



# Law and Business Review of the Americas

## PERSPECTIVE

PUTTING ASIDE DIFFERING CULTURES: IT IS INSTITUTIONS AND SYSTEMS

*Dr. Hernando de Soto*

## ARTICLES

WHERE THERE'S A WILL, THERE'S A WAY: THE CAUSE FOR A CURE AND REMEDIAL PRESCRIPTIONS FOR FORUM NON CONVENIENS AS APPLIED IN LATIN AMERICAN PLAINTIFFS' ACTIONS AGAINST

U.S. MULTINATIONALS

*E.E. Daschbach*

INVESTOR-STATE DISPUTES IN LATIN AMERICA

*Omar E. García-Bolívar*

ENRON AND THE SPECIAL PURPOSE ENTITIES—USE OR ABUSE?—THE REAL PROBLEM—THE REAL FOCUS

*Neal Newman*

AGRICULTURE SUBSIDIES AND THE FREE TRADE AREA OF THE AMERICAS

*Pablo A. Ormachea*

THE TREATIFICATION OF INTERNATIONAL INVESTMENT LAW

*Jeswald W. Salacuse*

ANALYZING COMFORT LETTERS: THE BRAZILIAN LEGAL PERSPECTIVE

*Fionna Tsu*

## COMMENT AND CASENOTES

THE FREE TRADE AREA OF THE AMERICAS: DEAD BEFORE IT WAS EVER BORN

*Paul Rymerson*

U.S. AND CANADIAN TRADE WAR OVER SOFTWOOD LUMBER: THE CONTINUING DISPUTE

*Jennifer Lan*

THE INTERNATIONAL INVESTOR'S GUIDE TO RETAINING A SUCCESSFUL NAFTA CHAPTER 11 AWARD ON APPEAL

*Jennifer Trousdale*

## UPDATES

*Antonio Franck, Marroy Valadão, Nara Galeb Porto, Lindsey Shine, Jonathan L. Howell*

## DOCUMENTATION

ANDEAN COMMUNITY'S LETTER OF INVITATION TO CHILE

DECISION 645



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# INVESTOR-STATE DISPUTES IN LATIN AMERICA: A JUDGMENT ON THE INTERACTION BETWEEN ARBITRATION, PROPERTY RIGHTS PROTECTION, AND ECONOMIC DEVELOPMENT

Omar E. García-Bolívar\*

## I. INTRODUCTION

LATIN America is not the largest recipient of foreign investment in the world. In 2004, out of \$648 billion of the world's flow of Foreign Direct Investment (FDI), Latin America attracted \$67 billion,<sup>1</sup> only 10.3 percent.<sup>2</sup> Yet the majority of arbitration cases filed by investors against states have had a Latin American country as a defendant. In 2006, out of 106 pending cases at the International Center for

\* Omar García-Bolívar is President of BG Consulting in Washington, D.C., specializing in law and development consultancy. He is a lawyer admitted to practice law in Venezuela, New York, Washington, D.C., and the U.S. Court of International Trade. He graduated cum laude from Universidad Católica Andrés Bello in Venezuela in 1987. He has also completed graduate studies in political science at Universidad Simón Bolívar in Venezuela in 1989, a Masters in Law from Southern Methodist University, Dallas, Texas in 1992, a Masters in Philosophy, and a Ph.D. in Law and Foreign Investment from the University of Edinburgh, United Kingdom in 1997, where he was a chevening scholar. Mr. García-Bolívar is an arbitrator before the ICSID and the World Intellectual Property Organization, a member of the American Arbitration Association International Panel, and listed in the International Chamber of Commerce Arbitrator Database. He is Chair of the Inter-American Legal Affairs Committee of the International Law Section of the Washington, D.C. Bar. He is also a professional fellow of the Law Institute of the Americas at Southern Methodist University, Dallas, Texas and member of the board of editors of *Law and Business Review of the Americas*. He is associate editor of *Transnational Dispute Management*. Mr. García-Bolívar was listed in the 2005 edition of *Marquis Who's Who in American Law*. Email: omargarcia@bg-consulting.com.

1. U.N. Conference On Trade And Development [UNCTAD], *World Investment Report 2005*, 63, fig.II.12, available at [http://www.unctad.org/en/docs/wir2005\\_en.pdf](http://www.unctad.org/en/docs/wir2005_en.pdf) (last visited July 20, 2006) [hereinafter *UNCTAD World Investment Report 2005*].
2. *Id.* The data comprises Greenfield FDI and mergers and acquisitions. It does not cover portfolio investments represented in speculative investments where the investor is not involved in management of the investment. The data only relates to investment received by countries also known as inflow and does not represent the amount of outflow investment, that is investments sourced from a country different from the recipient. In 2004 the amount of outflow investment in the world was \$730 billion. Most of that amount was sourced from developed countries. Outflow FDI from Latin America amounted to \$10 billion during that year.

Settlement of Investment Disputes (ICSID), sixty cases have been filed against Latin American countries.<sup>3</sup> Likewise, it is estimated that there are around fifty-four non-ICSID investor-state arbitration cases, of which a large portion have a Latin American country as a defendant.<sup>4</sup>

One should wonder about the causes of this disparity. At first sight Latin American countries do not seem to treat investors worse than other countries. Why then has there been a surge of investment arbitrations? One possible explanation is the Argentine economic crisis that hit local and foreign investors alike and forced the government to devalue the currency, change the conditions of concession agreements, and freeze the prices of utilities and services.<sup>5</sup> But had there not been an international instrument that provided for the possibility of investors initiating arbitration cases directly against the states, none of the cases would have been possible.

So, the questions then turn to these international law instruments: why have countries entered into these instruments? Have they obtained what they were looking for? Is the moment appropriate for a judgment of those instruments? Should Latin American countries continue the path signaled by international investment law?

This article is divided into five parts and deals with the issues aforementioned. The first part deals with the general framework of foreign investment; it refers to the concept of investment arbitration. The next part deals with the rationale of the parties in international investment law. The next section refers to the evolution of international investment arbitration in Latin America. Next, the article highlights the impact investment arbitration has had in Latin America. The last part deals with the conclusions and recommendations.

## II. INTERNATIONAL INVESTMENT ARBITRATION

International investment arbitration is an alternative dispute resolution mechanism whereby foreign investors are entitled to settle disputes directly, without the intervention of intermediaries, with the host states. It is but one of the instruments provided by international investment law to protect investments internationally.<sup>6</sup> As per this mechanism, foreign in-

3. International Center for Settlement of Investment Disputes (ICSID), Pending Cases, <http://www.worldbank.org/icsid/cases/pending.htm> (last visited July 20, 2006). See also U.N. Conference on Trade and Development [UNCTAD], *Note by the UNCTAD Secretariat: Issues Related to International Arrangements, Investor-State Disputes and Policy Implications*, U.N. Doc. TD/B/COM.2/62 (Jan. 14, 2005), available at [http://www.unctad.org/en/docs/c2d62\\_en.pdf](http://www.unctad.org/en/docs/c2d62_en.pdf).

4. *Id.*

5. U.N. Conference on Trade and Development [UNCTAD], *Occasional Note: International Investment Disputes on the Rise*, U.N. Doc. UNCTAD/WEB/ITF/II/2004/2 (Nov. 29, 2004), available at [http://www.unctad.org/sections/dite/ia/docs/webiteit20042\\_en.pdf](http://www.unctad.org/sections/dite/ia/docs/webiteit20042_en.pdf) [hereinafter *UNCTAD Occasional Note*]. Accordingly, as of July 2006, Argentina was a defendant in forty-two ICSID arbitration cases.

6. Other instruments are non-commercial risk insurance and standards of treatment under international agreements. See M. SORNARAJAH, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* (Cambridge Univ. Press 2d. ed. 2004) (1994).

vestors, either under the form of corporations or as individuals, can present claims in an international and neutral forum against countries where they have conducted business, when the conditions are satisfied.

When foreign investors operate under the form of a corporation, many issues can be involved. For example, if the foreign investor has conducted business in the host country under the form of a corporation incorporated in the home country and a dispute has arisen, the arbitration could be filed by that entity that would be considered a foreign corporation. But the situation might be different when the foreign investor undertook activities in the host country under the form of a wholly owned subsidiary registered therein. That entity might not qualify as a foreign investor, but rather as a local investor not entitled to international protection.<sup>7</sup>

From the business point of view of the foreign investor, the wholly owned subsidiary incorporated in the host country might not be considered as an independent unit but rather as part of an economic unit using the same name, personnel, technology, management, guidelines, and funding. For strategic purposes, foreign investors operating as corporations might find operating through local subsidiaries very appealing because the mechanism allows them to limit their liability to the assets of the local subsidiary. But that benefit also comes with the burden of restricting the international protection of the foreign operations the foreign investor might be entitled to, unless an exception has been expressly agreed upon.<sup>8</sup>

In any event, in the absence of international investment arbitration, disputes between foreign investors and host countries can only be settled in two ways. First, the foreign investor initiates a lawsuit against the host country in the host country's courts. But if the host country's judicial system is not independent and reliable, the foreign investor may be subject to a biased trial where chances of success are slim.<sup>9</sup> In exceptional

7. See Omar García-Bolivar, *The Issue of a Foreign Company Wholly Owned by National Shareholders in the Context of ICSID Arbitration*, 2 *TRANSNAT'L DISP. MGMT.* no.5 (Nov. 2005), available at <http://www.transnational-dispute-management.com> (last visited Jul. 20, 2006); see also Francisco Orrego Vicuña, *Changing Approaches to the Nationality of Claims in the Context of Diplomatic Protection and International Dispute Settlement*, 15 *ICSID REV.-FOREIGN INVESTMENT L.J.* 340 (2000).

8. See *Barcelona Traction, Light & Power Co. (Belg. v. Spain)*, 1970 *I.C.J.* 3, 47 (Feb. 5). After that case a trend was developed whereby countries agreed through treaties to grant international protection to wholly owned subsidiaries if they were controlled by a foreign company.

9. See Greta Gainer, *Nationalization: The Dichotomy between Western and Third World Perspectives in International Law*, 26 *HOW. L.J.* 1547 (1983). Latin America can claim authorship of the Calvo doctrine, which had been incorporated into the constitutions of many countries, whereby foreign investors were not entitled to take disputes with host states to the international arena. The doctrine is a reflection of a historic attitude against foreign investments. Accordingly, investors were subject to the same treatment that domestic investors received in the host state, not better. Therefore, they could only claim diplomatic protection from their home states in a few restricted cases, and then only after exhausting local legal remedies. See also *BLACK'S LAW DICTIONARY* 257 (4th ed. 1951).

circumstances, if accepted by the host country, the foreign investor can be entitled to local arbitration. Second, the foreign investor asks for diplomatic protection from his home country. The home country has sole discretion to decide whether to grant the diplomatic protection. If the home country does grant the diplomatic protection, it might initiate a legal action against the host country under the principles of international law, such as the doctrine of state responsibility for injury to aliens. The home country can initiate negotiations or present a claim against the host country, for instance before an international body such as the International Court of Justice, if the conditions are in place. But regardless of where the dispute is presented, in this scenario the foreign investor does not have direct control of the dispute that turns into a dispute between states where the diverse interests of one another, rather than the sole interests of the investor, might play a role.<sup>10</sup>

International investment arbitration is not something that is imposed upon countries. On the contrary, it is something that the states in free use of sovereignty agree to. A state may express consent to be subjected to international arbitration initiated by foreign investors in different ways. Some of the states do this in international instruments, such as treaties for the promotion and protection of foreign investments or Bilateral Investment Treaties (BITs), where each signatory country mutually agrees to be subject to arbitral procedures, if all conditions are met, by investors from the other country. Occasionally countries enter into Free Trade Agreements (FTAs) with investment chapters, under which consent to be subjected to international investment arbitration is granted. This has been the case of the North America Free Trade Agreement (NAFTA),<sup>11</sup> the U.S.-Dominican Republic-Central America Free Trade Agreement,<sup>12</sup> and the U.S. and Chile Free Trade Agreement,<sup>13</sup> among others. In other cases, the consent to be subject to arbitration is expressed in internal laws, such as foreign investment laws or through ad-hoc internal statements. The investors in turn also need to express consent to arbitrate, something that in many cases is undertaken by filing the claim.

An important number of international investment arbitrations are filed

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10. See, e.g., *Electronica Sicula S.p.A. (ELSI) (U.S. v. Italy)*, 1989 I.C.J. 15, 109 (July 20).

11. See North American Free Trade Agreement ch. 11, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 605, available at <http://www.worldtradelaw.net/nafta/chap-11.pdf> [hereinafter NAFTA].

12. See The Central America-Dominican Republic-United States Free Trade Agreement ch. 10, Cent. Am.-Dom. Rep.-U.S., Aug. 5, 2005, available at [http://www.ustr.gov/Trade\\_Agreements/Bilateral/CAFTA/CAFTADR\\_Final\\_Texts/Section\\_Index.html](http://www.ustr.gov/Trade_Agreements/Bilateral/CAFTA/CAFTADR_Final_Texts/Section_Index.html).

13. See The United States-Chile Free Trade Agreement ch. 10, U.S.-Chile, June 6, 2003, available at [http://www.ustr.gov/Trade\\_Agreements/Bilateral/Chile\\_FTA/Final\\_Texts/Section\\_Index.html](http://www.ustr.gov/Trade_Agreements/Bilateral/Chile_FTA/Final_Texts/Section_Index.html).

before the ICSID—a center created by an international convention.<sup>14</sup> Countries that are signatories to the ICSID Convention do not automatically become subject to international investment arbitration at that center; express consent to be subject to international investment arbitration at ICSID is needed. Countries that have not signed the ICSID Convention, but have consented to international investment arbitration, can still be subject to procedures filed by foreign investors either at the ICSID additional facility<sup>15</sup> or at any other forum.

If the country has signed and ratified the ICSID Convention and has also expressed consent to be subject to arbitration at that center, certain conditions are necessary for the arbitral tribunal to have jurisdiction over the matter in dispute. Of paramount importance, the dispute needs to be about the legal issues of an investment. This requirement leaves out the possibility of taking disputes of a technical nature or disputes of a legal nature arising out of a trade operation. Likewise, the dispute needs to be between foreign investors and countries other than their countries of nationality. This issue might be of significance to investors who operate in the host countries under the form of local subsidiaries, which, as mentioned before, will not be considered foreign investors in the absence of an agreement to the contrary.<sup>16</sup>

### III. REASONS FOR THE EMERGENCE OF INTERNATIONAL INVESTMENT ARBITRATION

International investment arbitration is primarily a mechanism of protection of foreign investors' rights. But the instruments whereby international investment arbitration has emerged have been treaties and conventions between countries, not contracts between investors and states. In other words, although foreign investors have been the main beneficiaries of international investment arbitration, they have not participated in the making of the documents from which the dispute resolution mechanism has been brought about.

Capital-exporting countries have been enthusiastic about creating an international legal framework of foreign investment. It would provide their citizens with legal certainty, protection, and direct dispute control in connection with business conducted in capital-importing countries. The rationale of capital-exporting countries on proposing international instru-

14. Convention on Settlement of Investment Disputes Between States and Nationals of other States, Oct. 14, 1966, 17 U.S.T. 1270 (also known as the Washington Convention) [hereinafter ICSID Convention].

15. ICSID additional facility is available in the context of investment disputes whenever the state party to the dispute or the state of nationality of the investor, but not both, are not party to the ICSID Convention. See Rules Governing the Additional Facility for the Administration of Proceedings by the Secretariat of the International Centre for Settlement of Investment Disputes (Additional Facility Rule) art. 2, reprinted in ICSID Convention, Regulations and Rules, Document ICSID/15 (April 2006), available at <http://www.worldbank.org/icsid/facility/partA-article.htm#a02>.

16. García-Bolívar, *supra* note 7.

ments of protection of foreign investments historically has been to open markets for their business groups while guaranteeing minimum standards of treatment.<sup>17</sup> Over time capital-exporting countries have also been capital-importing countries and have also been subject to the standards of the emerging international law of foreign investment.<sup>18</sup>

As a consequence of the framework accepted by countries through BITs and FTAs, foreign investors have obtained international law protection for their property rights, minimum standards of treatment, and access to international investment arbitration at a neutral and transparent forum.<sup>19</sup>

Capital-importing countries were convinced that upon accepting the terms of international instruments for protection and promotion of foreign investments, they would be in a better position to foster their economic development. Accordingly, if a country had a sound investment climate, investors would be attracted to do business in that country. If that investment climate provided stability, the stakes of that attractiveness would be higher. Plus there was no better way to guarantee the stability of the legal framework, an instrumental part of the investment climate, than internationalizing the legal framework of foreign investment. On doing that, the legal framework would be much more difficult to change and investors would be provided with investment protection. It was understood that investments would be more inclined to flow into a country where foreign businesses were governed by an international legal framework of foreign investments as opposed to a country where they would only be subject to its internal laws.

Thus, many developing countries assumed that the path to economic development was marked by foreign investments, which, it was argued, would create jobs, transfer technology, boost production, and foster savings—things that were all considered essential to reduce poverty and consequently promote wealth and economic growth.

The argument also followed that local investors would also be indirect beneficiaries of the international investment law. By enhancing the standards of treatment for foreign investors according to international criteria, the standards of treatment for local investors tended to be bettered, if not at least harmonized, with the ones provided to foreigners.

In sum, by promoting international investment law, investors aspired to have international protection for their investments while capital-importing countries looked to enhance their appeal to investments deemed useful in fostering economic development.

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17. Examples are due process of law, protection against confiscation, and guarantees of fair treatment and capital repatriation.

18. See e.g., *Loewen Group, Inc. v. United States*, ICSID Case No. ARB(AF)/98/3, 24 I.L.M. 811 (2003), available at <http://www.state.gov/documents/organization/22094.pdf>.

19. In general ICSID is considered a transparent and neutral forum to settle investment disputes. See *ICSID Stakeholder Survey* (Oct. 2004), available at <http://www.worldbank.org/icsid/highlights/icsid-client-survey-100904.pdf>.

#### IV. EVOLUTION IN LATIN AMERICA

The practical edge of international investment law is materialized through international investment arbitration. The former provides the legal framework of protection whereas the latter constitutes the mechanism to make that protection real and eventually receive compensation for a country that has failed to abide by the terms set up by international law on behalf of foreign investors.

In Latin America, international investment arbitration has been tested on many occasions. Arbitral tribunals have been established at the request of investors in varying circumstances, such as the passing of emergency economic laws that affect businesses and imposition of regulations to property rights or denial of justice, among others.<sup>20</sup>

##### A. ECONOMIC MEASURES

In *CMS Gas Transmission Co. v. Argentina*,<sup>21</sup> the American company CMS, who had invested in the Argentine company Transportadora de Gas del Norte (TGN) and owned 29.42 percent of TGN's stock, was affected by an alleged suspension by Argentina of a tariff-adjustment formula for gas transportation that allegedly arose out of general economic policies.

The tribunal stated that although it did not have jurisdiction over general economic policies taken by Argentina, it did have jurisdiction over measures of general economic policies that affect the investment, provided they have been adopted in violation of international law or in violation of commitments made to the investor. "This means in fact that the issue of what falls within or outside the Tribunal's jurisdiction will be subsumed in the determination of whether a given claim is or is not directly connected with specific measures affecting the investment."<sup>22</sup>

##### B. REGULATIONS TO PROPERTY

Other cases have dealt with regulatory powers of the government and the balance to be guarded vis-à-vis the property rights of foreign investors under international law. In this category arbitral decisions have dealt with value-added taxes as regulations that have affected the property rights of foreign investors in a way that contradicted the established international law. Likewise, arbitral tribunals have issued awards in the context of governmental measures that changed the zoning of a land from agriculture to commercial. Environmental measures that have been considered a substantial interference with the property rights of the foreign investors have also been the subject matter of investment disputes against Latin American countries. The same can be said of regulatory measures

20. UNCTAD Occasional Note, *supra* note 5.

21. *CMS Gas Transmission Co. v. Argentina*, ICSID Case No. ARB/01/8, 42 I.L.M. 788 (2003), available at <http://www.asil.org/ilib/cms-argentina.pdf>.

22. *Id.* ¶ 34.



related to the treatment provided to foreign investors by media regulators.<sup>23</sup>

In all of these cases the arbitral tribunals have dealt with a myriad of issues that somehow have set up the criteria for future references.<sup>24</sup> One of these is expropriation, dealt with by many arbitral tribunals, confirming a well-established principle of international law according that whenever a foreign investors' property is taken, there should be compensation according to the Hull formula.<sup>25</sup>

But in some cases, when the expropriation has not been explicit, the tribunals have had to consider different factors to determine if an expropriation has occurred in order to subsequently award compensation. For example, in *Metalclad Corp. v. Mexico*, the tribunal held that article 1110 of NAFTA also includes "covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of the property even if not necessarily to the obvious benefit of the host State."<sup>26</sup>

Similarly, during *Santa Elena v. Costa Rica*, the ICSID arbitration tribunal dealt with the issue of the date of the property taking to determine the compensation payable. The tribunal noted that a measure taken for the purpose of environmental protection that gradually deprived owners of the value of their property was no different from a taking for which full compensation must be paid.<sup>27</sup>

Other awards have pointed to an analysis that balances the investor's property rights and the public good. In *S.D. Myers, Inc. v. Canada*, the tribunal held that regulatory takings of property might include denying the right to export with intent to transfer ownership.<sup>28</sup> But the facts did not support that happening to the claimant of that case.<sup>29</sup>

In *Feldman v. Mexico*, the tribunal held that some business problems of a foreign investor are not expropriations under NAFTA, and such was the situation in *Feldman*.<sup>30</sup> Similarly, in *Azinian v. Mexico*, the tribunal stated that not all governmental interference with a foreign investment

23. UNCTAD Occasional Note, *supra* note 5.

24. Precedents are not binding in ICSID. See ICSID Convention, *supra* note 14, at ch.4, art. 53(1). See also *SGS Société Générale de Surveillance S.A. v. Philippines*, ICSID Case No. ARB/02/6, available at <http://worldbank.org/icsid/cases/SGSvPhil-final.pdf>.

25. Accordingly compensation should be adequate, prompt, and effective. This is the Hull Formula, named after the U.S. Secretary of State Cordial Hull, who exchanged request on this sense with the Mexican government during the Mexican expropriations that followed the Revolution. See Francesco Francioni, *Compensation for Nationalisation of Foreign Property: The Borderland between Law and Equity*, 24 *Int'l. & Comp. L.Q.* 225 (1975).

26. *Metalclad Corp. v. Mexico*, ICSID Case No. ARB(AF)97/1, 40 *LL.M.* 36, 16 *IC-SID REV.-FOREIGN INVESTMENT L.J.* 168, 195 ¶ 103 (2001).

27. *Santa Elena v. Costa Rica*, ICSID Case No. ARB/96/1, 15 *IC-SID REV.-FOREIGN INVESTMENT L.J.* 169 (2000).

28. *S.D. Myers, Inc. v. Canada*, 40 *LL.M.* 625 ¶ 288 (2000).

29. *Id.*

30. *Feldman v. Mexico*, ICSID Case No. ARB(AF)88/1, 42 *LL.M.* 625 ¶ 112 (2002).

constitutes an expropriation.<sup>31</sup> The tribunal also found no expropriation in *Pope & Talbot, Inc. v. Canada*.<sup>32</sup> But it stated that to determine “whether a particular interference with business activities amounts to an expropriation, the test is whether that interference is sufficiently restrictive to support a conclusion that the property has been ‘taken’ from the owner.”<sup>33</sup>

In *Tecmed v. Mexico*,<sup>34</sup> the ICSID tribunal stressed the difference between direct, creeping, and de facto expropriation. The tribunal mentioned that, although creeping and de facto were kinds of indirect expropriation, the latter referred to conduct or actions that do not state an intent to deprive rights or assets but in fact have that effect,<sup>35</sup> either by “transfer[ring] assets to third parties different from the expropriating State or . . . without allocating such assets to third parties or to the Government.”<sup>36</sup> The tribunal supported its award with case law and found that there was de facto expropriation when the deprivation was irreversible and the action or decision destroyed the ability to use, enjoy, or dispose of the assets or rights.<sup>37</sup> This is the case even where legal ownership over the assets in question is not affected.<sup>38</sup> It then concluded that regulatory actions and measures would not be excluded from the definition of expropriation if they are excessive in proportion to the public interest being protected.<sup>39</sup> Accordingly, “[t]here must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure.”<sup>40</sup>

In sum, the principles set by those decisions can be useful in determining the extent that the regulatory authority of the states can be exercised without giving grounds to compensation. The authority of the states to regulate their economies remains intact, but if the regulation interferes with the right of property in a way that leaves it useless for the owner, then a regulatory taking has occurred and compensation should be paid. Such judgments should be made on a case-by-case basis. Thus, if the substance of the right is affected so that the owner of an asset no longer has the right to dispose, use, control, or profit from it, deprivation of property may have occurred through creeping expropriation, de facto expropriation, or constructive taking and the state must pay compensation.<sup>41</sup>

31. *Azinian v. Mexico*, ICSID Case No. ARB(AF)/97/2, 39 I.L.M. 537 ¶ 83 (1999).

32. *Pope & Talbot, Inc. v. Canada*, 122 Ivt'l. L. Rev. 336 (2000).

33. *Id.* ¶ 102.

34. *Tecnicas Medioambientales Tecmed S.A. v. Mexico*, ICSID Case No. ARB(AF)/00/2, 43 I.L.M. 133 (2004).

35. *Id.* ¶ 114.

36. *Id.* ¶ 113.

37. *Id.* ¶ 116.

38. *Id.*

39. *Id.* ¶ 122.

40. *Id.*

41. Rosalyn Higgins, *The Taking of Property by the State: Recent Developments in International Law*, 176 RECUEIL DES COURS 259, 330-31 (1982).

## C. SUDDEN CHANGES OF LAW

Sudden and unpredictable changes in the law have been considered violations of the duty to act fairly and equitably. In *MTD Equity Sdn. Bhd v. Chile*,<sup>42</sup> a Malaysian company made an investment in Chile to build a planned community in metropolitan Santiago. The company obtained a permit to invest under the form of a contract with Chile's Foreign Investment Commission. Subsequently, the investor learned that the land where the community was to be built could only be used for agricultural purposes and could not be changed without violating Chile's urban development and environmental policies. The investor initiated ICSID arbitration and alleged indirect expropriation and unfair and inequitable treatment in violation of the Malaysia-Chile BIT. The investor alleged the government violated its obligation to provide fair and equitable treatment by approving its investment in spite of knowing that the investment was not possible to be fulfilled.

Based on the Malaysia-Chile BIT Most Favored Nation (MFN) clause, the fair and equitable treatment provisions of the Denmark-Chile and the Croatia-Chile BITs were deemed applicable to the investor. The tribunal held that states have no limits in their authority under national laws or policies except to the extent that exercising that authority would contravene obligations undertaken in a BIT. It further indicated, "in terms of the BIT, fair and equitable treatment should be understood to be treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment."<sup>43</sup>

But the tribunal stressed that "BITs are not an insurance against business risk"<sup>44</sup> and pointed out that under international law a state cannot be compelled to change a policy or pass a law. The investor was not entitled to the amendment of a policy on land use. The investor was not denied a permit but a change in a regulation. Thus, lack of change of the public policy was not considered an expropriation but an unfair treatment, for the investor was admitted to invest in the country under circumstances known by the state, all of which made the investment unfeasible. The tribunal reached a decision whereby only a portion of the compensation claimed by the Malaysian firm was awarded because "[t]he Claimants failed to protect themselves from business risks inherent to their investment in Chile."<sup>45</sup>

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42. *MTD Equity Sdn. Bhd v. Chile*, ICSID Case No. ARB/01/7 (2004), available at <http://www.investmentclaims.com/decisions/MTD-Chile-Award-25May2004.pdf> (last visited July 20, 2006).

43. *Id.* ¶ 113.

44. *Id.* ¶ 178.

45. *Id.* ¶ 253(2).

## D. DENIAL OF JUSTICE

International investment arbitral tribunals involving Latin American countries have been friendly to considering denial of justice as a violation of the standard of treatment.

In *Waste Management Inc. v. Mexico*,<sup>46</sup> an American company brought a second claim against Mexico<sup>47</sup> under chapter eleven of NAFTA. It was submitted to ICSID's additional facility.<sup>48</sup> The dispute arose out of a concession contract between Waste Management's Mexican subsidiary, Acaverde, and the City of Acapulco, where the investor was granted the exclusive right to dispose of the municipal waste generated in a certain district of Acapulco and to provide street cleaning services. The city was to enforce the ordinances that prohibited others from providing competing services in that district. The parties clashed over certain terms during the implementation of the contract and a dispute arose. The investor filed an arbitration claim alleging violation of the treatment and expropriation provisions of NAFTA chapter eleven because it was subject to arbitrary acts by the state that "were capricious, lacking in due process of law and which rendered the investment valueless."<sup>49</sup>

The investor alleged that the Mexican State had violated article 1105 of NAFTA by committing a denial of justice because the city of Acapulco adopted a litigation strategy that slowed the process of recovery under local laws. The tribunal pointed out "that a *litigant* cannot commit a denial of justice unless its improper strategies are endorsed and acted on by the court, or unless the law gives it some extraordinary privilege which leads to a lack of due process."<sup>50</sup> It also stressed that "the basic obligation of the State under Article 1105(1) is to act in good faith and form, and not deliberately to set out to destroy or frustrate the investment by improper means."<sup>51</sup>

But in the same case, the tribunal stressed that non-performance of a contract is not expropriation.

[A]n enterprise is not expropriated just because its debts are not paid or other contractual obligations towards it are breached. . . . It is not the function of Article 1110 to compensate for failed business ventures, absent arbitrary intervention by the State amounting to a virtual taking or sterilising of the enterprise.<sup>52</sup>

46. *Waste Mgmt., Inc. v. Mexico*, ICSID Case No. ARB(AF)/00/03, 41 LL.M. 1315 (2004), available at [http://www.economiasnci.gob.mx/sphp\\_pages/importa/sol\\_control/consultoria/Casos\\_Mexico/Waste\\_2\\_management/laudo/laudo\\_ingles.pdf](http://www.economiasnci.gob.mx/sphp_pages/importa/sol_control/consultoria/Casos_Mexico/Waste_2_management/laudo/laudo_ingles.pdf) (last visited Jul 20, 2006).

47. The first ICSID tribunal dismissed Waste Management's claim because it had failed to waive those domestic proceedings in Mexico.

48. Mexico is not a signatory of the ICSID Convention.

49. *Waste Mgmt.*, ICSID Case No. ARB(AF)/00/03 ¶ 87.

50. *Id.* ¶ 131.

51. *Id.* ¶ 138.

52. *Id.* ¶ 160.

It then pointed out that "non-performance of a contractual obligation is not to be equated with a taking of property, nor (unless accompanied by other elements) is it tantamount to expropriation."<sup>53</sup>

The tribunal concluded that "it is one thing to expropriate a right under a contract and another to fail to comply with the contract."<sup>54</sup> It then added that "it is not the function of the international law of expropriation as reflected in Article 1110 to eliminate the normal commercial risks of a foreign investor[.] . . . A failing enterprise is not expropriated just because debts are not paid or other contractual obligations are not fulfilled."<sup>55</sup> The tribunal dismissed the claim and found no breach of article 1105 or 1110 of NAFTA.

In *Loewen Group, Inc. v. United States*,<sup>56</sup> the tribunal also dealt with the issue of denial of justice in connection with an alleged violation of article 1121 of NAFTA. It stated that

[a]lthough the precise purpose of NAFTA Article 1121 is not altogether clear, it requires a waiver of domestic proceedings as a condition of making a claim to a NAFTA tribunal. . . . One thing is, however, reasonably clear about Article 1121 and that is that it says nothing expressly about the requirement that, in the context of a judicial violation of international law, the judicial process be continued to the highest level. Nor is there any basis for implying any dispensation of that requirement. It would be strange indeed if sub silentio the international rule were to be swept away. And it would be very strange if a State were to be confronted with liability for a breach of international law committed by its magistrate or low-ranking judicial officer when domestic avenues of appeal are not pursued, let alone exhausted. If Article 1121 were to have that effect, it would encourage resort to NAFTA tribunals rather than resort to the appellate courts and review processes of the host State, an outcome which would seem surprising, having regard to the sophisticated legal systems of the NAFTA Parties.<sup>57</sup>

The tribunal concluded that Loewen failed to pursue available domestic remedies, and as a consequence, there was no violation of customary international law, nor a violation of NAFTA that the United States could be held liable.

#### E. UMBRELLA CLAUSE

Many BITs and investment chapters of FTAs establish that breach of contracts or other obligations by the state will be considered violation of the agreements. That is commonly known as the umbrella clause. Some arbitral tribunals involving developing countries have dealt with the issue

53. *Id.* ¶ 174.

54. *Id.* ¶ 175.

55. *Id.* ¶ 177.

56. *Loewen Group*, ICSID Case No. ARB(AF)/98/3.

57. *Id.* ¶¶ 161-62.

differently. The outcomes of those cases have had an impact on the interpretation of similar facts involving Latin American countries.

In *SGS Société Générale de Surveillance S.A. v. Pakistan*,<sup>58</sup> a Swiss company, SGS, had entered into a contract with Pakistan to provide pre-shipment inspection services for goods to be exported from certain countries to Pakistan. Subsequently Pakistan notified SGS that the contract was terminated. Both Pakistan and SGS initiated separate legal actions in Switzerland and Pakistan for breach of contract. SGS also filed a request for ICSID arbitration alleging that Pakistan had breached the contract and had also violated the BIT between Switzerland and Pakistan.

Pakistan objected to the tribunal's jurisdiction, *inter alia*, because the dispute had arisen out of actions and omissions with respect to a contractual arrangement (between Pakistan and SGS) that had a choice of forum provision different from ICSID.

SGS argued that by virtue of an arguable umbrella clause (article 11) in the relevant BIT,<sup>59</sup> a breach of contract was elevated to a violation of a BIT. Thus, when the contract was breached, SGS had two actions against Pakistan—one for breach of contract and one for violation of the BIT.

The tribunal appeared to be the first ICSID tribunal facing the issue of whether a BIT provision could transform a purely contractual claim into a BIT claim. It held "that under general international law, a violation of a contract entered into by a State with an investor of another State, is not, by itself, a violation of international law."<sup>60</sup> But it "is not saying that States may not agree with each other in a BIT that henceforth, all breaches of each State's contracts with investors of the other State are forthwith converted into and be treated as breaches of the BIT."<sup>61</sup>

But the tribunal found that was not the intention of the parties to the BIT; it rejected SGS's argument about article 11. The tribunal pointed out that article 11 contained an obligation to constantly guarantee the observance of the commitments the state has entered into with respect to the investments of the other contracting party. Those commitments could imply implementing rules to give effect to contractual or statutory undertakings or could preclude a state from taking actions short of denial of justice.

The tribunal concluded that it did not have jurisdiction over the contractual claim or over the contractual claim transformed into a BIT claim

58. *SGS Société Générale de Surveillance S.A. v. Pakistan*, 18 *Iscr't. Ann. Rev.* 9 (2003).

59. Article 11 of the Switzerland-Pakistan BIT provided: "Either Contracting Party shall constantly guarantee the observance of the commitments it has entered into with respect to the investments of the investors of the other Contracting Party." *Accord Entre la Confédération Suisse et la République des Philippines Concernant la Promotion et la Protection Réciproque des Investissements* art. 11, *Switz.-Phil.*, Mar. 31, 1997, 0.975.264.5 (Fr.) (translated by author).

60. *SGS v. Pakistan*, 18 *Iscr't. Ann. Rev.* ¶ 167.

61. *Id.* ¶ 173.

by virtue of an umbrella clause. But it retained jurisdiction over the other parts of the BIT claim.

But other tribunals had a different view of the umbrella clause. In *SGS Société Générale de Surveillance S.A. v. Philippines*,<sup>62</sup> the Philippines awarded SGS, a Swiss business group, a contract to provide comprehensive import supervision for goods prior to shipment to the Philippines and specialized services to assist in improving the customs clearance and control processes. Part of the service was undertaken overseas.

A dispute arose between SGS and the Philippines concerning alleged breaches of the services contract. SGS submitted certain monetary claims to the Philippines for amicable settlement before submitting the dispute to arbitration. SGS invoked the provisions of the 1997 BIT, an agreement between the Swiss Confederation and the Republic of the Philippines on the promotion and protection of investments.

The tribunal was faced with a question similar to the one made in *SGS v. Pakistan*. Specifically, the tribunal had to determine whether a breach of contract was considered a violation of a BIT as per an umbrella clause. To do that it had to analyze article X(2) of the Switzerland-Philippines BIT, which read: "Each Contracting Party shall observe any obligation it has assumed with regard to specific investments in its territory by investors of the other Contracting Party."<sup>63</sup>

The question in place this time was whether that provision gave the tribunal jurisdiction over claims against the respondent state that were essentially contractual. The tribunal held that, "if commitments made by the State towards specific investments do involve binding obligations or commitments under the applicable law, it seems entirely consistent with the object and purpose of the BIT to hold that they are incorporated and brought within the framework of the BIT by Article X(2)."<sup>64</sup>

The tribunal concluded,

Article X(2) makes it a breach of the BIT for the host State to fail to observe binding commitments, including contractual commitments, which it has assumed with regard to specific investments. But it does not convert the issue of the *extent* or *content* of such obligations into an issue of international law.<sup>65</sup>

Recently, in *El Paso Energy International Company v. Argentina*,<sup>66</sup> the tribunal looked at the aforementioned cases. It stressed that the BITs should be interpreted in a balanced way, considering "both State sovereignty and the State's responsibility to create an adapted and evolution-

62. *SGS v. Philippines* ICSID Case No. ARB/02/6.

63. Accord Entre la Confédération Suisse et la République des Philippines Concernant la Promotion et la Protection Réciproque des Investissements, *supra* note 59 (translated by author).

64. *SGS v. Philippines*, ICSID Case No. ARB/02/6 ¶ 117.

65. *Id.* ¶ 128.

66. *El Paso Energy Int'l Co. v. Argentina*, ICSID Case No. ARB/03/15 (2006), available at [http://www.investmentclaims.com/decisions/El\\_Paso\\_Energy-Argentina\\_Jurisdictional\\_Decision.pdf](http://www.investmentclaims.com/decisions/El_Paso_Energy-Argentina_Jurisdictional_Decision.pdf) (last visited July 20, 2006).

ary framework for the development of economic activities, and the necessity to protect foreign investment and its continuing flow."<sup>67</sup>

It then endorsed the interpretation given in the *SGS v. Pakistan* and stated

that the umbrella clause does not extend to any contract claims when such claims do not rely on a violation of the standards of protection of the BIT, namely, national treatment, MFN clause, fair and equitable treatment, full protection and security, protection against arbitrary and discriminatory measures, protection against expropriation or nationalisation either directly or indirectly, unless some requirements are respected.<sup>68</sup>

#### F. INVESTORS' NATIONALITY

The nationality of the investor has been a common issue in the context of international investment disputes. For ICSID to have jurisdiction, the legal investment dispute needs to be between a contracting state and a national of another contracting state. If the dispute is between a national of the contracting state and that state, ICSID will not have jurisdiction. Thus, the criteria to determine when a party is a national of a state are crucial. Furthermore, article 25(2)(b) of the ICSID Convention states that any juridical person with the nationality of the contracting state party to the dispute can have the treatment of a national of another contracting state for purposes of the Convention, if that juridical person is under foreign control and the parties have agreed to such treatment. But the ICSID Convention does not provide for a definition of foreign control. Recent ICSID tribunals have addressed these issues.

In one case when an individual had nationality from one state and residence from another state, the tribunal had to establish clarifications. In the *Feldman* case,<sup>69</sup> the tribunal mentioned that nationality and residence were different concepts. Nationality was the main connecting factor between a state and an individual. It also stated that nationality prevailed over permanent residence in matters of standing.

Mr. Feldman was a national of the United States but had residence in Mexico. ICSID's jurisdiction was objected to by Mexico based on article 201 of NAFTA, which provides that a national is, among others, a citizen or permanent resident. If Mr. Feldman was considered a national of Mexico, he did not have standing to initiate a proceeding before ICSID. The tribunal solved the issue by stating that article 201 of NAFTA was only relevant with respect to the state party other than the one where the investment is made. Thus, a permanent resident in the United States who did not have American citizenship could claim to have U.S. nationality for purposes of NAFTA protection and initiate an arbitration proceeding

67. *Id.* ¶ 70.

68. *Id.* ¶ 84.

69. *Feldman*, ICSID Case No. ARB(AF)88/1.



before ICSID. Mr. Feldman, however, was found to only have U.S. nationality. For that reason the issue of double nationality did not arise.

In another case the tribunal had to deal with nationality of an entity when there was foreign control. In *Autopista Concesionada de Venezuela, C.A. (AUCOVEN) v. Venezuela*,<sup>70</sup> the tribunal was asked to address the issue of foreign control of a company with the nationality of the host state. The tribunal emphasized the role of the consent of the parties. The parties had agreed in a concession contract to ICSID jurisdiction, subject to the condition that the majority of the shares in AUCOVEN were transferred to a national of another contracting state. Upon that happening, the parties agreed that AUCOVEN would be considered a company under foreign control and consequently a national of another contracting state. The tribunal found that the parties chose to define the term foreign control, taking into consideration only the transfer of shares of AUCOVEN.

It also stressed that economic criteria usually reflect reality better than legal criteria. But the tribunal had to mark distance from that statement and distinguished from *SOABI v. Senegal*<sup>71</sup> and *Amco v. Indonesia*<sup>72</sup> where the tribunals made interpretations to determine the foreign control beyond the first level of control, although they reached different levels of control.

On determining the nationality of the company that acquired the majority of the shares of AUCOVEN, the tribunal used the most common criterion (i.e., place of incorporation). It concluded that it had jurisdiction because AUCOVEN, a company incorporated in Venezuela, was under control of an American company and the parties consented that that factor was sufficient to consider the investor a national of another contracting state.

Although not involving a Latin American country, an investment arbitral tribunal had to look at the issue of nationality when there was a group of companies. In *Banro American Resources, Inc. v. Republic of the Congo*,<sup>73</sup> the tribunal looked at the company's nationality from a different perspective: the company with the nationality of the other contracting state and the company giving the consent and in connection with whom the host state gave consent to arbitrate disputes involving them were not the same.

The tribunal established that a company could transfer consent to a subsidiary to submit a dispute to ICSID as per the terms of the agreement where consent was originally granted. But for the consent to be transfer-

70. *Autopista Concesionada de Venezuela, C.A. (AUCOVEN) v. Venezuela*, ICSID Case No. ARB/00/5 (2001), available at <http://www.investmentclaims.com/decisions/Autopista-Venezuela-Award-27Sept2001.pdf> (last visited July 20, 2006).

71. *SOABI v. Senegal*, 2 ICSID Rep. 164, 182-83 (1984).

72. *Amco v. Indonesia*, 1 ICSID Rep. 376, 404-05 (1983).

73. *Banro American Resources, Inc. v. Republic of the Congo*, ICSID Case No. ARB/98/7 (2000), available at <http://www.worldbank.org/icsid/cases/banro-excerpts.pdf> (last visited July 20, 2006).

able the consent had to be previously granted. In the case in point, the consent could not have been granted nor transferred because the parent company did not have the nationality of a contracting state to the ICSID Convention. Thus, if a claimant lacked the nationality of a contracting state, ICSID could not have jurisdiction. The tribunal also considered the possibility of the claimant having the nationality of a contracting state but not having granted consent, and the possibility of the host state granting consent but not including disputes involving the claimant. In both cases the tribunal stated that it lacked jurisdiction.

On reaching a conclusion, the tribunal established differences with two previous cases: a) where a request to submit a dispute to ICSID was submitted by a member company of a group of companies while the consent was expressed by another company of the group; and b) when following the transfer of shares, the request to submit the dispute to ICSID came from the transferee company while the consent had been given by the company making the transfer. The tribunal stressed that in general it tends to be less formalistic and that ICSID is more willing to work its way from the subsidiary to the parent company rather than the other way around. "Consent expressed by a subsidiary is considered to have been given by the parent company, the actual investor, whose subsidiary is merely an 'instrumentality.'"<sup>74</sup>

#### G. MFN

In a peculiar case, a MFN clause of a BIT was used to extend ICSID jurisdiction. In *Maffezini v. Spain*,<sup>75</sup> the tribunal analyzed the MFN clause of the Argentina-Spain BIT in connection with the provisions of the Chile-Spain BIT, which did not require exhausting a certain period of time before filing a claim.

The tribunal noticed two principles: *res inter alios acta* and *ejusdem generis*. According to *res inter alios acta*, the treaties are valid among the parties. According to *ejusdem generis*, the effect of a treaty can be extended via the MFN clause to treaties of the same nature. The tribunal ruled that in the absence of express provisions to the contrary, the provisions of investment disputes of another treaty of the same nature can be extended to an investor of a third country because the purpose of the BITs is to protect foreign investors and their rights, and because the provisions of investment disputes settlement are inextricably related to investment protection. The tribunal also stated some exceptions to the ruling, such as when consent to arbitration is conditioned on exhaustion of local remedies, when the parties have the option to choose between local remedies or international arbitration, and when the parties have chosen an institutional arbitration. The tribunal applied the procedural

74. *Id.* ¶ 12.

75. *Maffezini v. Spain*, ICSID Case No. ARB/97/7 (2000), available at <http://www.investmentclaims.com/decisions/Maffezini-Spain-Jurisdiction-25Jan2000-Eng.pdf> (last visited July 20, 2006).

provisions of the Chile-Spain BIT and ruled that the investor did not have to exhaust a certain period of time before filing a claim against the state.

## V. THE JUDGMENT

As noted previously, international investment law has been motivated by two reasons: protection of foreign investors and economic development of countries.

The evidence portrayed in the previous sections shows that the interests of the foreign investors have been protected. Foreign investors have found, in international investment law, a shield that not only protects their property rights and sets minimum international standards of treatment, but also a mechanism to make that protection enforceable under the form of international investment arbitration. But international investment arbitration has not been biased against the interests of countries or in favor of investors, a factor that speaks about the independence and neutrality of that alternative dispute resolution mechanism.

### A. STATISTICS

For instance, until the year 2003, of eighteen awards on the merits issued by ICSID arbitral tribunals, the claimants (i.e., the investors) prevailed in ten awards, whereas in eight awards, their claims were dismissed and the states prevailed.<sup>76</sup> In the context of NAFTA, the investors had prevailed in two awards and the states had prevailed in four awards.<sup>77</sup> More recent data available from investment arbitration cases filed under ICSID, United Nations Commission on International Trade Law rules,<sup>78</sup> and other arbitration centers<sup>79</sup> show a similar picture; out of forty-six cases where there was a partial or final award on the merits and where jurisdiction was upheld, investors prevailed in twenty-seven, but lost to the states in nineteen, including four in favor of the United States and four in favor of Mexico under NAFTA.<sup>80</sup>

Nevertheless, in the context of international investment arbitrations, the issue of economic development of countries has rarely been considered, although there are many circumstances where economic development could be analyzed by the arbitral tribunals.

76. WORLD BANK, WORLD DEVELOPMENT REPORT 2004: MAKING SERVICES WORK FOR POOR PEOPLE 167 BOX 9.4.

77. *Id.*

78. Arbitration Rules of the United Nations Commission on International Trade Law [UNCITRAL], G.A. Res. 31/98 (Dec. 15, 1976), available at <http://www.uncitral.org/pdf/english/texts/arbitration/arb-rules/arb-rules.pdf> (last visited July 20, 2006).

79. Other arbitration centers such as the London Court of International Arbitration and International Chamber of Commerce have issued investment arbitration awards. See, e.g., Investment Treaty Arbitration, Investment Treaty Awards: Chronological Listing, [http://ita.law.uvic.ca/chronological\\_list.htm](http://ita.law.uvic.ca/chronological_list.htm).

80. *Id.*

## B. ECONOMIC DEVELOPMENT

For example, commentators have suggested that for an investment to be qualified as foreign and, hence, entitled to access the investment dispute settlement mechanism of ICSID, certain conditions need to be met: a) the project must have a certain duration; b) there must be a certain regularity in the earnings and the return; c) there should be a typical element of risk on both sides; d) there should be a substantial commitment to develop certain activities; and e) the operation must be significant for the development of the host state, as stated in the Convention's preamble.<sup>81</sup> In some decisions on jurisdiction, these criteria have been considered incidentally.

In *Salini Costruttori S.P.A. v. Morocco*,<sup>82</sup> two Italian companies claimed compensation for damages from Morocco under the treaty between the government of Morocco and the government of Italy for the reciprocal promotion and protection of investments due to a dispute that arose out of the construction contract related to a section of a highway joining Rabat to Fés. Morocco objected to the tribunal jurisdiction based on different grounds, one that referred to the argument that construction contracts did not qualify as investments under the ICSID Convention. Upon considering that objection, the tribunal pointed out that the ICSID Convention does not define the term investment. It then considered the criteria generally identified by the Convention's commentators, indicating that the criteria included the existence of contribution, certain duration, and risk participation. It also added that the operation should contribute to the development of the host state, as provided by the Convention's preamble.<sup>83</sup> The tribunal found that the construction contract fulfilled the criteria. Even in regard to the risk aspect, the tribunal indicated that a construction project that lasts several years, for which total costs cannot be established with certainty in advance, created a risk for the contractor. Thus, a construction operation could qualify as an investment, and the disputes that arise directly out of it are susceptible to be heard by ICSID. In connection with the economic development requirement, the tribunal mentioned that in most countries construction of infrastructure falls under the tasks to be carried out by the state or by other public authorities. It then mentioned that the highway in question served the public interest and that the claimant companies were also able to provide the host state with know-how in relation to the work.<sup>84</sup>

The tribunal also mentioned that all the elements to be taken into account for defining when there is an investment in the context of the ICSID Convention may be interdependent. Thus, had the investment failed the test of any of the elements (i.e., the one on economic development),

81. ICSID Convention, *supra* note 14, at pmbl.

82. *Salini Costruttori S.P.A. v. Morocco*, ICSID Case No. ARB/00/4, 42 I.L.M. 609 (2005).

83. *Id.* ¶ 52.

84. *Id.* ¶ 57.

the tribunal would have had to reject the claim and declare that it did not have jurisdiction.

Based on the claimants' fulfillment of each of the criteria, the tribunal found that the construction contract constituted an activity within ICSID jurisdiction and that disputes arising directly out of the contract would be heard by the tribunal.

Thus, based on Salini's argument, an ICSID arbitral tribunal could deny jurisdiction to an investment dispute when the investment has been detrimental to the host country's development. A consideration of that nature might touch the merits of the case, and hence it could be an issue to be analyzed and solved by each tribunal on a case by case basis.

### C. LOCAL INVESTORS

Likewise, the issue of economic development in the context of foreign investment could be considered by arbitral tribunals to deny jurisdiction when an analysis of the substance beyond the forms yields the result that the dispute is not between a foreign investor and the host state but between a local investor disguised as a foreigner and its state of nationality. In some cases that analysis has been flexible. As a result, arbitral tribunals have ended up looking at disputes between local investors and their states.

In *Tokios Tokeles v. Ukraine*,<sup>85</sup> a firm incorporated in Lithuania, but of whom the majority of shares were owned by Ukrainian nationals, initiated arbitration against Ukraine. The firm alleged that the Ukrainian government breached the Ukraine-Lithuania BIT. Ukraine objected to the tribunal's jurisdiction, arguing, *inter alia*, that the claimant was not a foreign investor and hence the dispute was between a state and its own citizens and therefore, not a matter for ICSID arbitration.

The Ukraine-Lithuania BIT defined foreign investors as those entities incorporated in the other state party. Based on that definition, the majority of the tribunal stated that the parties to a BIT were free to determine the criteria for nationality<sup>86</sup> and set the definition of investor and foreign control of a local entity for purposes of article 25(2)(b) of the ICSID Convention. Accordingly, it was not up to the tribunal to question the criteria used therein.

Article 25(2)(b) states:

Contracting Parties are free to define their consent to jurisdiction in terms that are broad or narrow; they may employ a control-test or reserve the right to deny treaty protection to claimants who otherwise would have recourse under the BIT. Once that consent is defined, however, tribunals should give effect to it, unless doing so would allow the Convention to be used for purposes for which it

85. *Tokios Tokeles v. Ukraine*, ICSID Case No. ARB/02/18 (2004), available at <http://worldbank.org/reisd/cases/tokios-decision.pdf>.

86. *Id.* at 215, ¶ 24.

clearly was not intended.<sup>87</sup>

The majority thus concluded that Tokios was a foreign investor under the terms of the BIT and rejected Ukraine's objection to jurisdiction, stating,

In our view, however, neither the text of the definition of "investment," nor the context in which the term is defined, nor the object and purpose of the Treaty allow such an origin-of-capital requirement to be implied. The requirement is plainly absent from the text. . . . [T]he origin-of-capital requirement is inconsistent with the object and purpose of the Treaty, which . . . is to provide broad protection to investors and their investments in the territory of either party.<sup>88</sup>

The majority then held that, "the ICSID Convention contains no inchoate requirement that the investment at issue in a dispute have an international character in which the origin of the capital is decisive."<sup>89</sup> Regarding the Convention's purpose, the majority considered that the decision had not allowed "the Convention to be used for purposes for which it clearly was not intended."<sup>90</sup>

The dissenting arbitrator stressed that the purpose of the ICSID Convention was to govern international investments: investments characterized by a trans-border movement of capital rather than investment disputes between a country and its citizens.<sup>91</sup> In the dissenting opinion, the minority arbitrator explained this distinction, stating,

when it comes to ascertaining the *international* character of an investment, the origin of the capital *is* relevant, and even decisive. True, the Convention does not provide a precise and clear-cut definition of the concept of *international* investment—no more than it provides a precise and clear-cut definition of the concept *investment*—, and it is therefore for each ICSID tribunal to determine whether the specific facts of the case warrant the conclusion that it is before an international investment.<sup>92</sup>

The dissenting arbitrator also objected to the right of contracting parties to extend the Convention's jurisdiction, explaining,

it is within the limits determined by the basic ICSID Convention that the BITs may determine the jurisdiction and powers of the ICSID tribunal, and it is not for the Contracting Parties in their BIT to extend the jurisdiction of the ICSID tribunal beyond the limits determined by the basic ICSID Convention.<sup>93</sup>

87. *Id.* at 220, ¶ 39.

88. *Id.* at 233, ¶ 77.

89. *Id.* at 235, ¶ 82.

90. *Id.* at 220, ¶ 39.

91. *See Id.* at 252 (Weil, dissenting).

92. *Id.* at 253, ¶ 20.

93. *Id.* at 249-50, ¶ 13.

The doctrine of company law is based on assumptions regarding the costs and benefits provided by limited liability. Generally, it is understood that limiting shareholders' liability is socially beneficial as it allows a greater number of people to establish or own portions of a corporation and allows for greater specialization of a firm's functions and the externalization of business risks beyond its owners to creditors, who may be better suited to bare risk.<sup>94</sup> But should the negative externalities produced by limited liability exceed those deemed acceptable; the legal personality of the company can be disregarded.

The abuse of legal personality apparent in *Tokios* offered arbitrators the means by which the formal definition of nationality could have been weighed against its social costs. In *Tokios*, the use of a Lithuanian company owned by Ukrainian nationals to obtain international protection against Ukraine not only constituted an abuse of the legal personality of the Lithuanian company but also created a risk for the entire international investment arbitration system. Investment disputes between states and their citizens—albeit disguised as foreigners—could be settled internationally.

The majority's decision to take a formalistic rather than an instrumentalist approach was contrary to the primary purpose of the ICSID Convention: to protect foreign investments. A teleological approach might have disregarded the legal personality based on the Ukrainian owners' abuse of it by pursuing international protection on behalf of a purely domestic investment.

As a result, the decision of *Tokios* not only failed to protect a truly foreign investment, it also failed to foster the economic development of the respondent state by opening a venue for local investors to sue their own countries. Such a consequence was not in tune with the rationale that originally moved countries to accept international investment arbitration.

#### D. AMOUNT OF AWARDS

Analysis of economic development issues could have been considered for determining the amount of the arbitral awards. For developing countries under financial stress exorbitant awards could have a tremendous impact on economic development policies and affect their implementation.

Perhaps for this reason, tribunals should consider issues such as the level of poverty of the country in question, amount of public debt, and fiscal deficit, along with the relevant arguments on the merits and impose awards—when needed—that protect foreign investment but do not impair the economic development of the recipient countries.

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94. Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L.R. 99 (1985).

For example, in an investment arbitration case against Ecuador, the investor, American Petroleum Company Occidental was awarded \$71 million.<sup>95</sup> For a country with 12 million people living below an annual income of \$3,260 per capita, with a long term debt of \$16 billion, a GDP of \$30 billion,<sup>96</sup> and a debt service ratio of 31 percent,<sup>97</sup> an award of that magnitude could mean significantly less money devoted to economic development.

If one were to add the arbitration costs to the amount of the awards, the impact could be greater. Costs of investment arbitrations are high. On average, the cost of these cases range around \$2 million in fees with around \$400 thousand in pure costs under the low range.<sup>98</sup> In some cases the fees have been as high as \$4 million, as was the case in *Metalclad*.<sup>99</sup>

Obviously, arbitrators are called to solve disputes, not to solve economic issues. But when the facts are analyzed and the legal instruments give room for considering economic development issues, a careful analysis of the interests of host countries should be undertaken and, if possible, weight should be given to the impact an award might have on the wellbeing of the citizens of that country.

The question is where arbitrators should draw the line so that the rights and interests of the investors are protected, as established in the relevant international investment law, while economic development issues are considered. Stretching that line too far from the agreed law might impair the predictability expected in international investment law. But not considering issues of economic development in the analysis of investment arbitration cases might also impair not only the compliance of the awards but the evolution of international investment law as well.

#### E. INTERPRETATION OF INTERNATIONAL INVESTMENT LAW

Be that as it may, investment arbitral tribunals are empowered with different international instruments of law to consider issues of economic development while protecting foreign investments and investors.

According to the Vienna Convention on the Law of the Treaties, the purpose of the treaties as expressed in their body texts, preambles, annexes, and *travaux préparatoires* shall be taken into account in treaty in-

95. UNCTAD Occasional Paper, *supra* note 5. By the time of publication of this article a newspaper reported that an arbitral tribunal in *Azurix Corp. v. Argentina* had issued an award ordering Argentina to pay Azurix \$165.2 million. See Lucio Fernandez Moores, *Ordenan al Estado Pagarle a una Privatizada US\$165, 2 millones*, CLARIN.COM, July 18, 2006 (Arg.), <http://www.clarin.com/diario/2006/07/18/elpais/p-01001.htm> (last visited July 20, 2006).

96. World Bank Indicators Database, <http://devdata.worldbank.org/data-query/> (select Ecuador as the selected country; click next; select GDP, Long-term debt, and Population, total as the selected series; click next; select 2003, 2004, and 2005 as selected years; click next).

97. *The World in 2006*, THE ECONOMIST, at 41.

98. UNCTAD Occasional Paper, *supra* note 5.

99. The U.S. Government asked the losing party, the investor, for payment of \$4 million in legal costs. This figure does not take into account the costs of a review of the award undertaken by a Canadian court. See *id.*



terpretation.<sup>100</sup> Specifically, article 31 of the Vienna Convention states that, “[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”<sup>101</sup>

Article 32 also states:

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31: (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable.<sup>102</sup>

The ICSID Convention has addressed the question of the purpose of international investment agreements by means of textual reference to economic development in its preamble where it states, “[c]onsidering the need for international cooperation for economic development, and the role of private international investment therein.”<sup>103</sup>

While the report from the executive directors states that the primary purpose of the Convention is to stimulate international investment flows, the report underlines the body’s desire to address the interests of both investors and states:

The Executive Directors believe that private capital will continue to flow to countries offering a favorable climate for attractive and sound investments, even if such countries did not become parties to the Convention or, having joined, did not make use of the facilities of the Centre. On the other hand, adherence to the Convention by a country would provide additional inducement and stimulate a larger flow of private international investment into its territories, which is the primary purpose of the Convention.

While the broad objective of the Convention is to encourage a larger flow of private international investment, the provisions of the Convention maintain a careful balance between the interests of investors and those of host States.<sup>104</sup>

Whereas occasional investment agreements place economic development within the teleology of international investment law, the majority of international investment agreements limit their purpose to the promotion and protection of foreign investment. One of the most contentious legal

100. Vienna Convention on the Law of Treaties art. 31, May 23, 1969, 1155 U.N.T.S. 331, available at [http://www.untreaty.un.org/loc/texts/instruments/english/conventions/1\\_1\\_1969.pdf](http://www.untreaty.un.org/loc/texts/instruments/english/conventions/1_1_1969.pdf) (last visited July 20, 2006).

101. *Id.* at art. 31(1).

102. *Id.* at art. 32.

103. ICSID Convention, *supra* note 14, at pmbl.

104. International Bank for Reconstruction and Development, *Report of the Executive Directors on the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States*, ¶¶ 12-13 (Mar. 18, 1965), available at <http://www.worldbank.org/icsid/basicdoc/partB-section03.htm> (last visited July 20, 2006).

bodies dealing with international investment, NAFTA, which covers the treatment of investments in chapter 11, does not mention economic development. As NAFTA's chapter 11 does not define objectives that are particular to the investment provisions, the agreement's purpose as related to investments is the same as that of the rest of the agreement. The preamble of NAFTA states that the treaty seeks to, "[contribute] to the harmonious development and expansion of world trade and provide a catalyst to broader international cooperation; . . . [and ensure] a predictable commercial framework for business planning and investment."<sup>105</sup>

From this reading, it seems that the reference to development made in the preamble relates to world trade development, presumably a synonym of trade growth. Thus, as NAFTA does not mention economic development in its trade-related sections or preamble, investments are not required to contribute to economic development in order to receive treaty protection.

In general, the international investment agreements that the United States is a party to extend investor protection further than agreements made by other states. The United States typically requires that international investment agreements grant party investors the right to invest. That is, these agreements extend protection beyond the treatment and grant investors the right of entry for future foreign investments to be made into party states. U.S. agreements also generally forbid the imposition of performance requirements, such as the use of local content, export requirements, employment, and technology transfer, on foreign investors, which have been used to ensure that investments render economic benefit to the host state.<sup>106</sup>

Noticeably, the 2004 U.S. model BIT seems much more balanced than previous model agreements. It affirms the desire "to promote greater economic cooperation between" signatories "with respect to investment by nationals and enterprises of one Party in the territory of the other Party."<sup>107</sup> The model treaty also recognizes "that agreement on the treatment to be accorded such investment will stimulate the flow of private capital and the economic development of the Parties" and states that signatories agree "that a stable framework for investment will maximize effective utilization of economic resources and improve living standards."<sup>108</sup>

From the wording of the preamble in the model BIT, it seems that another purpose of the parties is to encourage economic development

105. NAFTA, *supra* note 11, at pmbl.

106. Marie-Frane Houde & Katia Yannaca-Small, *Relationships Between International Investment Agreements* (OECD, Working Papers on Int'l Inv., Paper No. 2004/1), available at <http://www.oecd.org/dataoecd/8/43/31784519.pdf>.

107. 2004 U.S. Model BIT, Treaty Between the Government of The United States Of America And The Government Of [Country] Concerning The Encouragement And Reciprocal Protection Of Investment, 2004, available at [http://www.ustr.gov/assets/Trade\\_Sectors/Investment/Model\\_BIT/asset\\_upload\\_file847\\_6897.pdf](http://www.ustr.gov/assets/Trade_Sectors/Investment/Model_BIT/asset_upload_file847_6897.pdf) (last visited July 20, 2006).

108. *Id.*

through foreign investment protection. The way the link between treatment and economic development has been made seems confusing and could give rise to different interpretations. But the fact that the preamble of the model BIT somehow makes reference to economic development can very well be interpreted as an indication that the purpose of the parties to the agreement was to protect foreign investments in order to attract capital and foster economic development of the parties involved. Taken from there, it could be argued that protection to some investments should be denied whenever they are not beneficial for the economic development of the recipient country.

#### F. LEGAL PERSONALITY OF SUBSIDIARIES

Economic development reasons are not considered to disregard the legal personality of the subsidiary in order to ascertain the responsibility of the parent company. Presently, under article 25(2)(b) of the ICSID Convention, the legal personality of a wholly owned subsidiary can be disregarded, but not for purposes of liability.<sup>109</sup> Accordingly, the purpose of the Convention's article 25(2)(b) was to facilitate foreign investments through locally incorporated companies so that they could qualify to present claims at ICSID. Hence, when the parties to the Convention have agreed to consider a local subsidiary as a foreign entity due to foreign control, the legal personality is disregarded on behalf of international law protection. Disregarding the personality of the local subsidiaries in order to consider them as nationals of the parent company's country works well for the interests of the investors who, by this means, would be entitled to international law protection, even though the legal form of the subsidiary is that of a domestic entity. But when the subsidiaries of foreign companies delve into activities that are inflammatory to the interests of the host countries quite frequently, it is argued that those entities are independent and separate, that they are incorporated in the host country and subject to its laws and that responsibility for their acts should not be extended to the parent company.

109. ICSID Convention, *supra* note 14, at art. 25.

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

(2) "National of another Contracting State" means:

...  
(b) any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.

Thus, for the sake of balance, international investment law instruments should also provide for circumstances when the personality of the subsidiary should be disregarded in order to attain the parent company and make it responsible for the actions of entities under its control. Arbitrators should also consider that possibility when it is clear that the parent company is dodging responsibility by arguing the separation of legal personalities. Doctrines such as that of representation, piercing the corporate veil and *abus de droit*,<sup>110</sup> among others, could be of use to arbitral tribunals willing to look beyond the corporate form.

#### G. IMPACT OF BITs

In real terms, the impact of international investment arbitration in Latin America has been uncertain. Studies show that the relation between BITs and the flow of FDI is weak.<sup>111</sup> Signing BITs and agreeing to international investment arbitration does not guarantee that foreign investors will create business in a given country. At most, the international investment law framework creates a positive investment climate, which diminishes the risk associated with the transaction costs of doing business. Added to the existence of a business opportunity, along with other business related factors, this framework could move the investors to choose that country as a location to invest. But more and more there are indications that the mere acceptance of international investment law is not sufficient to attract foreign investments.

In Latin America, the largest recipient of FDI is Brazil.<sup>112</sup> Of a total of \$67 billion of FDI inflow into Latin America in 2005, Brazil attracted more than \$18 billion.<sup>113</sup> Yet, Brazil is not a signatory of the ICSID Convention and has not ratified any BIT. Thus, the lack of adherence to the international investment law has not affected Brazil's foreign investments attractiveness.

On the other hand, international investment law might have a negative impact in terms of local governance. Through BITs, for instance, foreign investors may escape local courts and not play a role in the dynamic to reform those institutions. In that sense, it has been argued that in some developing countries already suffering from low-quality institutions, the presence of international alternatives to adjudicatory or regulatory bodies may reduce local institutional quality by not allowing strong political

110. BIN CHENG, *GENERAL PRINCIPLES OF LAW AS APPLIED BY INTERNATIONAL COURTS AND TRIBUNALS* 121 (1987).

111. See Jennifer Tobin & Susan Rose-Ackerman, *Foreign Direct Investment and the Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties* (Yale Law Sch., Ctr. for Law, Econ. & Pub. Policy, Research Paper No. 293, 2005), available at [http://www.law.yale.edu/outside/html/faculty/sroseack/FDI\\_BITs\\_may02.pdf](http://www.law.yale.edu/outside/html/faculty/sroseack/FDI_BITs_may02.pdf) (last visited Jul. 20, 2006). See also Mary Hallward-Dreimeier, *Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit... and They Could Bite* (World Bank Policy Research Working Paper Series, Paper No. 3121, 2003), available at <http://ssrn.com/abstract=636541>.

112. UNCTAD *World Investment Report 2005*, *supra* note 1.

113. *Id.*

coalitions to be formed.<sup>114</sup> Foreigners would have no interest in pressing for changes in the judicial system, for instance, since they are subject to a special dispute resolution regime.

It has also been said that BITs might reduce the interest of foreign investors in property and enforcement reforms in developing countries. Domestic reforms may be less likely and the country may even regress toward policies that harm domestic investors. Attempts to reform may fail, or no attempts to reform may be made at all. In such cases, the BIT, although benefiting foreign investors, could have a negative effect on the trustworthiness of the business environment for domestic investors.<sup>115</sup>

Obviously, BITs are not the cause of weak legal reforms or law enforcement in developing countries. But they might not be helpful on reform efforts or might even make things worse by opening a discriminatory and unfair system of investment protection composed of two paths: a strong international path for some foreign investors and a weak domestic path for the rest of businesses and locals. More research needs to be conducted to determine the impact of international investment law in local governance and legal reforms before a final judgment is issued. For now, one should only say that doubt has been expressed concerning the positive externalities the system of international investment law brings to developing countries in general, and to Latin American countries in particular.

## VI. CONCLUSIONS

Economic development needs to be financed. Historically, developing countries have obtained that financing through the revenues yielded by the sale of their commodities in international markets, through loans granted either by international commercial banks or multilateral entities, or through bilateral aid provided by the wealthy countries. Not until recently have developing countries accepted the argument that foreign investments could be a means to finance economic development both directly and indirectly through its positive externalities.<sup>116</sup> In the past, foreign investments were either despised and rejected or heavily regulated because they were considered instruments of neo-colonialism or dominance.<sup>117</sup>

In the 1990s, Latin America countries began to favor public policies favorable to foreign investment. As part of policies aimed at reducing the size of the state and opening space for private investors, countries were somehow convinced that legal reforms were needed. Amid those reforms, countries were supposed to enter into international agreements

114. Tom Ginsburg, *International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance*, 25 INT'L REV. L. AND ECON 107 (2005).

115. See Tobin & Rose-Ackerman, *supra* note 111.

116. An example of positive externalities is seen in job creation and technology transfer. See SANJAYA LALL & PAUL STREETEN, *FOREIGN INVESTMENT, TRANSNATIONALS AND DEVELOPING COUNTRIES* 5 (1977).

117. See SORNARAJAH, *supra* note 6.

that would provide a sound, secure, and predictable investment climate for foreign investors. Being signatory to the ICSID Convention and executing BITs with capital exporting countries where investment arbitration was consented were part of the package better known as the Washington Consensus.<sup>118</sup>

But although the Washington Consensus delivered some results, it came under heavy criticism in the region mainly because those policies failed to cure the endemic inequality of the western hemisphere, and made the rich richer while the poor remained poor, if not poorer. Many of the policies portrayed by the Washington Consensus came under scrutiny, and a shift of policies has been recommended.<sup>119</sup> Under this scenario, the rationale behind the international investment law could be questioned. This should not be underestimated if one takes into account that Latin America was the birthplace of the Calvo doctrine<sup>120</sup> and the creative nationalization schemes during of the 1970s.<sup>121</sup>

If the good of foreign investments comes into doubt because it is not beneficial to the economic development of the countries, the use of the international investment law would inevitably be at risk. Countries could start judging the pros and cons of the system and eventually reject their outcomes by failing to comply, or more likely, by denouncing previous commitments assumed under the form of international agreements or by not entering into new instruments of international investment law.

In order to avoid this, the whole system of international investment law, including international investment arbitration needs to be more balanced. Arbitrators need to give more weight to considerations of economic development in the context of their awards, whenever this is feasible. For example, arbitrators need to look at the objective of international investment law in broad terms and find out the real purpose of that legal framework: is it only to protect foreign investments or is it to protect foreign investments because they are beneficial to the economic development of the recipient country? If the purpose of the international investment law is merely to protect foreign investments, the results of the arbitrators' analysis would be totally different from an approach that also considers the economic development of the host state.

But arbitrators can only look at the law as it exists, not how it should exist. Thus, although arbitrators might be willing to make interpretations

118. See John Williamson, *Did the Washington Consensus Fail?*, INST. FOR INT'L ECON. (Nov. 6, 2002) (outline of speech at the Center for Strategic & International Studies), available at <http://www.iie.com/publications/papers/paper.cfm?ResearchID=488> (last visited July 20, 2006).

119. *Id.*; see also *After the Washington Consensus: Restarting Growth and Reform in Latin America*, INST. FOR INT'L ECON. (Piero-Pablo Kuczynski & John Williamson eds., Mar. 2003), available at <http://www.cid.harvard.edu/cidtrade/issues/washington.html>.

120. See Gainer, *supra* note 9, at 1574.

121. See HARALD KNUDSEN, *EXPROPRIATION OF FOREIGN PRIVATE INVESTMENTS IN LATIN AMERICA* (1974). For instance Kennecott's copper mining was expropriated in Chile in 1971 using the argument of excessive profits for not compensating.

of the law when possible, and look at the purpose of the treaties and the intention of the states, they cannot make up an objective that has not been expressed by the parties to the agreement.

For this reason, the treaty negotiators should bear in mind that the law is only as good as they make it. For countries harboring skepticism about the benefits of international investment law in general, and of international investment arbitration in particular, the importance of clearly stating their economic development objectives vis-à-vis foreign investment cannot be underestimated.

Likewise, within the treaties, the impact of foreign investments on economic development should expressly be made part of the criteria to be taken into account by the arbitral tribunals when admitting a claim, upholding jurisdiction, and awarding monetary compensations.

Fairness and balance should be the rationale for these approaches. For instance, there is a need to amend the practice whereby the legal personality of the foreign investor can be disregarded for purposes of granting international law protection to a host state incorporated subsidiary while the same is not contemplated for purposes of liability of the parent company. The policy of granting international law protection to wholly owned subsidiaries incorporated in the host state makes sense. But in order for the foreign parent company to be liable for the actions of the local subsidiary, the same criterion should be applied and under certain circumstances, the personality of the local subsidiary should be disregarded. For that to be possible, negotiators should devise mechanisms to be included in the relevant treaties.

International law of foreign investment has evolved to a point where it is in need of change. So far this field of international law has generated a good deal of treaties, jurisprudence, legal doctrines, and principles. But a more balanced approach, inspired by a close examination of its roots, is necessary if the international investment law approach is to survive.