforts to negate the control of the laws and the courts of the host state over the destiny of international investment contracts even imposed itself on the more long-standing and more persistent countries of Latin America. In an article published in 1989, a commentator from Latin America narrated an end to the ‘Latin American hostility’ vis-a-vis international arbitration beginning from 1975 or thereabouts.³³ According to Salacuse, the fact that in the 1990s, many of the Latin American countries acceded and/or ratified the ICSID Convention is an indicator of their approach to the internationalisation of foreign investment contracts and their departure from localisation theories including the Calvo Doctrine.³⁴
20. Apart from these sturdy legal encounters on the part of the developed countries’ scholars and practitioners, the economic element also simultaneously betrayed the governments of the developing countries leaving them almost empty-handed vis-à-vis their nations with no substantial attainment to justify the workability of their much-vaunted domestic-based legal and economic theories. Put differently, these domestic-based legal and economic theories had not brought wealth and prosperity to the developing nations. Therefore, the

³⁰ See, for instance, *Petroleum Development Ltd. v. The Sheikh of Abu Dhabi* (n 29) 144; *Ruler of Qatar v. International Maritime Oil Company* (n 29) 534; *Saudi Arabia v. Arabian American Oil Company* (n 29) 117 *et seq.*

³¹ See, for instance, *Sapphire International Petroleum Ltd. v. National Iranian Oil Company (NIOC)* (n 29) 1011 *et seq.*; *BP Exploration Company (Libya) Limited v. Government of the Libyan Arab Republic* (n 29) 297 *et seq.*; *Texaco Overseas Petroleum Company and California Asiatic Oil Company v. The Government of the Libyan Arab Republic* (n 29) 389; *LIAMCO v. The Government of the Libyan Arab Republic* (n 29) 89 *et seq.*; *Revere Copper and Brass, Inc v. Overseas Private Investment Corporation* (n 29) 1321.

³² See, for instance, *Texaco Overseas Petroleum Company, California Asiatic Oil Company v. The Government of the Libyan Arab Republic* (n 29) 389 [83].

³³ HAG Naon (n 11) 137-138, 156-157. See also VC Igbokwe, ‘Determination, Interpretation and Application of Substantive Law in Foreign Investment Treaty Arbitrations’ (2006) 23(4) *J Int’l Arb* 274.

³⁴ JW Salacuse, *The Three Laws of International Investment: National, Contractual, and International Framework for Foreign Capital* (n 10) 72. Most Latin American countries signed and ratified the ICSID Convention in the 1990s: Argentina (signature 1991, ratification 1994); Bolivia (signature 1991, ratification 1995); Chile (signature 1991, ratification 1991); Colombia (signature 1993, ratification 1997); Costa Rica (signature 1981, ratification 1993); Ecuador (signature 1986, ratification 1986); Guatemala (Signature 1995, ratification 2003); Nicaragua (signature 1994, ratification 1995); Panama (signature 1995, ratification 1996); Peru (signature 1991, ratification 1993); Uruguay (signature 1992, ratification 2000), and Venezuela (signature 1993, ratification 1995). See <<https://icsid.worldbank.org/en/Pages/about/Database-of-Member-States.aspx>> ‘accessed 31 May 2018’. However, three of these countries, namely Bolivia, Ecuador, and Venezuela denounced the ICSID Convention respectively in 2007, 2009, and 2012.

governments of these countries did not have a good reason to persist in the pursuit of such theories any further.³⁵

21. As a result of the western legal theorising and legal actions as well as the new economic realities, it was not difficult to hear the drums of the funeral ceremony of the 'localisation theory' and the new international economic order. Indeed, one commentator observed that by 1990, the new international economic order project was 'basically dead'.³⁶
22. From a legal angle, the last element that came to the scene to totally defeat the 'localisation theory' and the purported legal achievements of the UN Resolutions (including the 'New International Economic Order' and the 'Charter of Economic Rights and Duties of States') was the vast and ever-increasing conclusion of bilateral – and in certain instances multilateral – investment treaties which were intended to actually – and this time not artificially – internationalise foreign investment contracts, thus, effectively dispossessing the laws and the courts of the host state of any meaningful effect on the fate of these transnational investment arrangements. This significant development in the history of international investment law and its consequences will be studied briefly below.

Section Two: The Emergence of Bilateral Investment Treaties

23. While the theory of 'localisation' was fading away by the enormous attacks of arbitral awards, doctrinal authorities, and the new realities of the liberal economic world, a new player, full of vim and vigour, stepped into the battleground and put an end to the already doomed 'localisation theory'.

³⁵ Analysing the historical developments from an economic point of view, Salacuse describes two general development models adopted by developing countries since the 1950s. For Salacuse, the first development model, i.e. Development Model I, which was very popular in the 1950s-1960s, had four basic elements: (i) public ordering and state planning; (ii) reliance on public sector enterprises; (iii) restriction and regulation of the private sector; and (iv) restrictions on foreign investment and influence of the economy. Salacuse considers that Development Model II stood in sharp contrast to Development Model I with the following chief features: (i) reliance on markets and private ordering; (ii) privatization; (iii) deregulation; and (iv) opening economies. According to Salacuse, the 1980s was the period for shifting of developing countries from Development Model I to Development Model II with plenty of consequences for the legal and regulatory policy-making of developing countries. It is the opinion of the said commentator that the main reasons for the switch from Development Model I to Development Model II were the following: (i) "Development Model I had quite simply failed to bring about development. By the 1980s, the economies of most developing countries were stagnant, burdened with enormous debt, and saddled with inefficient public enterprises requiring constant government subsidies"; (ii) "powerful external forces were insisting upon fundamental changes in Third World economic policies, often as a condition to financial and developmental assistance"; (iii) "the end of the communism in Eastern Europe and the Soviet Union in 1989 deprived many developing countries of sources of moral and material support for Development Model I"; (iv) "the successful example of certain high-growth Asian states which had avoided many of the elements of Model I, particularly its restrictions on foreign capital and private enterprise, also promoted a search for a new approach." See JW Salacuse, *The Three Laws of International Investment: National, Contractual, and International Framework for Foreign Capital* (n 10) 59-74. In this respect, see also T Wälde (n 10) 778-796. According to Herdegen, the following three were the principal reasons for the abandonment of the 'new international economic order' project by developing countries: (a) the quest for foreign investment as a vital factor for economic and social development; (b) collapse of most communist systems; (c) an ever-increasing number of bi- and multilateral investment treaties providing comprehensive protection of foreign investments. M Herdegen (n 14) 18. See also R Dolzer and C Schreuer, *Principles of International Investment Law* (OUP 2012) 5.

³⁶ JW Salacuse, *The Three Laws of International Investment: National, Contractual, and International Framework for Foreign Capital* (n 10) 58. See also T Wälde (n 11) 771. Already in 1997, even Sornarajah, one of the most determined supporters of the 'localisation theory', had felt the fading away of the efforts of the developing countries to localise foreign investment contracts. M Sornarajah, 'Power and Justice in Foreign Investment Arbitration' (n 10) 103, 139.

24. At the time when developing countries – formerly fond of the localisation theory – were desperately seeking to obtain foreign investment to restructure, and indeed rescue, their economies, these treaties were deemed as the holy grail for the attraction of foreign capital and technology.³⁷ The conclusion of such treaties by developing countries was also considered as a signal that the developing country concerned does not follow the classical ‘Calvo’ or ‘localisation’ theories any longer, and surely not strictly. Other external forces also prompted the conclusion of such treaties, including, *inter alia*, the requirement by export credit guarantee agencies of developed states and international financial institutions that, for insurance, for coverage to be granted to investments abroad or for loans to be granted, there should be or there should better be a bilateral investment treaty in place between the home and the host country.³⁸
25. Whereas most of the developing countries welcomed the conclusion of such treaties for the reasons outlined above, it was the western capital-exporting world which invented and was the initiator and the driving force behind the conclusion of bilateral investment treaties.³⁹ In the eyes of the developed countries of West Europe and North America, these treaties were considered to safeguard foreign private investments on the basis of international law and to remove disputes arising from such investments from national courts’ jurisdiction and the perceived yoke of local laws of the host state.⁴⁰ Indeed, in view of the developed countries, the greatest deficiency of rules of customary international law in the realm of foreign investment protection was that they did not accord western investors with an

³⁷ Even the most resistant South American countries which were obsessed with the Calvo Doctrine started to conclude such agreements in the 1990s. For instance, Argentina concluded its first bilateral investment treaty on 22 May 1990 with Italy; Venezuela also concluded its first bilateral investment treaty with Italy one month later in June 1990; Peru concluded its first bilateral investment treaty with Thailand on 15 November 1991; Brazil concluded its first bilateral investment treaty with Portugal on 09 February 1994, and Colombia signed its first bilateral investment treaty with the United Kingdom on 09 March 1994.

³⁸ M Sornarajah, *The International Law on Foreign Investment* (n 22) 204-206; J Voss (n 14) 363, 372; JW Salacuse, ‘BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries’ (1990) 24(3) *The International Lawyer* 661; R Dolzer and M Stevens, *Bilateral Investment Treaties* (Martinus Nijhoff Publishers 1995) 11-13 (saying that Germany and France link the availability of insurance from national investment guarantee schemes to the existence of a bilateral investment treaty); R Dolzer and C Schreuer (n 35) 5-6. In this respect, see also LS Poulsen, ‘Political Risk Insurance and Bilateral Investment Treaties: A View from Below’ (02 August 2010) Columbia FDI Perspectives. See <<http://www.vcc.columbia.edu/content/political-risk-insurance-and-bilateral-investment-treaties-view-below>> ‘accessed 31 May 2018’.

Dolzer and Stevens also explain that one reason for the emergence of bilateral investment treaties was that FCNs were not any longer appropriate to regulate the investor-state relations in the new decolonised world. See R Dolzer and M Stevens, *Bilateral Investment Treaties* (Martinus Nijhoff Publishers 1995) 10-11. See also, JW Salacuse, *The Three Laws of International Investment: National, Contractual, and International Framework for Foreign Capital* (n 10) 340, 344.

³⁹ See R Dolzer and M Stevens (n 38) 1-3; JW Salacuse, ‘BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries’ (n 38) 657-658; JW Salacuse, *The Three Laws of International Investment: National, Contractual, and International Framework for Foreign Capital* (n 10) 342 (all explaining the practice of the West European countries and the United States in concluding bilateral investment treaties in the post-World War II period). Sornarajah considers that the move for investment treaties was set off by developed countries in response to the calls for a ‘New International Economic Order’ made by developing states. Sornarajah, *The International Law on Foreign Investment* (n 22) 206.

⁴⁰ See J Voss (n 14) 363, 369; K Kunzer, ‘Developing a Model Bilateral Investment Treaty’ (1983) 15 *Law & Policy of International Business* 273, 292-293; JW Salacuse, ‘BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries’ (n 38) 659-661.

effective and binding mechanism for settlement of investment disputes. Thus, they tried to remedy and address this perceived defect by concluding bilateral investment treaties which after a while provided prospective state consent for a mechanism of the settlement of investment disputes between states and investors through international arbitration,⁴¹ thus giving investors a direct right to bring claims against host states without needing an awkward diplomatic protection piggyback from their home government and, additionally, stripping local courts of the host state – which always tended to apply their own laws to investment disputes – of their jurisdiction to decide investment disputes,⁴² thereby entangling developing countries in a self-induced ‘internationalisation’ situation.⁴³ In fact, this investor-state arbitration mechanism granted investors a privilege of direct recourse to

⁴¹ In fact, in the early years of the conclusion of bilateral investment treaties, such agreements did not contain investor-state dispute settlement procedures. See R Dolzer and C Schreuer (n 35) 6-7 (referring to Article 11 of the 1959 BIT between Germany and Pakistan, and stating that at the time investment agreements did not contain investor-state dispute settlement clauses.) In fact, the very next bilateral investment agreement concluded by Germany with Malaysia did not also contain an investor-state dispute settlement mechanism. See Agreement between the Federal Republic of Germany and the Federation of Malaya Concerning the Promotion and Reciprocal Protection of Investments, signed on 22 December 1960, entered into force on 06 July 1963. Dolzer and Schreuer explain that it was with the treaty between Chad and Italy of 1969 that BITs began offering arbitration between host states and foreign investors. *ibid* 7.

⁴² JW Salacuse, ‘BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries’ (n 38) 672-673; R Dolzer and C Schreuer (n 35) 235.

⁴³ Of course, this is not to suggest that such agreements did not provide for the jurisdiction of the national courts of the host state. To be sure, many of these agreements did contemplate the jurisdiction of the national courts of the host state as an option. For instance, Article 9(2) of the bilateral investment treaty between Egypt and Finland has given an investor as many as four (4) choices to select from for the settlement of its disputes with the host state, including opting for the courts of the host state. See Agreement between The Government of The Republic of Finland and The Government of The Arab Republic of Egypt on The Promotion and Protection of Investments, signed on 03 March 2004, entered into force on 05 February 2005. Investor’s freedom to choose, however, signifies a natural preference for arbitration. As Dolzer and Schreuer explain:

From the investor’s perspective, this is not an attractive solution. Rightly or wrongly, the investor will fear a lack of impartiality from the courts of the state against which it wishes to pursue its claim. In many countries, an independent judiciary cannot be taken for granted and executive interventions in court proceedings or a sense of judicial loyalty to the forum state are likely to influence the outcome. This is particularly so where large amounts of money are involved. Not infrequently, legislation is the cause of complaints by investors. Domestic courts will often be bound to apply the local law even if it is at odds with international legal rules protecting the rights of investors. In fact, in some countries the relevant treaties may not even be part of the domestic legal order. At times, domestic courts may be the perpetrators of the alleged violation of investor rights [...] Even where courts decide in the investor’s favour, the executive may ignore their decisions.[...] In all these situations domestic courts cannot offer an effective remedy to foreign investors. [footnotes omitted]

See R Dolzer and C Schreuer (n 35) 235. See also C Schreuer, ‘Calvo’s Grandchildren: The Return of Local Remedies in Investment Arbitration’ (2005) 4(1) *The Law & Practice of International Courts and Tribunals* 1; C Schreuer, ‘Interaction of International Tribunals and Domestic Courts in Investment Law’ in Arthur W. Rovine (ed), *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers* (Martinus Nijhoff Publishers 2010) 71. Regarding some of the same points, namely, the alleged corruption of the courts of the host state and their alleged dependability, see CN Brower & S Blanchard, ‘What’s in a Meme? The Truth about Investor-State Arbitration: Why It Need Not, and Must Not, Be Repossessed by States’ (2014) 52 *Columbia Journal of Transnational Law* 757.

arbitration without first having a contractually-agreed arbitration clause in place.⁴⁴ This granting of a procedural right to private persons to have direct recourse to international arbitration with respect to a wide range of investment protection issues was seen as a “dramatic extension of arbitral jurisdiction in the international realm”.⁴⁵ In view of the late Thomas Wälde, from the lens of the investor, the advantage of accessing international arbitration which was supposed to unchain the investor from the yoke of the host state courts even trumps the application of international law to the investment dispute:

It is the ability to access a tribunal outside the sway of the host State which is the principal advantage of a modern investment treaty. This advantage is much more significant than the applicability to the dispute of substantive international law rules. The remedy trumps in terms of practical effectiveness the definition of the right.⁴⁶

26. Besides, to the best satisfaction of foreign investors, as will be discussed below, under the new regime of protection by bilateral investment treaties, the investors did not need to exhaust local remedies anymore in order to obtain international protection for their investments as the condition was removed under the new system of international investment protection.⁴⁷
27. Bearing all these considerations in mind, even a commentator like Sornarajah, who is known to be always supportive of the localisation-related theories, concedes that when subject to bilateral investment treaties, international investment arrangements will slip out of the hands of domestic laws and will fall in the domain of international law:

The proposition that a State contract falls within the domestic sovereignty of a host State may not hold valid where the investment made in pursuance of it is protected by a bilateral investment treaty or an international convention like the Convention on the Settlement of International Disputes [sic].⁴⁸

28. Thus, as a result of this significant development, it was presumed that the more these treaties were concluded, the more the role of the laws and the courts of the host state was diminished. Whereas by 1989, approximately only 300 bilateral investment treaties had

⁴⁴ See J Paulsson, ‘Arbitration without Privity’ (1995) 10(2) ICSID Rev-FILJ 232; JW Salacuse, *The Three Laws of International Investment: National, Contractual, and International Framework for Foreign Capital* (n 10) 343.

⁴⁵ J Paulsson (n 44) 232-233.

⁴⁶ TW Wälde, ‘The “Umbrella” Clause in Investment Arbitration: A Comment on Original Intentions and Recent Cases’ (2005) 6(2) Journal of World Investment & Trade 183, 190. See also PB Stephan, ‘International Investment Law and Municipal Law: Substitutes or Complements?’ (2014) 9(4) CMLJ 355 (saying that: “What investors do not trust is not so much the governing law, but rather the institutions that will apply the law. Investors demand a more reliable dispute resolution process than the host state normally can provide.”)

⁴⁷ In this Regard, see Chapter 7, Section One.

⁴⁸ M Sornarajah, ‘The Climate of International Arbitration’ (n 6) 47, 66, 81-86; VC Igbokwe, ‘Determination, Interpretation and Application of Substantive Law in Foreign Investment Treaty Arbitrations’ (n 33) 275.

been concluded,⁴⁹ by September 1994 they more than doubled reaching the approximate number of 700,⁵⁰ at the end of 2008 the number of bilateral investment treaties amounted to 2608,⁵¹ and reached the figure of 2,957 by the end of 2016.⁵² This dense network of bilateral investment treaties connecting all the four corners of the world formed a very strong front of ‘internationalisation’, practically wiping out any possible remaining actual materialisation of the ‘localisation’ theory.

Conclusion

29. In short, the ‘treatification’⁵³ of international investment law tended to elevate the mere domestic public and private law relationship between states and foreign investors to an international level where international law was expected to overtake the domestic law of the host state and was supposed to have the last say on all matters. Furthermore, under the recently designed scheme of bilateral investment treaties, international law was believed to be uttered principally by international arbitral tribunals not the courts of the recipient state.
30. Judge Brower, an arbitrator most frequently appointed by investors in the history of investment treaty arbitrations,⁵⁴ describes these developments as follows:

Fortunately, the ‘Southern’ tsunami of NIEO and the Charter eventually abated. The subsequent conclusion of thousands of bilateral investment treaties, and, more recently, several multilateral investment treaties, in which States record their true, practical interests, have replaced the ‘soapbox’ Resolutions of the General Assembly. The landmark arbitral award of Professor Rene-Jean Dupuy in the case of *Texaco Overseas Petroleum Company and California Asiatic Petroleum Company v Libya* issued 19 January 1977 soon established definitively that neither the NIEO nor the succeeding Charter constituted international law, in part precisely because of the aforementioned votes against the Charter and abstentions by industrialized States [...] In due course the late Professor Thomas Waelde declared ‘A Requiem for the “New International Economic Order”’: The Rise and Fall of Paradigms in International Economic Law’... Thus was ‘the South’ defeated and both international law and peaceful

⁴⁹ JW Salacuse, ‘BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries’ (n 38) 655.

⁵⁰ R Dolzer and M Stevens (n 38) 1.

⁵¹ UNCTAD, *World Investment Report 2008: Transnational Corporations and the Infrastructure Challenge*, U.N. Doc. UNCTADIWIR/2008 (United Nations 2008) 14.

⁵² UNCTAD, *World Investment Report 2017: Investment and the Digital Economy*, U.N. Doc. UNCTAD/WIR/2017 (United Nations 2017) 111.

⁵³ The term ‘treatification’ in this context has been devised by Salacuse. JW Salacuse, ‘The Treatification of International Investment’ (2007) *Law and Business Review of the Americas* 155. See also JW Salacuse, *The Three Laws of International Investment: National, Contractual, and International Framework for Foreign Capital* (n 10) 331-332.

⁵⁴ See <<http://investmentpolicyhub.unctad.org/ISDS/FilterByArbitrators>> ‘accessed 31 May 2018’.

investor–State dispute settlement through international arbitration restored, indeed enhanced.⁵⁵ [Footnotes omitted]

31. With what is said so far, it might strike any reasonable bystander that the ‘localisation’ theory was totally wiped out and its story finishes here. However, as was already foreshadowed in Chapters 1-4, considering the current status of investment treaty law, domestic law of the host state plays a prominent role in determining the threshold question of jurisdiction *ratione materiae* of an investment treaty tribunal. In addition, as will be seen more fully in Chapters 6 and 7, the developments in investment treaty law manifest a broader role for domestic laws and national courts of the host state in investment treaty arbitrations. When one considers the discussions in Chapters 1-4 regarding the role of host state law in subject-matter jurisdiction and then bears in mind the recent developments in investment treaty law concerning the broader role of domestic law and national courts in investor-state arbitrations (discussed in Chapters 6 and 7), one may not be blamed for thinking that the ‘localisation’ theory has been revived to some extent. In fact, it is pursuant to the analysis conducted in Chapters 6 and 7 that I argue that the ‘localisation’ theory has resurfaced in the field of investment treaty arbitration to some extent.

⁵⁵ CN Brower & S Melikian, “‘We Have Met The Enemy And He Is US!’ Is the Industrialized North ‘Going South’ on Investor–State Arbitration?” (2015) 31(1) Arb Int’l 22. In the words of the *Antoine Goetz* tribunal, the emergence of bilateral investment treaties revived the role of international law in international investment disputes:

It may be interesting to remark on this subject that choice of law clauses in investment protection treaties frequently refer to the provisions of the treaty itself, and, more broadly, to international law principles and rules. This leads to a remarkable comeback of international law, after a decline in practice and jurisprudence, in the legal relations between host States and foreign investors.

Antoine Goetz et consorts v. République du Burundi, ICSID Case No. ARB/95/3, Award, 10 February 1999 [20].