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The juridical foundations of investment treaty arbitration

Rule 1: Where the contracting states to an investment treaty have agreed to a procedure for the judicial settlement of disputes between an investor and the host state, a claim advanced by the investor in accordance with such procedure is its own claim and the national contracting state of the investor has no legal interest in respect thereof.

Rule 2: The rules of admissibility of diplomatic protection in general international law are not generally applicable to the regime for the settlement of disputes between an investor and the host state created by an investment treaty.

A. INVESTMENT TREATIES AND INVESTMENT TREATY ARBITRATION

1. There is a highly competitive global market for foreign direct investment. The standing of each nation state in that market depends upon a myriad of factors, among which the stability and predictability of the existing regulatory regime for investments is always important and often decisive. Stability and predictability are attributes that are rarely ascribed to a regulatory environment created by nascent public institutions and hence many developing countries might be expected to suffer from a serious competitive disadvantage. Many of those developing countries have sought to redress that disadvantage by concluding investment treaties. These operate to reduce the level of sovereign risk inherent in every foreign direct investment project by establishing a regime of international minimum standards for the exercise of public power by the host contracting state in relation to investments made in its territory by the nationals of another contracting state. In this way, a state that is unable to trade on an inherent confidence in its regulatory regime (predicated upon decades of proven commitment to the rule of law) can nevertheless compete for foreign direct investment by subjecting the conduct of its public institutions to exogenous minimum standards. Those minimum standards take the form of investment treaty obligations such as the probibition of uncompensated expropriation, fair and equitable treatment, national treatment, full protection and security

compromis.[120] It is possible to assert more generally that international law always governs arbitrations or other judicial proceedings involving two states when the claim is for a breach of an international treaty or of an obligation in general international law. As will be considered further in Rule 13, this principle is likely to have its roots in the immunity of foreign states from the jurisdiction of national courts insofar as an arbitration governed by international law remains outside the legal order of the state that provides the territorial seat of the arbitration.

54. Investment treaty arbitrations, in contrast, are ultimately governed by the *lex loci arbitri*, viz. the municipal law of the seat of the arbitration.[121] This is also a principle of general application but subject to the exceptional instance of investment treaty arbitrations conducted under the ICSID Convention, where the procedural rules set out in the Convention govern the conduct of the arbitration largely to the exclusion of any municipal law.[122]

55. If an investor were in essence bringing a claim on behalf of its national state, the logical consequence would be that international law would govern the arbitration by default as the rights of two states under an international treaty would be the subject matter of the dispute. Put differently, if the claim belonged to the national state of the investor, the municipal courts at the seat of the arbitration arguably could not sit in judgment in respect of a challenge to the validity of the treaty tribunal's award. Hence the general application of the municipal law of the seat of the arbitration to investment treaty arbitrations and the jurisdiction of the municipal courts once again refute the derivative theory for investment treaty claims.

(5) The exhaustion of local remedies

56. The defendant state has the primary interest in compliance with the rule that the injured national must exhaust local remedies available in the host state before

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[120] Mann, *ibid*.

[121] See the commentary to Rule 13 below.

[122] The ICSID Convention creates, according to Broches, 'a complete, exclusive and closed jurisdictional system, insulated from national law': A. Broches, 'Awards Rendered Pursuant to the ICSID Convention: Binding Force, Finality, Recognition, Enforcement, Execution' (1987) 2 *ICSID Rev – Foreign Investment LJ* 287, 288. See also: I. Shihata and A. Parra, 'Applicable Substantive Law in Disputes Between States and Private Foreign Parties: The Case of Arbitration under the ICSID Convention' (1994) 9 *ICSID Rev – Foreign Investment LJ* 183, 186; A. Parra, 'Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investment' (1997) 12 *ICSID Rev – Foreign Investment LJ* 287, 301. This 'insulation' from national law is achieved as follows. Art. 44 of the ICSID Convention, which exhaustively prescribes the sources of procedural rules for ICSID arbitration, makes no reference to domestic law. Art. 53 excludes any remedies in relation to ICSID awards save those speficied in Arts. 50–2. The exclusivity of these remedies was confirmed by the French *Cour de cassation*: *Guinea v Atlantic Triton Co*., Cass Civ 1re, 11 June 1991 (1991) 118 *Journal du droit international* 1005. Art. 54 obliges Contracting States to recognise and enforce ICSID awards. The execution of ICSID awards is, however, governed by national law at the place of execution pursuant to Art. 54(3).

and most-favoured-nation treatment. These investment treaty obligations are generally enforceable against the host state of the investment at the suit of the investor by recourse to international arbitration. Hence the protection afforded by investment treaties is tangible enough to feature in the investor's calculus of investment risks. An investment treaty can thus serve to bridge part of the gap between the perception of sovereign risk in a developing country, on the one hand, and in a highly developed country with public institutions that have acquired a firm reputation for fairness and transparency, on the other. An investment treaty cannot, of course, be expected to bridge that gap entirely. That is not its function. Investment treaties do not create a uniform law on the establishment, acquisition, expansion, management, conduct, operation or alienation of foreign investments; their object and purpose is not to create a single regulatory regime for foreign investment. Sovereign risk will vary considerably from country to country regardless of the existence of investment treaties. For a developing country to compete successfully for foreign direct investment, however, it is sufficient if the level of sovereign risk is counterbalanced by its comparative advantages as a destination for foreign capital (cheaper labour or material costs, expanding consumer markets, higher profit margins, etc.). An investment treaty can assist a developing country to tip these scales in its favour.[1]

2. Bilateral investment treaties ('BITs') for the reciprocal encouragement of investment, predominantly between capital importing and exporting states, numbered 2,573 at the end of 2006.[2] Multilateral investment treaties such as the North Atlantic Free Trade Agreement ('NAFTA')[3] and the Energy Charter Treaty[4] create reciprocal investment protection obligations across the same divide but are also notable for extending the regime to investment relations between states with highly developed economies as well.[5] Investment treaties usually create two distinct dispute resolution mechanisms: one for disputes

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[1] J. Voss, 'The Protection and Promotion of Foreign Direct Investment in Developing Countries: Interests, Interdependencies, Intricacies' (1982) 31 *ICLQ* 686, 687; G. Sacerdoti, 'Bilateral Investment Treaties and Multilateral Instruments on Investment Protection' (1997) 269 *Hague Recueil* 251, 290–1.

[2] UNCTAD, *World Investment Report 2007* (2007) xvii, available at www.unctad.org/en/docs/wir2007p1_fn.pdf.

[3] Reprinted at: (1993) 32 ILM 605.

[4] Reprinted at: (1995) 35 ILM 509.

[5] See generally the following studies on the NAFTA and Energy Charter Treaty: T. Wälde (ed.), *The Energy Charter Treaty: An East–West Gateway for Investment and Trade* (1996); M. Omalu, *NAFTA and the Energy Charter Treaty: Compliance with, Implementation, and Effectiveness of International Investment Agreements* (1999); T. Wälde, 'International Investment under the 1994 Energy Charter Treaty' (1995) 29 *J of World Trade L* 5; T. Wälde, 'Investment Arbitration under the Energy Charter Treaty' (1996) *Arbitration Int* 429; T. Weiler (ed.), *NAFTA Investment Law and Arbitration: Past Issues, Current Practice, Future Prospects* (2004); M. Kinnear, A. Bjorklund and J. Hannaford, *Investment Disputes under NAFTA: An Annotated Guide to NAFTA Chapter 11* (2006); C. Ribiero, *Investment Arbitration and the Energy Charter Treaty* (2006).

between a qualifying investor and the host state in relation to its investment ('investor/state disputes') and another for disputes between the contracting state parties to the treaty ('state/state disputes'). Investment treaties generally provide that the state/state mechanism covers disputes 'concerning the interpretation or application' of the treaty,[6] whereas disputes relating to a specific investment of a particular investor (which may of course give rise to interpretative questions) are encompassed by the investor/state dispute resolution procedure.[7] This study focuses almost exclusively on the resolution of investor/state disputes through recourse to international arbitration, which is by far the most utilised dispute resolution mechanism that is available under investment treaties.[8] Nevertheless, it is useful to set the stage with a brief appraisal of each type of mechanism.

3. The judicial forums specified for the resolution of investor/state disputes generally include one or more of the following at the option of the claimant investor:

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[6] Asian–African Legal Consultative Committee Model BIT, Art. 11(i), UNCTAD Compendium (Vol. III, 1996) 122; Chile Model BIT, Art. 9(1), *ibid*. 148; China Model BIT, Art. 8(1), *ibid*. 154; Switzerland Model BIT, Art. 9(1), *ibid*. 181; UK Model BIT, Art. 9(1), *ibid*. 190; Egypt Model BIT, Art. 9(1), *ibid*. (Vol. V, 2000) 297; France Model BIT, Art. 11(1), *ibid*. 306; Jamaica Model BIT, Art. 9(1), *ibid*. 321; Malaysia Model BIT, Art. 8(1), *ibid*. 329; Netherlands Model BIT, Art. 12(1), *ibid*. 337; Sri Lanka Model BIT, Art. 9(1), *ibid*. 344; Cambodia Model BIT, Art. 9(1), *ibid*. (Vol. VI, 2002) 467; Croatia Model BIT, Art. 11(1), *ibid*. 477; Iran Model BIT, Art. 13(1), *ibid*. 483; Peru Model BIT, Art. 9(1), *ibid*. 498; USA Model BIT, Art. 10(1), *ibid*. 508; Austria Model BIT, Art. 18, *ibid*. (Vol. VII) 267; Belgo-Luxembourg Economic Union Model BIT, Art. 11(1), *ibid*. 276; Denmark Model BIT, Art. 10(1), *ibid*. 284; Finland Model BIT, Art. 10(1), *ibid*. 293; Germany Model BIT, Art. 10(1), *ibid*. 300; South Africa Model BIT, Art. 8(1), *ibid*. (Vol. VIII) 277; Turkey Model BIT, Art. 8(1), *ibid*. 284; Benin Model BIT, Art. 8(1), *ibid*. (Vol. IX) 282; Burundi Model BIT, Art. 9(1), *ibid*. 292; Mauritius Model BIT, Art. 9(1), *ibid*. 300; Mongolia Model BIT, Art. 9(1), *ibid*. 306; Sweden Model BIT, Art. 9(1), *ibid*. 314; Indonesia Model BIT, Art. 9 ('Disputes between the Contracting Parties concerning the interpretation or application of this Agreement should, if possible be settled through diplomatic channels' but fails to provide for any compulsory dispute resolution in the event that diplomacy is not successful), *ibid*. (Vol. X) 313; OPEC Fund Model BIT, Art. 9.01, *ibid*. (Vol. VI) 489; Bolivia Model BIT, Art. 10, *ibid*. (Vol. X) 283; Burkina Faso Model BIT, Art. 10(1), *ibid*. 292; Guatemala Model BIT, Art. 9(1), *ibid*. (Vol. XII) 292; Italy Model BIT, Art. 9(1), *ibid*. 300; Kenya Model BIT, Art. 11(a), *ibid*. 310; Uganda Model BIT, Art. 11(1), *ibid*. 319; Ghana Model BIT, Art. 11(1), *ibid*. (Vol. XIII) 284; Romania Model BIT, Art. 10(1), *ibid*. 291; Canada Model BIT, Art. 48(1), *ibid*. (Vol. XIV) 252–3; Energy Charter Treaty, Art. 27(1), Appendix 4; USA Model BIT (2004), Art. 37(1); Germany Model BIT (2005), Art. 10(1), Appendix 7; France Model BIT (2006), Art. 11(1), Appendix 6; China Model BIT (1997), Art. 8(1), Appendix 5; UK Model BIT (2005), Art. 9(1), Appendix 10.

[7] See the discussion accompanying Rule 25 in relation to the jurisdiction *rationae materiae* of an investment treaty tribunal.

[8] The only example of a state/state arbitration to date has arisen under the Peru/Chile BIT, where Peru invoked the state/state dispute mechanism against Chile after being served with a notice of arbitration by a Chilean investor under the same BIT. Peru apparently sought a favourable interpretation of the BIT in the state/state arbitration to assist its case in the investor/state arbitration. In the end, the claim of the Chilean investor failed. See: *Lucchetti v Peru* (Preliminary Objections) 12 ICSID Rep 219, 221/7.

– municipal courts of the host state;[9]
– arbitration pursuant to the ICSID Arbitration Rules or the ICSID Additional Facility Rules;[10]
– *ad hoc* arbitration pursuant to the UNCITRAL Arbitration Rules;[11]

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[9] Chile Model BIT, Art. 8(2)(a), UNCTAD Compendium (Vol. III, 1996) 147; China Model BIT, Art. 9(2), *ibid*. 155; Egypt Model BIT, Art. 8(2)(a), *ibid*. (Vol. V, 2000) 297; Jamaica Model BIT, Art. 8(2)(a), *ibid*. 322; Sri Lanka Model BIT, Art. 8(2)(a), *ibid*. 343; Croatia Model BIT, Art. 10 (2)(a), *ibid*. (Vol. VI, 2002) 476; Iran Model BIT, Art. 12(2), *ibid*. 483; Peru Model BIT, Art. 8(2) (a), *ibid*. 497; USA Model BIT, Art. 9(2)(a), *ibid*. 507; Austria Model BIT, Art. 12(1)(a), *ibid*. (Vol. VII) 264; Finland Model BIT, Art. 9(2)(a), *ibid*. 292; Benin Model BIT, Art. 9(2)(a), *ibid*. (Vol. IX) 283; Indonesia Model BIT, Art. 8(2), *ibid*. (Vol. V) 313; Bolivia Model BIT, Art. 10, *ibid*. (Vol X) 283; Burkina Faso Model BIT, Art. 9(2)(a), *ibid*. 292; Guatemala Model BIT, Art. 8 (a), *ibid*. (Vol. XII) 292; Italy Model BIT, Art 10(3)(a), *ibid*. 301; Kenya Model BIT, Art. 10(b)(1), *ibid*. 309; Uganda Model BIT, Art. 7(2), *ibid*. 317; Ghana Model BIT, Art. 10(1), *ibid*. (Vol. XIII) 283; Romania Model BIT, Art. 9(2)(a), *ibid*. 291; China Model BIT (2003), Art. 9(2)(a), Appendix 5; Energy Charter Treaty, Art. 26(2)(a), Appendix 4.

[10] Asian–African Legal Consultative Committee Model 'A' BIT, Art. 10(v), UNCTAD Compendium (Vol. III, 1996) 122; Asian–African Legal Consultative Committee Model 'B' BIT, Art. 10(v), *ibid*. 133; Chile Model BIT, Art. 8(2)(b), *ibid*. 147; Switzerland Model BIT, Art. 8(2), *ibid*. 181; UK Model BIT, Art. 8, *ibid*. 189; Egypt Model BIT, Art. 8(2)(b), *ibid*. (Vol. V, 2000) 297; France Model BIT, Art. 8, *ibid*. 305; Indonesia Model BIT, Art. 8(3)(a), *ibid*. 313; Jamaica Model BIT, Art. 10, *ibid*. 322; Malaysia Model BIT, Art. 7(3), *ibid*. 329; Netherlands Model BIT, Art. 9, *ibid*. 336; Sri Lanka Model BIT, Art. 8(2)(b), *ibid*. 343; Cambodia Model BIT, Art. 8(3)(a), *ibid*. (Vol. VI, 2002) 467; Croatia Model BIT, Art. 10(2)(b), *ibid*. 476; Peru Model BIT, Art. 8(2)(b), *ibid*. 497; USA Model BIT, Art. 9(3)(a), *ibid*. 507; Austria Model BIT, Art. 12 (1)(c), *ibid*. (Vol. VII) 264; Belgo-Luxembourg Economic Union Model BIT, Art. 10(3), *ibid*. 275; Denmark Model BIT, Art. 9(2)(a), *ibid*. 283; Finland Model BIT, Art. 9(2)(b), *ibid*. 292; Germany Model BIT, Art. 11, *ibid*. 301; South Africa Model BIT, Art. 7(2), *ibid*. (Vol. VIII) 276; Turkey Model BIT, Art. 7(2)(a), *ibid*. 284; Benin Model BIT, Art. 9(3), *ibid*. (Vol. IX) 283; Burundi Model BIT, Art. 8(3), *ibid*. 292; Mongolia Model BIT, Art. 8(2)(a), *ibid*. 306; Sweden Model BIT, Art. 8(2), *ibid*. 313; Indonesia Model BIT, Art. 3(a), *ibid*. (Vol. V) 313; Bolivia Model BIT, Art. 10, *ibid*. (Vol. X) 283; Burkina Faso Model BIT, Art. 9(2)(c), *ibid*. 292; Guatemala Model BIT, Art. 8(b), *ibid*. (Vol. XII) 292; Italy Model BIT, Art. 10(3) (c), *ibid*. 301; Kenya Model BIT, Art. 10(b)(ii), 10(c), *ibid*. 310; Uganda Model BIT, Art. 7(3), *ibid*. 317; Ghana Model BIT, Art. 9(2)(b), *ibid*. (Vol. XIII) 284; Romania Model BIT, Art. 10(1), *ibid*. 291; Canada Model BIT, Art. 27(1)(a),(b), *ibid*. (Vol. XIV) 240; Germany Model BIT (2005), Art. 11, Appendix 7; France Model BIT (2006), Art. 8, Appendix 6; China Model BIT (1997), Art. 9(2) (b) ('provided that the Contracting Party involved in the dispute may require the investor to go through the domestic procedures specified by the laws and regulations of the Contracting Party before the submission to the ICSID'); UK Model BIT (2005), Art. 8(2)(a) (if 'the national or company and the Contracting Party concerned in the dispute may agree …'), Appendix 5; Energy Charter Treaty, Art. 26(4); NAFTA, Art. 1120(1), Appendix 3.

[11] Asian–African Legal Consultative Committee Model 'A' BIT, Art. 10(v), UNCTAD Compendium (Vol. III, 1996) 122; Asian–African Legal Consultative Committee Model 'B' BIT, Art. 10(v), *ibid*. 133; UK 'Alternative' Model BIT, Art. 8, *ibid*. 189; Egypt Model BIT, Art. 8(2)(c), *ibid*. (Vol. V, 2000) 297; Indonesia Model BIT, Art. 8(3)(b), *ibid*. 313; Sri Lanka Model BIT, Art. 8(2)(f), *ibid*. 343; Cambodia Model BIT, Art. 8(3)(b), *ibid*. (Vol. VI, 2002) 467; Iran Model BIT, Art. 12(6), *ibid*. 483; USA Model BIT, Art. 9(3)(a)(iii), *ibid*. 507; Austria Model BIT, Art. 12(1)(c), *ibid*. (Vol. VII) 265; Belgo-Luxembourg Economic Union Model BIT, Art. 10(3), *ibid*. 275; Denmark Model BIT, Art. 9(2)(c), *ibid*. 283; Finland Model BIT, Art. 9(2)(d), *ibid*. 292; Turkey Model BIT, Art. 7(2)(b), *ibid*. 284; Benin Model BIT, Art. 9(3)(b), *ibid*. (Vol. IX) 284; Mongolia Model BIT, Art. 8(2)(b), *ibid*. 306; Sweden Model BIT, Art. 8(2), *ibid*. 313; Indonesia Model BIT, Art. 3(b), *ibid*. (Vol. V) 313; Bolivia Model BIT, Art. 10, *ibid*. (Vol X) 283;

– arbitration pursuant to the Rules of Arbitration of the International Chamber of Commerce;[12]
– arbitration pursuant to the Rules of Arbitration of the Stockholm Chamber of Commerce;[13]
– arbitration pursuant to the Rules of the Cour Commune de Justice et d'Arbitrage (CCJA);[14]
– a settlement procedure previously agreed to between the investor and host state.[15]

4. In relation to state/state disputes, investment treaties almost without exception refer such disputes to *ad hoc* arbitration with the President of the International Court of Justice nominated as the appointing authority.[16] Also,

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Burkina Faso Model BIT, Art. 9(2)(d), *ibid*. 292; Guatemala Model BIT, Art. 8(d), *ibid*. (Vol. XII) 292; Italy Model BIT, Art. 10(3)(b), *ibid*. 301; Uganda Model BIT, Art. 7(3), *ibid*. 317; Ghana Model BIT, Art. 9(2)(c), *ibid*. (Vol. XIII) 284; Romania Model BIT, Art. 10(2)(b), *ibid*. 291; Canada Model BIT, Art. 27(1)(c), *ibid*. (Vol. XIV) 240; UK Model BIT (2005), Art. 8 (2) ('If after a period of six months from written notification of the claim this is no agreement on one of the above procedures [ICSID or ICSID Additional Facility, ICC or UNCITRAL]'), Appendix 10; Energy Charter Treaty, Art. 26(4), Appendix 4; NAFTA, Art. 1120(1), Appendix 3.

[12] UK 'Alternative' Model BIT, Art. 8(2)(b), UNCTAD Compendium (Vol. III, 1996) 190; Austria Model BIT, Art. 12(1)(c), *ibid*. (Vol. VII) 265; Belgo-Luxembourg Economic Union Model BIT, Art. 10(3), *ibid*. 275; Denmark Model BIT, Art. 9(2)(d), *ibid*. 283; Germany Model BIT, Art. 11, *ibid*. 301; Guatemala Model BIT, Art. 8(c), *ibid*. (Vol. XII) 292; Uganda Model BIT, Art. 7(3), *ibid*. 317; UK Model BIT (2005), Art. 8(2)(b), Appendix 10; Germany Model BIT, Art. 11, Appendix 7.

[13] Sri Lanka Model BIT, Art. 8(2)(e), UNCTAD Compendium (Vol. V, 2000) 343; Belgo-Luxembourg Economic Union Model BIT, Art. 10(3), *ibid*. (Vol. VII, 2002) 275; Energy Charter Treaty, Art. 26(4).

[14] Burkina Faso Model BIT, Art. 9(2)(b), *UNCTAD Compendium* (Vol. X) 292.

[15] USA Model BIT, Art. 9(3)(a)(iv), UNCTAD Compendium (Vol. VI, 2002) 507; Austria Model BIT, Art. 12(1)(b), *ibid*. (Vol. VII) 264; Guatemala Model BIT, Art. 8(d), *ibid*. (Vol. XII) 292; Kenya Model BIT, Art. 10(b)(iii), 10(c), *ibid*. 310; Ghana Model BIT, Art. 9(2)(c), *ibid*. (Vol. XIII) 284; Romania Model BIT, Art. 10(2)(b), *ibid*. 291; Canada Model BIT, Art. 27(d), *ibid*. (Vol. XIV) 240 ('any other body of rules approved by the Commission as applicable for arbitration under this Section', the Commission to be established in accordance with Art. 51 and 'comprising cabinet-level representatives of their designees'); Energy Charter Treaty, Art. 26 (2)(6), Appendix 4.

[16] Asian–African Legal Consultative Committee Model BIT, Art. 11(iii), UNCTAD Compendium (Vol. III, 1996) 122; Chile Model BIT, Art. 9(4), *ibid*. 148; China Model BIT, Art. 8(4), *ibid*. 154; Switzerland Model BIT, Art. 9(4), *ibid*. 182; UK Model BIT, Art. 9(4), *ibid*. 191; Egypt Model BIT, Art. 9(4), *ibid*. (Vol. V, 2000) 298; Jamaica Model BIT, Art. 9(4), *ibid*. 321; Malaysia Model BIT, Art. 8(4), *ibid*. 330; Netherlands Model BIT, Art. 12(4), *ibid*. 337; Sri Lanka Model BIT, Art. 9(4), *ibid*. 344; Croatia Model BIT, Art. 11, *ibid*. (Vol. VI, 2002) 477; Iran Model BIT, Art. 13, *ibid*. 483–4; Peru Model BIT, Art. 9, *ibid*. 498; Austria Model BIT, Art. 20, *ibid*. (Vol. VII) 267; Belgo-Luxembourg Economic Union Model BIT, Art. 11, *ibid*. 276; Denmark Model BIT, Art. 10, *ibid*. 284–5; Finland Model BIT, Art. 10, *ibid*. 293; Germany Model BIT, Art. 10, *ibid*. 300–1; South Africa Model BIT, Art. 8, *ibid*. (Vol. VIII) 277; Turkey Model BIT, Art. 8, *ibid*. 284–5; Benin Model BIT, Art. 8, *ibid*. (Vol. IX) 282–3; Burundi Model BIT, Art. 9, *ibid*. 292–3; Mauritius Model BIT, Art. 9, *ibid*. 300; Mongolia Model BIT, Art. 9, *ibid*. 306–7; Sweden Model BIT, Art. 9, *ibid*. 314. The USA Model BIT nominates the Secretary-General of ICSID as the appointing authority: Art. 10, *ibid*. (Vol. VI) 508; Bolivia Model BIT, Art. 10, *ibid*. (Vol. X) 283; Burkina Faso Model BIT, Art. 10(5), *ibid*. 293; Guatemala Model BIT, Art. 9(4), *ibid*. (Vol. XII) 293; Italy Model BIT, Art. 9(5), *ibid*. 300–1; Kenya Model BIT, Art. 11(d), *ibid*. 310; Uganda

in the vast majority of cases, investment treaties prescribe that the arbitral tribunal shall determine its own rules of procedure. In the rare instances that a model set of rules is specified, those rules designed for public international law arbitrations between states are generally preferred.[17]

5. The rights and obligations as between the state parties to investment treaties arise in the context of a classic bilateral relationship on the international plane and are opposable by one state party against another on that basis. Furthermore, disputes between the contracting states fit into the familiar paradigm of arbitrations governed by public international law. In contradistinction, it will be demonstrated in this chapter that the public international law paradigm for international claims for harm to individuals or legal entities – the customary law of diplomatic protection – is inappropriate as a foundation for the rationalisation of the legal relationship between the private investor and the host state of the investment. It is a relationship that can only be described as *sui generis*; one of the principal objectives of this study is to give precise content to that characterisation.

B. THE LEGAL CHARACTER OF THE INVESTMENT TREATY REGIME

6. The analytical challenge presented by the investment treaty regime for the arbitration of investment disputes is that it cannot be adequately rationalised either as a form of public international or private transnational dispute resolution.[18] Investment treaties are international instruments between states governed by the public international law of treaties. The principal beneficiary of the investment treaty regime is most often a corporate entity established under a municipal law,[19] while the legal interests protected by the regime are a bundle of

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Model BIT, Art. 11(3), *ibid*. 319; Ghana Model BIT, Art. 11(4), *ibid*. (Vol. XIII) 284; Romania Model BIT, Art. 10(3), *ibid*. 291; Canada Model BIT, Art. 48(4), *ibid*. (Vol. XIV) 253. The France Model BIT nominates the Secretary General of the UN, Art. 11: *ibid*. (Vol. V) 307. The Energy Charter Treaty nominates the Secretary General of the Permanent Court of Arbitration: Art. 27, see Appendix 4.

17 The Austria Model BIT selects the Permanent Court of Arbitration Optional Rules for Arbitrating Disputes, Art. 21(2), UNCTAD Compendium (Vol. VII, 2002) 267. The NAFTA Parties have enacted a very detailed set of 'Model Rules of Procedure for Chapter 20 of the NAFTA' (relating to state/state disputes) in accordance with Article 2012 of the NAFTA. Conversely, the Energy Charter Treaty makes no distinction between the procedural rules for investor/state and state/state arbitrations by selecting the UNCITRAL Arbitration Rules for state/state disputes in Article 27(3)(f), see Appendices 3 and 4.

18 See, e.g.: J. Paulsson, 'Arbitration Without Privity' (1995) 10 *ICSID Rev – Foreign Investment LJ* 232, 256 ('[T]his is not a sub-genre of an existing discipline. It is dramatically different from anything previously known in the international sphere').

19 See the commentary to Rule 7 below.

rights in an investment arising under a different municipal law.[20] The standards of protection are prescribed by the international treaty,[21] but liability for their breach is said to give rise to a 'civil or commercial' award for enforcement purposes.[22]

7. There is nothing revolutionary in abandoning the simple dichotomy between public and private international law conceptions of dispute resolution. Modern international society and commerce are characterised by a complex and sometimes disordered web of relationships between states, individuals, international organisations and multinational corporations. As this web grows in density and coverage, traversing territorial and jurisdictional frontiers, the challenges for the international or transnational legal order become ever more acute. The response to these challenges has often been in the form of innovative international treaties that introduce an array of substantive norms and a distinct dispute resolution mechanism. In the sphere of legal relationships between private entities and sovereign states, there are parallels between the legal regime created by investment treaties on the one hand, and those regimes established by the European Convention on Human Rights,[23] and the Algiers Accords (creating the Iran/US Claims Tribunal), on the other.[24] Anyone within the 'juridical space' of the European Convention on Human Rights has the right to pursue remedies directly against a contracting state party for violations of international minimum standards of treatment, formulated as universal and inalienable human rights, before an international tribunal.[25] Nationals of Iran and the United States have the right to pursue remedies directly against the other state for certain violations of international minimum standards of treatment, such as the prohibition against

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[20] See the commentary to Rule 4 below.

[21] See the commentary to Rule 10 below.

[22] See the commentary to Rule 12 below.

[23] This link was made by G. Burdeau, 'Nouvelles perspectives pour l'arbitrage dans le contentieux économique intéressant l'Etat' (1995) *Revue de l'arbitrage* 3, 16 ('[L]a "philosophie" des deux mécanismes paraît la même: il s'agit dans l'un et l'autre cas d'ouvrir à des particuliers non identifiés à l'avance un droit de recours direct contre un Etat en vue de sanctionner le respect de l'engagement pris par ce dernier dans un traité international d'accorder un certain traitement à des personnes privées.').

[24] Investment treaty tribunals, and counsel pleading before them, cite precedents of the Iran/US Claims Tribunal with great frequency. However, the tribunal in *Pope & Talbot v Canada* (First Merits) 7 ICSID Rep 69, 84–94 and 84–104, appeared to reject the significance of the precedents of the Iran/US Claims Tribunal in relation to the prohibition against expropriation in Article 1110 of NAFTA. For a critique of this approach: M. Brunetti, 'The Iran-United States Claims Tribunal, NAFTA Chapter 11, and the Doctrine of Indirect Expropriation' (2001) *2 Chicago J of Int L* 203.

[25] See generally: J. Fawcett, *The Application of the European Convention on Human Rights* (1987); P. Van Dijk and G. Van Hoof, *Theory and Practice of the European Convention of Human Rights* (2006, 4th edn); D. Harris, M. O'Boyle and A. Warbick, *Law of the European Convention on Human Rights* (1995); D. Shelton, *Remedies in International Human Rights Law* (2004, 2nd edn) 147; M. Janis, R. Kay and A. Bradley, *European Human Rights Law* (2008, 3rd edn); A. Mowbray, *Cases and Materials on the European Convention on Human Rights* (2007, 2nd edn); R. Blackburn and J. Polakiewicz (eds.), *Fundamental Rights in Europe* (2002); H. Steiner, P. Alston and R. Goodman, *International Human Rights in Context* (2007, 3rd edn).

uncompensated expropriation, before an international tribunal.[26] The right of recourse to the European Court of Human Rights, the Iran/US Claims Tribunal and the international tribunals established pursuant to investment treaties has catapulted individuals and corporate entities into an international system of adjudication alongside states. In this respect also the traditional view of the international legal order that relegated individuals and corporate entities to the status of mere 'objects' of international law is no longer sustainable.[27]

8. An analysis of these different treaty regimes would be distorted if one were to adhere to a strict distinction between public and private international law conceptions of dispute resolution. Many of the awards of investment treaty tribunals – and the pleadings of parties to these disputes – disclose a dogmatic distinction between 'international' or 'treaty' versus 'municipal' or 'contractual' spheres, as if each concept can be forced into a separate hermetically sealed box. By characterising the status of an investment treaty tribunal as 'international', arbitrators have professed to occupy a position of supremacy in a 'hierarchy' of legal orders to justify the relegation of any competing law or jurisdiction. The principle of international law that is used to buttress this approach, whether expressly or implicitly, is the rule of state responsibility that a state cannot invoke provisions of its own law to justify a derogation from an international obligation. Article 3 of the ILC's Articles on the Responsibility of States for International Wrongs, titled 'Characterization of the act of a State as internationally wrongful', is a codification of this rule, which reads:

> The characterization of an act of a State as internationally wrongful is governed by international law. Such characterization is not affected by the characterization of the same act as lawful by internal law.[28]

9. When an investment treaty tribunal rules upon the international legality of a state's conduct then an appeal to this conflict-regulating norm is entirely justified. But investment disputes give rise to a host of other issues that do not generate a clash between the international and municipal legal orders – questions pertaining to the existence, nature and scope of the private rights

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[26] See generally: G. Aldrich, *The Jurisprudence of the Iran–United States Claims Tribunal* (1996); R. Lillich, D. Magraw and D. Bederman, *The Iran–United States Claims Tribunal: Its Contribution to the Law of State Responsibility* (1997); C. Brower and J. Brueschke, *The Iran–United States Claims Tribunal* (1998); M. Mohebi, *The International Law Character of the Iran–United States Claims Tribunal* (1999); C. Drahozal and C. Gibson, *The Iran–U.S. Claims Tribunal at 25* (2007).

[27] The 'father' of the positivist conception of the subjects of international law was arguably Bentham, who in 1789 defined international law as 'the mutual transactions between sovereigns': J. Bentham, *Introduction to the Principles of Morals and Legislation* (1789) 296. Janis has pointed out the irony that in the same year as Bentham propounded this thesis, the First United States Congress authorised suits by individuals to address grievances under the law of nations before the Federal District Courts pursuant to the Judiciary Act: M. Janis, 'Subjects of International Law' (1984) 17 *Cornell Int L J* 61.

[28] The ILC's Articles and official commentary thereto are reproduced in: Crawford, *ILC's Articles*, 61.

comprising the investment being the prime example. These matters are outside the purview of international law and the rule of state responsibility just recalled. To treat international law as a self-sufficient legal order in the sphere of foreign investment is untenable. At the intersection of private investment rights and international investment regulation, problems relating to overlapping adjudicative competence and the application of municipal law cannot be resolved by playing the simple 'international trump card' of Article 3 of the ILC's Articles.

10. There is, moreover, precious little utility in adopting a binary classification scheme that distinguishes between 'international' and 'municipal' in respect of procedural matters. Witness the example of the Iran/US Claims Tribunal, whose precise legal status remains a subject of controversy even as its mandate expires after nearly thirty years of activity. The literature on the subject testifies to a complete lack of consensus. Judge Brower of the Tribunal asserts that 'there can be little doubt that the Tribunal is an international institution established by two sovereign States and subject to public international law'.[29] Similarly, Fox regards the Tribunal as an example of 'private claims taken up by the State and presented through an inter-State arbitration'.[30] The Iranian writer, Seifi, emphasises the Tribunal's 'exclusively international character',[31] while the American writer, Caron, takes the view that, at least in relation to claims involving nationals, 'the Accords established a clear presumption that the legal system of the Netherlands would govern the Tribunal's arbitral process'.[32] Two Dutch lawyers, Hardenberg and van den Berg, reach contrary conclusions on the applicability of Dutch law as the *lex loci arbitri*.[33] Other commentators have perhaps sought the middle ground in describing the procedural regime for the Iran/US Claims Tribunal as 'denationalised':

> [I]t appears truer to the Accords to recognize the Tribunal as a denationalized body subject to its organic treaty and its rules, but not to national arbitral law.[34]

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[29] Brower and Brueschke, *The Iran–United States Claims Tribunal*, 16.

[30] H. Fox, 'States and the Undertaking to Arbitrate' (1988) 37 *ICLQ* 1, 3.

[31] J. Seifi, 'State Responsibility for Failure to Enforce Iran–United States Claims Tribunal Awards by the Respective National Courts: International Character and Non-Reviewability of the Awards Reconfirmed' (1999) 16 *J of Int Arbitration* 5, 17.

[32] D. Caron, 'The Nature of the Iran–United States Claims Tribunal and the Evolving Structure of International Dispute Resolution' (1990) 84 *AJIL* 104, 146.

[33] L. Hardenberg, 'The Awards of the Iran–US Claims Tribunal Seen in Connection with the Law of the Netherlands' (1984) *Int Business Lawyer* 337 (concluding that Dutch law does not apply as the *lex loci arbitri*); A. van den Berg, 'Proposed Dutch Law on the Iran–United States Claims Settlement Declaration, A Reaction to Mr. Hardenberg's Article' (1984) *Int Business Lawyer* 341 (concluding that Dutch law does apply).

[34] W. Lake and J. Dana, 'Judicial Review of Awards of the Iran–United States Claims Tribunal: Are the Tribunal's Awards Dutch?' (1984) 16 *Law & Policy in Int Business* 755, 811. Sacerdoti also avoids the public/private dichotomy simply by characterising the awards as commercial arbitral awards: G. Sacerdoti, 'Bilateral Investment Treaties and Multilateral Instruments on Investment

11. An Iranian writer, Avanessian, agrees with this analysis, but adds:

> [The Tribunal] somehow exists and operates on the borderline of public and private international law, sometimes falling in the domain of one and sometimes in that of the other.[35]

12. A complete spectrum of views can thus be distilled from the literature on the juridical status of the Iran/US Claims Tribunal. The fact that the writers just mentioned reach divergent conclusions on this subject should at least put those dealing with investment treaty arbitration on notice of the complexity of the issues at hand. Any single-sentence proclamations about the true nature of the legal regime for the settlement of investor/state disputes must be viewed with scepticism.

Rule 1. Where the contracting states to an investment treaty have agreed to a procedure for the judicial settlement of disputes between an investor and the host state, a claim advanced by the investor in accordance with such procedure is its own claim and the national contracting state of the investor has no legal interest in respect thereof.

Rule 2. The rules of admissibility of diplomatic protection in general international law are not generally applicable to the regime for the settlement of disputes between an investor and the host state created by an investment treaty.

A. THE BENEFICIARY OF INVESTMENT TREATY RIGHTS

13. In this chapter we are concerned with a question of singular importance: whether a claimant investor, by prosecuting an investment treaty claim, is vindicating its own rights conferred by the treaty or is acting as a proxy for its national state as the true repository of the rights and obligations set out in the treaty. From the perspective of public international law the same question can be formulated differently: does the investor/state arbitral mechanism in the modern investment treaty create a device for triggering the rights and obligations of diplomatic protection? If it does, then the investor would essentially be stepping into the shoes of its national state and bringing a claim on behalf of its national

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Protection' (1997) 269 *Hague Recueil* 251, 423 ('[J]udgments issued by the Tribunal on private claims can be equated to those of international commercial arbitral tribunals and … can be enforced accordingly.').

[35] A. Avanessian, 'The New York Convention and Denationalised Arbitral Awards (With Emphasis on the Iran–United States Claims Tribunal)' (1991) *J of Int Arbitration* 5, 8.

state. This is the 'derivative' as opposed to 'direct' model for rationalising the juridical nature of investment treaty arbitration.

14. The implications that follow either approach range from the possibility of the investor's waiver of investment treaty protection to the justiciability of the judicial review of arbitral awards rendered by investment treaty tribunals. Moreover, if the investment treaty regime can be conceptualised according to the 'derivative' model, then it would be logical to import into the investment treaty regime the admissibility rules of diplomatic protection in general international law.

15. For the purposes of the following analysis, a distinction will be made between the procedural right to prosecute an international arbitration against the host state and the substantive obligations of treatment upon which the claims in such an arbitration are founded.

B. THE 'DERIVATIVE' MODEL VERSUS THE 'DIRECT' MODEL

(i) The 'derivative' model and diplomatic protection

16. At the heart of the 'derivative' theory is the idea that investment treaties 'institutionalise and reinforce'[36] the system of diplomatic protection. In accordance with this model, the obligations of minimum treatment are owed to the contracting states just as in general international law, but those states confer standing upon their national investors to enforce such obligations before an international tribunal. Investors therefore procedurally step into the shoes of their national state, without thereby becoming privy to their inter-state legal relationship. This was the procedural regime adopted by the Mixed Claims Commissions established to hear US and British claims against Latin American states including Mexico, Chile, Venezuela and Peru as well as claims against Germany after the First World War.[37] As the institution of diplomatic protection forms the centrepiece of the 'derivative' model it is necessary to examine the legal relationships that are generated by that institution.

17. The rights and obligations in the general international law of diplomatic protection arise exclusively as between states. The injured foreign national is not privy to this legal relationship and is thus impotent to enforce the obligations of general international law in its own right. This has been the orthodox view of

[36] J. Crawford, 'The ILC's Articles on Responsibility of States for International Wrongful Acts: A Retrospect' (2002) 96 *AJIL* 874, 888.
[37] J. Simpson and H. Fox, *International Arbitration, Law and Practice* (1959) Chs. 1–4.

diplomatic protection since it was first rationalised by Vattel in the middle of the eighteenth century:

> Anyone who mistreats a citizen directly offends the State. The sovereign of that State must avenge its injury, and if it can, force the aggressor to make full reparation or punish him, since otherwise the citizen would simply not obtain the main goal of civil association, namely, security.[38]

18. Borchard, in his influential treatise on diplomatic protection in 1913, was able to divine a consistent line of judicial authority supporting Vattel's rationalisation of diplomatic protection, and on this basis articulated his own restatement of the principle:

> Diplomatic protection is in its nature an international proceeding, constituting an appeal by nation to nation for the performance of the obligations of the one to the other, growing out of their mutual rights and duties.[39]

19. It was some years later that the Permanent Court of International Justice made its pronouncement in the *Mavrommatis Palestine Concessions* case[40] in line with these earlier authorities:

> It is an elementary principle of international law that a State is entitled to protect its subjects, when injured by acts contrary to international law committed by another State, from whom they have been unable to obtain satisfaction through the ordinary channels. By taking up the case of one of its subjects and by resorting to diplomatic action or international judicial proceedings on his behalf, a State is in reality asserting its own rights – its right to ensure, in the person of its subjects, respect for the rules of international law.[41]

20. The dispute in *Mavrommatis Palestine Concessions* originated in the British Government's decision, as Mandatory for Palestine, to grant concessions for the provision of public services which duplicated earlier concessions obtained by a Greek national (Mavrommatis) from the previous ruler of Palestine (the Ottoman Empire). The Permanent Court found that upon the election by the Government of Greece to espouse a diplomatic protection claim to redress the wrong to its national, the dispute became a dispute between the Mandatory (United Kingdom) and a member of the League of Nations, Greece,

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[38] E. de Vattel, *Le droit des gens ou les principes de la loi naturelle* (Vol. I, 1758) 309. The context of Vattel's formulation of diplomatic protection, as an alternative to the private right of reprisal, is explained by R. Lillich, 'The Current Status of the Law of State Responsibility for Injuries to Aliens', in R. Lillich (ed.), *International Law of State Responsibility for Injuries to Aliens* (1983) 2–3.

[39] E. Borchard, *The Diplomatic Protection of Citizens Abroad or The Law of International Claims* (1915) 354; J. Brierly, 'Implied State Complicity in International Claims' (1928) 9 *BYBIL* 48.

[40] (*UK v Greece*) 1924 PCIJ (Ser. A) No. 2.

[41] *Ibid*. 12.

for the purposes of the dispute resolution provision contained in the British Mandate over Palestine.[42]

21. The *Mavrommatis* 'formula' was applied in several other cases before the Permanent Court[43] and found its way into the judgments of the International Court of Justice[44] and several other international tribunals[45] so that its continued validity is beyond doubt.[46] This is not to say that the modalities of diplomatic protection have not come under criticism as out of step with the modern system of international law, which elevates the rights of individuals and private entities to a more prominent place. But deviations from the orthodox position articulated in *Mavrommatis Palestine Concessions* have been few and unpersuasive. García Amador argued that developments in international human rights law have rendered the device whereby a state asserts its own right when it acts on behalf of its national an 'outdated fiction' that should be discarded.[47] O'Connell likewise rejected the *Mavrommatis* formula as 'a survival of the nineteenth-century thesis of a world composed of absolute sovereignties unwilling to limit their sovereign freedom of action except in their own interests'.[48] These critiques may be fair, but far from providing an analytical rationale for rejecting the received orthodoxy in general international law, they simply anticipate the reason that human rights conventions and investment treaties now overshadow recourse to diplomatic protection. Attempts to equate the traditional institution of diplomatic protection to the new treaty regimes that provide direct rights of recourse are counterproductive because they ultimately undermine the possibility of diplomatic protection assuming even a residual role in the resolution of international disputes.[49]

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[42] *Ibid*.

[43] *Panecezys-Saldutiskis Railway* (*Estonia v Latvia*) 1938 PCIJ (Ser. A/B) No. 76; *Serbian and Brazilian Loans* (*France v Serbia*) 1929 PCIJ (Ser. A) No. 20; *Chorzów Factory* (*Germany v Poland*) 1928 PCIJ (Ser. A) No. 17 (Merits).

[44] *Reparations for Injuries Suffered in the Service of the United Nations Case (Advisory Opinion)* 1949 ICJ Rep 174, 181 ('[T]he defendant State has broken an obligation towards the national State in respect of its nationals.'); *Nottebohm* (*Liechtenstein v Guatemala*) 1954 ICJ Rep 4; *Barcelona Traction, Light and Power Co. Ltd* (*Belgium v Spain*) 1970 ICJ Rep 4.

[45] *Administrative Decision No. V* (*USA v Germany*) 7 RIAA 140 (1924) *per* Umpire Parker: ('[T]he nation is injured through injury to its national and it alone may demand reparation as no other nation is injured.') See also the cases cited by: C. Amerasinghe, *Local Remedies in International Law* (1990) 57 at note 15; C. Parry, 'Some Considerations upon the Protection of Individuals in International Law' (1956) *Hague Recueil* 672, 676–80.

[46] J. Dugard, 'First Report on Diplomatic Protection' (2000) UN Doc A/CN.4/506, paras. 10–32.

[47] F. García Amador, 'State Responsibility. Some New Problems' (Vol. II, 1958) 94 *Hague Recueil* 421, 437–9, 472.

[48] D. O'Connell, *International Law* (Vol. 2, 1970, 2nd edn) 1030; C. de Visscher, 'Cours général de principes de droit international public' (1954/II) 86 *Hague Recueil*, 507 ('[Diplomatic protection is] a procedure by which States assert the right of their citizens to a treatment in accordance with international law').

[49] In her report to the Committee on Diplomatic Protection of Persons and Property of the International Law Association, Kokott raised two possible approaches to the law of diplomatic protection. The first is to 'call for a change of the rules governing diplomatic protection with the

22. The notion of a vicarious injury caused to the state of the national is essential to the rationalisation of diplomatic protection because it transforms damage done to private interests into an international delict opposable by one sovereign state to another. This transformation is not a procedural quirk or 'fiction' as is sometimes maintained,[50] but is instead fundamental to the compatibility of diplomatic protection with the traditional principles of state responsibility for international wrongs. As Judge Fitzmaurice stated in *Barcelona Traction*:

> Clearly the 'bond of nationality' between the claimant State and the private party for whom the claim is brought must be in existence at the time when the acts complained of occurred, or it would not be possible for the claimant State to maintain that it had suffered a violation of international law 'in the person of its national', – and although this doctrine has been called the 'Vatellian fiction', it nevertheless seems to constitute an indispensable foundation for the right of international claim on behalf of private parties.[51]

23. It would be a mistake, therefore, to postulate that the international law of diplomatic protection could do without this transformation if push came to shove. A state bringing a diplomatic protection claim is not an agent of its national who has a legally protected interest at the international level; the state is rather seeking redress for the breach of an obligation owed to itself.[52]

(ii) The 'derivative' model and the Iran/US Claims Tribunal

24. The Iran/US Claims Tribunal, established by the Algiers Accords,[53] has jurisdiction over: (i) claims by American and Iranian nationals against Iran and the United States respectively that 'arise out of debts, contracts … expropriations or other measures affecting property rights';[54] (ii) 'official claims of the United States and Iran against each other arising out of contractual arrangements

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aim of meeting the demands of investors'. The second option, which the author endorsed as more 'realistic', is 'to accept that, in the context of foreign investment, the traditional law of diplomatic protection has been to a large extent replaced by a number of treaty-based dispute settlement procedures'. It is submitted that Kokott's conclusion is correct. J. Kokott, 'Interim Report on the Role of Diplomatic Protection in the Field of the Protection of Foreign Investment' in International Law Association, *Report of the Seventieth Conference, New Delhi* (2002) 31. It was later adopted by the ILA: F. Orrego Vicuna, D. Bederman and J. Kokott, 'Diplomatic Protection of Persons and Property', in International Law Association, *Report of the Seventy second Conference, Toronto* (2006) 388.

50 J. Dugard, 'First Report on Diplomatic Protection' (2000) UN Doc A/CN.4/506, paras. 19–21.

51 *Barcelona Traction, Light and Power Co. Ltd* (*Belgium v Spain*) 1970 ICJ Rep 4, 99 at para. 61.

52 The ILC's Articles on Diplomatic Protection are neutral as to whether the state exercising diplomatic protection does so in its own right or that of its national: ILC, *Report of the Fifty-eighth Session* (2006) UN Doc A/CN 4/L 684, Commentary to Art. 1 at para. 5.

53 The General Declaration and the Claims Settlement Declaration (the 'Algiers Accords') are reproduced at: (1981) 75 *AJIL* 418.

54 Art. II(1) of the Claims Settlement Declaration.

between them for the purpose and sale of goods and services';[55] and (iii) disputes between Iran and the United States concerning the interpretation or performance of the General Declaration or the Claims Settlement Declaration.[56]

25. There is an important difference between the three types of jurisdiction vested in the Iran/US Claims Tribunal[57] for the investment treaty regime. Investor/state disputes under investment treaties most closely resemble the first of the three heads of jurisdiction of the Iran/US Claims Tribunal because private interests are clearly at stake. Therefore it is valuable to examine how the Tribunal itself has rationalised the nature of the claimant's cause of action. Is this an example of a private claimant stepping into the shoes of its national state?

26. The issue arose most directly in the *Dual Nationality* case.[58] Iran challenged the admissibility of claims brought against it by persons who were both citizens of the United States and Iran by relying on a rule of general international law prohibiting the exercise of diplomatic protection on behalf of a national who also has the nationality of the respondent state.[59] Iran justified its reliance on this rule on the basis that the Algiers Accords 'intended the function of the Tribunal to be the adjudication of international claims on the basis of the exercise of diplomatic protection'.[60]

27. The Full Tribunal rejected Iran's argument emphatically, clearly distinguishing its jurisdiction over inter-state disputes from its jurisdiction extending to private claimants:

> While this Tribunal is clearly an international tribunal established by treaty and while some of its cases involve the interpretation and application of public international law, most disputes (including all of those brought by dual nationals) involve a private party on one side and a Government or Government-controlled entity on the other, and many involve primarily issues of municipal law and general principles of law. In such cases it is rights of the claimant, not of his nation, that are to be determined by the Tribunal.[61]

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[55] *Ibid*. Art. II(2).
[56] *Ibid*. Art. II(3).
[57] The distinction is explored by some writers, including: D. Lloyd Jones, 'The Iran–United States Claims Tribunal: Private Rights and State Responsibility' (1984) 24 *Victoria J of Int L* 259, 261–2; H. Fox, 'States and the Undertaking to Arbitrate' (1988) 37 *ICLQ* 1, 21.
[58] *Iran v USA* (Case DEC 32-A18-FT, 6 April 1984) (Dual Nationality) 5 Iran-US CTR 251.
[59] *Ibid*.
[60] *Ibid*. 254.
[61] *Ibid*. 26. See also: Concurring Opinion of Willem Riphagen, *ibid*. paras. 2–3; *Esphanian (Nasser) v Bank Tejarat* (Case 31-157-2, 29 March 1983) 2 Iran-US CTR 157, 165 ('[T]he agreement of the two Governments to create this Tribunal was not a typical exercise of diplomatic protection of nationals in which a State, seeking some form of international redress for its nationals, creates a tribunal to which it, rather than its nationals, is a party. In that typical case, the State espouses the claims of its nationals, and the injuries for which it claims redress are deemed to be injuries to itself; here, the Government of the United States is not a party to the arbitration of claims of United States nationals, not even in the same claims where it acts as counsel for these nationals.').

28. The Full Tribunal later reiterated in Case A/21, when confronted again with Iran's submission that the claims of nationals are in reality the claims of their governments, that 'Tribunal awards uniformly recognize that no espousal of claims by the United States is involved in the cases before it.'[62]

(iii) The 'derivative' model and investment treaty arbitration

29. In the investment treaty context, the leading authority for a 'derivative' conceptualisation of the international claim brought by the investor is *Loewen v USA*.[63] The tribunal first endorsed a sharp distinction between the 'municipal' and 'international' legal orders in its description of the rights and obligations existing under NAFTA:

> Rights of action under private law arise from personal obligations … brought into existence by domestic law and enforceable through domestic tribunals and courts. NAFTA claims have a quite different character, stemming from a corner of public international law in which, by treaty, the power of States under that law to take international measures for the correction of wrongs done to its nationals has been replaced by an ad hoc definition of certain kinds of wrong, coupled with specialist means of compensation.[64]

30. Upon this foundation, the tribunal then articulated a 'derivative' scheme for understanding the investor's claim:

> There is no warrant for transferring rules derived from private law into a field of international law where *claimants are permitted for convenience to enforce what are in origin the rights of Party states*.[65]

31. The result of this derivative approach in *Loewen* was the application of the continuous nationality rule in diplomatic protection. In the NAFTA context, the United States of America,[66] Canada[67] and

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[62] *Iran v USA* (Case DEC 62-A21-FT, 4 May 1987) (State Party Responsibility for Awards Rendered against its Nationals) 14 Iran-US CTR 324, 330 at para. 12. The position was different in relation to the small claims: Claims Settlement Declaration, Article III(3) ('Claims of nationals of the United States and Iran that are within the scope of this Agreement shall be presented to the Tribunal either by claimants themselves or, in the case of claims of less than $250,000, by the government of such national.').

[63] (Merits) 7 ICSID Rep 442.

[64] *Ibid*. 488/233.

[65] *Ibid*. 488/233 (emphasis added). Elsewhere in its award, the *Loewen* tribunal appears to contradict this 'derivative' approach by stating that 'Chapter Eleven of NAFTA represents a progressive development in international law whereby the individual investor may make a claim on its own behalf and submit the claim to international arbitration' *ibid*. 485/223.

[66] See, in particular, the US Government's arguments to the effect that 'direct claims' are no different, and subject to the same rules as 'espoused claims': Reply to the Counter-Memorial of the Loewen Group, Inc on Matters of Jurisdiction and Competence (26 April 2002) 33 *et seq*., available at: www.state.gov/documents/organization/9947.pdf.

[67] *S.D. Myers v Canada* (Merits) 8 ICSID Rep 18; Amended Memorandum of Fact and Law of the Applicant, the Attorney General of Canada, *The Attorney General of Canada v S.D. Myers, Inc*, Court File No. T-225-01, para. 67, available at: www.dfait-maeci.gc.ca/tna-nac/documents/Myersamend.pdf ('The obligations listed in Section A of NAFTA Chapter Eleven are not owed

Mexico[68] have argued for the derivative model in defending claims based upon the NAFTA Chapter 11 obligations.

(iv) The investment treaty regime and diplomatic protection distinguished

32. In deciding between the competing 'derivative' and 'direct' theories, the starting point must be that international legal theory allows for both possibilities. There is no impediment to states in effect delegating their procedural right to bring a diplomatic protection type claim to enforce the substantive rights of the states concerned within a special treaty framework. On the other hand, there is also no reason why an international treaty cannot create rights for individuals and private entities, whether or not such rights fall to be classified as 'human rights'. This was the conclusion of the International Court of Justice in the *LaGrand* case.[69]

33. The following analysis of the practice of investment treaty arbitration suggests that investment treaties do not give legislative effect to the 'derivative' model based on the *Mavrommatis* formula for the presentation of international claims against a state, but rather encapsulate a 'direct' model.

(1) Functional control of the claim

34. In the context of diplomatic protection, the state of the injured national has full discretion as to whether to take up the claim on behalf of its injured national at all.[70] It may waive, compromise or discontinue the presentation of the claim irrespective of the wishes of the injured national.[71] In exercising this discretion, the state often gives paramount consideration to the wider ramifications of the espousal of a diplomatic protection claim for the conduct of its foreign policy vis-à-vis the host state.[72] If the state does elect to espouse a diplomatic

directly to individual investors. Rather, the disputing investor must prove that the NAFTA Party claimed against has breached an obligation owed to another NAFTA Party under Section A and that the investor had incurred loss or damage by reason of or arising out of that breach.').

[68] See Chapter 2 note 357 below.

[69] (*Germany v USA*) Judgment of 27 June 2001, 2001 ICJ Rep 466, 494 at para. 78 ('At the hearings, Germany further contended that the right of the individual to be informed without delay under Article 36, paragraph 1, of the Vienna Convention was not only an individual right, but has today assumed the character of a human right. In consequence, Germany added, "the character of the right under Article 36 as a human right renders the effectiveness of this provision even more imperative". The Court having found that the United States violated the rights accorded by Article 36, paragraph 1, to the LaGrand brothers, it does not appear necessary to it to consider the additional argument developed by Germany in this regard.').

[70] See the state practice on the regulation of this discretion under municipal law: J. Dugard, 'First Report on Diplomatic Protection' (2000) UN Doc A/CN.4/506, paras. 80–7.

[71] Borchard, *Diplomatic Protection of Citizens Abroad*, 366.

[72] *Barcelona Traction, Light and Power Co. Ltd (Belgium v Spain)* 1970 ICJ Rep 4, 44 at paras. 78–9; G. Berlia, 'Contribution à l'étude de la nature de la protection diplomatique' (1957) *Annuaire français de droit international* 63; A. Lowenfeld, 'Diplomatic Intervention in Investment Disputes' (1967) 61 *American Society Int Law Proceedings* 97.

protection claim then it is master of the claim in the sense that it is not obliged to consult with its national on the conduct of the proceedings. If liability is established then damages are awarded to the state and not to the national, and there is no international rule to compel any form of distribution of the monetary award to the *de cujus*.[73] Moreover, the national state is entitled to compromise the award of full compensatory damages by settling the claim for a reduced amount with the host state. It may enter into a general lump sum agreement for the partial compensation of multiple claims.[74] It may abandon the claim entirely, in effect waiving the right in question.

35. The International Court of Justice gave a stark appraisal of these features of a diplomatic protection claim in *Barcelona Traction*:[75]

> [W]ithin the limits prescribed by international law, a State may exercise diplomatic protection by whatever means and to whatever extent it thinks fit, for it is its own right that the State is asserting…
>
> The State must be viewed as the sole judge to decide whether its protection will be granted, to what extent it is granted, and when it will cease. It retains in this respect a discretionary power the exercise of which may be determined by considerations of a political or other nature, unrelated to the particular case. Since the claim of the State is not identical with that of the individual or corporate person whose cause is espoused, the State enjoys complete freedom of action.[76]

36. The situation with an investment treaty claim is very different. In pursuing its own claim, the investor is under no obligation to inform its national state of the existence of proceedings against the host state, nor to consult with the state on the substantive and procedural issues that arise in the proceedings. The investor is guided in the prosecution of its claim solely by the dictates of self-interest without necessary regard for any consequences to the diplomatic relationship between its national state and the host state. The financial burden of presenting an investment treaty claim falls exclusively on the investor. Damages recovered in the award are to the account of the investor and the national state has no legal interest in the compensation fixed by the arbitral tribunal.

37. Although the point is by no means conclusive, one would expect that if the investor were merely stepping into the shoes of its national state to enforce

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[73] *Administrative Decision No. V* (*USA v Germany*) 7 RIAA 119, 152–3 (1924). See also the precedents cited by: Amerasinghe, *Local Remedies in International Law*, 60 at note 24. The same rule applies in relation to lump sum agreements: D. Bederman, 'Interim Report on Lump Sum Agreements and Diplomatic Protection' in International Law Association, *Report of the Seventieth Conference, New Delhi* (2002) 7.

[74] M. Bennouna, 'Preliminary Report on Diplomatic Protection' (1998) UN Doc A/CN.4/484, para. 20.

[75] *Barcelona Traction, Light and Power Co. Ltd* (*Belgium v Spain*) 1970 ICJ Rep 4.

[76] *Ibid*. 44 at paras. 78–9.

that state's treaty rights, the national state would retain a residual interest in the investment treaty arbitration. The precedents of the American–Turkish Claims Commission are instructive on this point. Many claims were dismissed summarily by the Commission because they were presented directly by counsel retained by the injured nationals. This was found to be incompatible with the diplomatic protection model incorporated into the American–Turkish Claims Settlement of 1937:

> It would, of course, be monstrous to suggest that a government would through some subterfuge pretend to support a claim without having any knowledge of what, if anything, had in some way come before the Commission.[77]

38. The conclusion must be that, in the absence of a specific provision in the BIT to the contrary, the national state of the investor retains no interest in an investment treaty arbitration instituted against another contracting state. It would no doubt be open to states to regulate their nationals' conduct of arbitration proceedings under investment treaties, for example by imposing an obligation to keep the relevant government ministry informed of the existence and progress of such arbitrations. Such a development is not reflected in investment treaty practice and this is consistent with the notion that an investor is invoking its own right in instituting an investment treaty arbitration.

39. This conclusion is reinforced by the instances when the national state of the investor has actually *opposed* its claim before an investment treaty tribunal. In the NAFTA case of *GAMI v Mexico*,[78] the national state of the investor, the United States of America, intervened pursuant to Article 1128 to contend that the tribunal had no jurisdiction to hear GAMI's claim.[79] Likewise, in *Mondev v USA*[80] Canada (the national state of Mondev) made submissions to the tribunal, which, without claiming to address the specific facts, tended to the conclusion that Mondev's claims should be dismissed on the merits.[81] This practice contradicts the view that investors are bringing derivative claims on behalf of their own national state. There may be no community of interest between them in the prosecution of investment treaty arbitrations; indeed, it may well be that their interests are adverse.[82]

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[77] J. Moore, *A Digest of International Law* (1906) 616.

[78] (Merits).

[79] Submission of the United States of America, 30 June 2003, available at: www.state.gov/documents/organization/22212.pdf.

[80] (Merits) 6 ICSID Rep 192.

[81] Second Submission of Canada Pursuant to NAFTA Article 1128, 6 July 2001, available at: www.state.gov/documents/organization/18271.pdf.

[82] In *Occidental Exploration & Production Company v Republic of Ecuador* [2005] EWCA Civ 1116, [2006] QB 432, 12 ICSID Rep 129, 136/16–17, the English Court of Appeal referred to these examples as set out in Z. Douglas, 'The Hybrid Foundations of Investment Treaty Arbitration' (2003) *BYBIL* 151, 169–70 and adopted this writer's conclusion that the situation is 'very different' as compared with diplomatic protection.

(2) The nationality of claims rule

40. The nationality of claims rule in diplomatic protection prescribes that the injured national must have the nationality of the claimant state at the time of injury through to when notice of the claim is presented or the date of the award or judgment.[83]

41. The doctrine of continuous nationality developed in response to the frictions caused by individuals shifting allegiances to powerful states for the purposes of espousing a diplomatic protection claim.[84] This concern is obviously not applicable to investment treaty arbitration because the procedural right of recourse vests directly in the investor and remains with that investor; hence there is less to be gained by the investor in contriving to 'swap' investment treaties with a change of nationality.[85] Here one would not necessarily expect identity in the tests for nationality for diplomatic protection claims in general international law and for investment treaty claims.

42. In relation to natural persons, the International Court of Justice in the *Nottebohm* case[86] imposed a requirement for the admissibility of diplomatic protection claims that there must be an 'effective' or 'genuine link' between the individual who has suffered the injury and the national state prosecuting the claim. The Court thereby rejected the conferral of nationality under municipal law as definitive for this purpose.[87] The Court was concerned to ensure that only one state could have standing to bring a diplomatic protection claim on the basis

[83] The authorities are divided as to whether the doctrine of continuous nationality requires the relevant nationality at the time of the presentation of the claim or through to the date of the award. The 'limited' requirement is favoured by the ILC in its Articles on Diplomatic Protection, Art. 5(1) and (4). See further: J. Dugard, 'Fourth Report on Diplomatic Protection' (2003) UN Doc A/CN.4/530, para. 93l; J. Dugard, 'Fifth Report on Diplomatic Protection' (2004) UN Doc. A/CN.4/538, para. 10; J. Dugard, 'Seventh Report on Diplomatic Protection' (2006) UN Doc.A/CN.4/567, paras. 31–47. See also: D. O'Connell, *International Law* (Vol. 2 1970, 2nd edn) 1033. Judge Fitzmaurice asserted in *Barcelona Traction* that the only relevant date was the time of the injury for the nationality of the claim 'then became once and for all indelibly impressed with Belgian national character, and that any subsequent dealings in the shares were immaterial': 1970 ICJ Rep 4, 102 at para. 65. The majority of lump sum agreements favour the test of nationality at the date of claim accrual: D. Bederman, 'Interim Report on Lump Sum Agreements and Diplomatic Protection', in International Law Association, *Report of the Seventieth Conference, New Delhi* (2002) 10. Nevertheless, a majority of writers appear to support the more 'expansive requirement': E. Borchard, 'The Protection of Citizens Abroad and Change of Original Nationality' (1933–4) 43 *Yale LJ* 359, 372; Sohn and Baxter, Harvard Draft Convention, Art. 22(8) at 186–7; *Oppenheim's International Law* (Vol. 1, 1992, 9th edn by R. Jennings and A. Watts) 512–13; I. Brownlie, *Principles of Public International Law* (2003, 6th edn) 460.

[84] E. Borchard, *ibid*. 377–80. Judge Jessup in *Barcelona Traction* noted that 'One of the reasons for the rule of continuity of nationality is the avoidance of assignments of claims by nationals of a small State to nationals of a powerful State': 1970 ICJ Rep 4, 189 at para. 48.

[85] This is not to deny that the jurisdictional provisions and substantive provisions on the minimum standards of investment protection do differ from one investment treaty to the next.

[86] (*Liechenstein v Guatemala*) 1954 ICJ Rep 4.

[87] *Ibid*. 23.

that the individual 'is in fact more closely connected with the population of the State conferring nationality than with that of any other State'.[88]

43. The International Court in the *Barcelona Traction* case[89] also examined the 'manifold links' between the company Barcelona Traction and Canada as the state of incorporation and concluded that 'a close and permanent connection ha[d] been established'.[90] On the other hand, Belgium's assertion of an independent right to exercise diplomatic protection on behalf of the shareholders of Barcelona Traction was rejected by the Court, despite the fact that the majority of the shareholders were Belgium nationals. Hence by recognising that Canada alone as the state of incorporation could pursue a claim on behalf of Barcelona Traction, the Court achieved the same objective of channelling the interests of an aggrieved foreign entity into a single rubric of nationality.

44. A number of writers have juxtaposed the 'genuine connection' test for natural persons in *Nottebohm* with the 'mere place of incorporation' test for corporations in *Barcelona Traction*. This is not a satisfactory dichotomy for at least two reasons.[91] First, the International Court was careful to describe the 'manifold

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[88] *Ibid*. The ILC rejected the requirement in *Nottebohm* of proving an effective or genuine link between the state exercising diplomatic protection and its national in its Draft Articles on Diplomatic Protection: ILC, *Report of the Fifty-eighth Session* (2006) UN Doc A/CN 4/L 684, Commentary to Art. 4 at para. 5.

[89] 1970 ICJ Rep 4.

[90] *Ibid*. 42 at para. 71. The ICJ summarised the links as follows: 'The incorporation of the company under the law of Canada was an act of free choice. Not only did the founders of the company seek its incorporation under Canadian law but it has remained under that law for a period of over 50 years. It has maintained in Canada its registered office, its accounts and its share registers. Board meetings were held there for many years; it has been listed in the records of the Canadian tax authorities.' *Ibid*.

[91] In particular, it is widely commented that the ICJ rejected the *Notebohm* test in the context of a diplomatic claim on behalf of a corporate entity. The Court stated that: '[R]eference has been made to the Nottebohm case. In fact the Parties made frequent reference to it in the course of the proceedings. However, given both the legal and factual aspects of protection in the present case the Court is of the opinion that there can be no analogy with the issues raised or the decision given in that case.' *Ibid*. ICJ Rep 4, 42 at para. 70. As Judge Fitzmaurice explained, the Court refrained from pronouncing upon the relevance of the *Nottebohm* decision because neither Spain nor Belgium contested Canada's right to pursue a diplomatic protection claim on behalf of Barcelona Traction and hence there was no need to inquire whether there was, according to *Nottebohm*, a 'genuine link' between Barcelona Traction and Canada. In light of what the Court said about the 'manifold links' in the very next paragraph after its statement about the relevance of *Nottebohm*, it is clear that the test would have been satisfied in the eyes of the Court. See Separate Opinion of Judge Fitzmaurice: 1970 ICJ Rep 4, 80 at para. 28. See further: I. Brownlie, *Principles of Public International Law* (2003, 6th edn) 467; A. Watts, 'Nationality of Claims: Some Relevant Concepts', in V. Lowe and M. Fitzmaurice (eds), *Fifty Years of the International Court of Justice. Essays in Honour of Sir Robert Jennings* (1996) 424. The ILC has also recognised that 'the Court in *Barcelona Traction* was not … satisfied with incorporation as the sole criterion for the exercise of diplomatic protection' and 'it suggested that in addition to incorporation and a registered office, there was a need for some "permanent and close connection" between the State exercising diplomatic protection and the corporation.': ILC, *Report of the Fifty-eighth Session* (2006) UN Doc A/CN 4/L 684, Commentary to Art. 9 at para. 3; J. Dugard, 'Seventh Report on Diplomatic Protection' (2006) UN Doc.A/CN.4/567, paras. 52–3.

links' between the company Barcelona Traction and Canada as the state of incorporation and it is clear from the Court's judgment that it was satisfied of a 'genuine connection' in this respect. Second, the theoretical right of Canada to exercise diplomatic protection on behalf of Barcelona Traction was actually conceded by both Spain and Belgium. The point of contention was whether Belgium should have an independent or parallel right to pursue a claim on behalf of its national shareholders.[92] Hence the Canadian nationality of Barcelona Traction for the purposes of diplomatic protection was never disputed.

45. The decision in *Barcelona Traction* was thus without prejudice to the practice of states which, in general, reveals that diplomatic protection is not exercised merely on the basis of incorporation.[93] In deciding whether or not to take up claims based on the corporate interests of their nationals, states are naturally preoccupied with the extent to which their own economy has been affected by the alleged violation of the host state. Thus it is common for states to insist that the corporate interest comprises a dominant shareholding or beneficial ownership or a connection based on the *siège social* of the company.[94] This practice is reflected in the International Law Commission's Draft Articles on Diplomatic Protection:

> For the purposes of the diplomatic protection of a corporation, the State of nationality means the State under whose law the corporation was incorporated. However, when the corporation is controlled by nationals of another State or States and has no substantial business activities in the State of incorporation, and the seat of management and the financial control of the corporation are both located in another State, that State shall be regarded as the State of nationality.[95]

46. Conversely, it is certainly true that the majority of investment treaties concluded after *Barcelona Traction* adopt the test of mere incorporation,[96]

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[92] In the words of Judge Fitzmaurice: '[T]he Belgian position… does not imply any denial of the Canadian nationality of the Barcelona Company or the right of the Company and its Government to claim, but merely asserts (failing such a claim) a "parallel" right of Belgium also to claim on behalf of any shareholders who are Belgian.' *Barcelona Traction, Light and Power Co. Ltd* (*Belgium v Spain*) 1970 ICJ Rep 4, 46 at para. 92.

[93] The ILC acknowledged this: ILC, *Report of the Fifty-eighth Session* (2006) UN Doc A/CN 4/L 684, Art. 9.

[94] See the official commentary to Rule IV of the applicable rules for the United Kingdom: 'In determining whether to exercise its right of protection, Her Majesty's Government may consider whether the company has in fact a real and substantial connection with the United Kingdom.' Reproduced at: (1988) 37 *ICLQ* 1006, 1007.

[95] ILC, *Report of the Fifty-eighth Session* (2006) UN Doc A/CN 4/L 684, Art. 9.

[96] Energy Charter Treaty, Art. 1(7), Appendix 4; UK Model BIT, Art. 1(d), UNCTAD Compendium (Vol, III, 1998) 186; Egypt Model BIT, Art. 2(b), *ibid*. (Vol. V, 2000) 294; Indonesia Model BIT, Art. 1(2)(ii), *ibid*. 310; Malaysia Model BIT, Art. 1(b)(ii), *ibid*. 326; Netherlands Model BIT, Art. 1(b)(iii), *ibid*. 334; Cambodia Model BIT, Art. 1(2)(ii), *ibid*. (Vol. VI, 2002) 464; Peru Model BIT, Art. 1, *ibid*. 494; United States Model BIT, Art. 1, *ibid*. 501; Austria Model BIT, Art. 1, *ibid*. (Vol. VII) 259; Belgo-Luxembourg Economic Union Model BIT, Art. 1, *ibid*. 271; Denmark

thereby refuting the national state's interest as reflected by the requirement that the corporation in question has significant connections to that state in order to benefit from its diplomatic protection. No 'genuine link' of any sort is usually required by the treaty between the individual investor or corporate entity and the national state.[97] The ease with which the formal requirement of incorporation can be discharged has led to the growing practice of establishing investment vehicles in a jurisdiction which is 'covered' by an investment treaty with the host state of the investment. These investment vehicles may be corporate shells in a tax friendly jurisdiction that are bound to transfer any commercial returns from the investment enterprise to the parent company in a different jurisdiction.[98] The national state of the investor does not, in such circumstances, have a strong interest in the investment treaty claim of such an entity, thereby further undermining the notion that an investor pursues the claim of its national state in its conduct of an investment treaty arbitration.

Model BIT, Art. 1(5)(b), *ibid*. 280; Finland Model BIT, Art. 1(3)(b), *ibid*. 288; South Africa Model BIT, Art. 1, *ibid*. (Vol. VIII) 274; Mauritius Model BIT, Art. 1(1), *ibid*. (Vol. IX) 296; Sweden Model BIT, Art. 1(2), *ibid*. 310; Indonesia Model BIT, Art. 1(2)(i), *ibid*. (Vol. V) 310; Bolivia Model BIT, Art. 2(b)–(c), *ibid*. (Vol. X) 276; Guatemala Model BIT, Art. 1(c)(ii), *ibid*. (Vol. XII) 290; Italy Model BIT, Art. 1(4), *ibid*. 296 (a 'legal person' is 'any entity having its head office in the territory of one of the Contracting Parties and recognised by it'); Ghana Model BIT, Art. 1(d)(2), *ibid*. (Vol. XIII) 280; Romania Model BIT, Art. 1(1), *ibid*. 287; Canada Model BIT, Art. 1, *ibid*. (Vol. XIV) 222, 224; UK Model BIT (2005), Art. 1(d)(ii) ('firms and associations incorporated or constituted under the law in force in any part of the United Kingdom or in the territory to which this Agreement is extended in accordance with the provisions of Article 12, Appendix 10').

[97] There are examples of BITs that require incorporation in the host state *and* the presence of the company's *'siège'* or 'seat' or 'headquarters' in the host state as well, inspired by French Civil Law. Thus, in the France Model BIT, Art. 1(3) reads: 'Le terme de "sociétés" désigne toute personne morale constituée sur le territoire de l'une des Parties contractantes, conformément à la législation de celle-ci et y possédant son siège social, ou contrôlée directement ou indirectement par des nationaux de l'une de Parties contractantes, ou par des personnes morales possédant leur siège social sur le territoire de l'une des Parties contractantes et constituées conformément à la législation de celle-ci.' UNCTAD Compendium (Vol. V, 2000) 302. (An identical provision can be found in the new France Model BIT (2006), Art. 1(2)(b), Appendix 6). See also: China Model BIT, Art. 1(2), 'domiciled', UNCTAD Compendium (Vol. V, 2000) 152 (the new China Model BIT (1997), Art. 1(2)(b) provides for a slightly different definition ('incorporated or constituted … *and* having their seats'), Appendix 5); Jamaica Model BIT, Art. 1(3)(b), UNCTAD Compendium (Vol. V, 2000) 318; Iran Model BIT, Art. 1(2)(b), *ibid*. (Vol. VI, 2002) 280; Germany Model BIT, Art. 1(3)(a), *ibid*. (Vol. VII) 298; Turkey Model BIT, Art. 1(1), *ibid*. (Vol. VIII) 281; Benin Model BIT, Art. 1(2), *ibid*. (Vol. IX) 280; Burundi Model BIT, Art. 1(1), *ibid*. 287. There are also some exceptional cases of BITs that, in additional to these two requirements, also demand that the company performs 'real business activity' in the host state: Chile Model BIT, Art. 1(1)(b), seat and 'effective economic activities', *ibid*. (Vol. III, 1998) 144; Switzerland Model BIT, Art. 1(1)(b), seat and 'real economic activities', *ibid*. 177; Sri Lanka Model BIT, Art. 1(2)(b), seat and 'substantial business activities', *ibid*. (Vol. V, 2000) 340; Croatia Model BIT, Art. 1(2)(b), *ibid*. (Vol. VI) 472; Mongolia Model BIT, Art. 1(1)(b), *ibid*. (Vol. IX) 303; Uganda Model BIT, Art. 1(3), *ibid*. (Vol. XII) 314; Germany Model BIT (2005), Art. 1(3)(a) ('any juridical persons as well as any commercial or other company or association with or without legal personality having its seat in the territory of the Federal Republic of Germany, irrespective of whether or not its activities are directed at profit'), Appendix 7.

[98] E.g. *Saluka v Czech Republic* (Merits).

47. The state contracting parties to investment treaties have, furthermore, left the door wide open for claims relating to a single investment by different claimants with multiple nationalities. For instance, investment treaties sometimes define an investment as the ownership of *either* a company incorporated in the host state or the shares in such a company.[99] This exposes states to claims by multiple claimants with different nationalities pursuant to several investment treaties with either type of legal interest in the same underlying investment. In *CMS v Argentina*,[100] the tribunal held that it is 'not possible to foreclose rights that different investors might have under different arrangements'.[101]

48. Another potential source of overlapping national claims over the same underlying investment is the acceptance of an 'indirect' interest in an investment as sufficient to qualify for investment protection.[102] Thus, in *CME v Czech Republic*[103] and *Lauder v Czech Republic*,[104] two tribunals established pursuant to different BITs considered the conduct of the same executive organ of the Czech Republic in relation to the same investment and came to quite different results on liability. The *CME* tribunal recognised the Dutch company CME's controlling interest in a local Czech company with rights to operate a television

[99] USA Model BIT, Art. 1(d), UNCTAD Compendium (Vol. VI, 2002) 502; Austria Model BIT, Art. 1(2), *ibid*. (Vol. VII) 259; Denmark Model BIT, Art. 1(1)(b), *ibid*. 283; Sweden Model BIT, Art. 1(b), *ibid*. (Vol. IX) 309; Indonesia Model BIT, Art. 1(b), *ibid*. (Vol. V) 310 ('rights derive from shares… or any other form of interest in companies'); Bolivia Model BIT, Art. 1(a), (c), *ibid*. (Vol. X) 275; Burkina Faso Model BIT, Art. 1(b) *ibid*. 287; Guatemala Model BIT, Art. 1(a)(ii), *ibid*. (Vol. XII) 289; Italy Model BIT, Art. 1(1)(b), *ibid*. 295 ('shares, debentures, equity holdings and any other instruments of credit'); Kenya Model BIT, Art. 1(a)(ii), *ibid*. 305 ('rights derived from shares, bonds and other kinds of interests in companies and joint ventures'); Uganda Model BIT, Art. 1(b), *ibid*. 313 ('shares, premium on shares, and other kinds of interest including minority or indirect forms, in companies constituted in the territory of one Contracting Party'); Ghana Model BIT, Art. 1(a)(ii), *ibid*. (Vol. XIII) 279 ('shares…and other form of participation in a company'); Romania Model BIT, Art. 1(2)(b), *ibid*. 288 ('shares, parts or any other kinds of participation in companies'); Canada Model BIT, Art. 1, *ibid*. (Vol. XIV) 222–4; USA Model BIT (2004), Art.1, Appendix 11; China Model BIT (1997), Art. 1(1)(b) ('shares, debentures, stock and any other participation in companies'), Appendix 5; Germany Model BIT (2005), Art. 1(1)(b) ('shares of companies and other kinds of interest in companies'), Appendix 7; France Model BIT (2006) ('les actions, primes d'émission at autres formes de participation, même minoritaires aux sociétés constituées sur le territoire de l'une des Parties contractantes'), Appendix 6; UK Model BIT (2005), Art. 1(a)(ii) ('shares in and stock and debentures of a company and any other form of participation in a company'), Appendix 10; Energy Charter Treaty, Art. 1(6)(b), Appendix 4; NAFTA, Art. 1139, Appendix 3. See further: UNCTAD, *Series on Issues in International Investment Agreements: Scope and Definition* (1999) 10.

[100] *CMS v Argentina* (Preliminary Objections) 7 ICSID Rep 494.

[101] *Ibid*. 512/86.

[102] The most 'indirect' investment to date, in terms of corporate layers between the claimant investor and the covered investment, was perhaps that which was recognised in *Azurix v Argentina* (Preliminary Objections) 10 ICSID Rep 416. Here, a local investment vehicle registered in Argentina 'Z' had concessionary rights to provide sewerage services in an Argentine Province. Z was in turn owned by two other Argentine companies, 'X' and 'Y'. The Claimant (a Delaware company qualifying under the Argentina/USA BIT) ultimately owned and controlled X through another Argentine company, and Y through two levels of Cayman Island companies.

[103] *CME v Czech Republic* (Merits) 9 ICSID Rep 121.

[104] *Lauder v Czech Republic* (Merits) 9 ICSID Rep 66.

licence as an investment for the purposes of the Netherlands/Czech Republic BIT,[105] whereas the *Lauder* tribunal deemed that the shareholding of Mr Lauder (a US citizen) in the parent company of CME fell within the definition of an investment under the USA/Czech Republic BIT.[106] Hence multiple claims with respect to the same injury could proceed before two tribunals constituted pursuant to different treaties. This illustrates the point that, unlike the nationality of claims rule for diplomatic protection, the investment treaty regime is not overly concerned with the task of channelling the various interests of private entities arising from unlawful conduct attributable to a state into a single rubric of nationality with a single claimant state representing the affected interests.

49. Contrary to these precedents evidencing a less prominent concern with the nationality of claims, the tribunal's decision on admissibility in *Loewen* points the other way. In the absence of a specific provision of NAFTA dealing with the temporal requirements for the nationality of claims, the tribunal imported what it considered to be the rule of general international law requiring continuous nationality from the date of the events giving rise to the claim through to the date of the award, and applied it strictly. The claimant company, Loewen, was incorporated in Canada at the time of the events giving rise to the claim, but had subsequently reorganised as a US corporation after notice of the claim had been filed; it assigned its NAFTA claim to a Canadian company established for the sole purpose of retaining legal title to the claim.[107] The tribunal attached primary significance to the fact that the beneficiary of the claim (in the sense of the ultimate recipient of a damages award) would be the reorganised US company and thus the Canadian special purpose vehicle could not 'qualify as a continuing national for the purposes of this proceeding'.[108]

50. The *Loewen* tribunal recognised that other international treaties had made special provision for the 'amelioration of the strict requirement of continuous nationality',[109] such as the Algiers Accords establishing the Iran/US Claims Tribunal and several BITs. Furthermore, the ICSID Convention, which governs the procedure of many investment treaty arbitrations upon an election of this option by the claimant as permitted by the relevant BIT, expressly provides that the nationality requirement is to be tested at the time the notice of claim is filed.[110]

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[105] *CME v Czech Republic* (Merits) 9 ICSID Rep 121, 188/376.
[106] *Lauder v Czech Republic* (Merits) 9 ICSID Rep 66, 84/154.
[107] *Loewen v USA* (Merits) 7 ICSID Rep 442, 484/220.
[108] *Ibid*. 489/237.
[109] *Ibid*. 486/229.
[110] Article 25(2)(b) of the ICSID Convention defines a 'National of another Contracting State' as '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'. See Appendix 1. In *CSOB v Slovak Republic* (Preliminary Objections) 5 ICSID Rep 335, 343/31–2, the date-of-submission rule was upheld to dismiss the relevance of the Respondent's objection to the Claimant's standing due to the latter's assignment of the rights to the subject matter of the dispute. See also: *SOABI v Senegal* (Preliminary Objections) 2 ICSID

And yet, in the absence of a specific provision in Chapter 11 of NAFTA, the *Loewen* tribunal saw no reason to depart from what it perceived to be a strict rule of general international law requiring continuous nationality.[111] Most significantly, the tribunal implicitly rejected the argument advanced by Jennings as expert witness testifying on behalf of Loewen that 'the rule of the nationality of claims was never a free-standing general rule of international law; it was a concomitant, and of the very essence, of diplomatic protection'.[112]

(3) Forum selection clauses

51. An exclusive jurisdiction clause in favour of the municipal courts of the host state in an investment agreement between a foreign investor and the host state cannot prejudice the standing of the national state of the investor to bring a diplomatic protection claim against the host state. The right to bring a diplomatic protection claim vests in the national state of the investor and hence no agreement concluded by the investor can encumber this right.[113] By parity of reasoning, the foreign investor's acceptance of a 'Calvo Clause' in the investment agreement that purports to effect an express waiver of any potential diplomatic protection claim is also ineffective to diminish the right of the national state of the investor to seek redress on this basis.[114] At most, the

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Rep 175, 180/29; *Banro v Congo* (Preliminary Objections); C. Amerasinghe, 'The International Centre for Settlement of Investment Disputes and Development Through the Multinational Corporation' (1976) 9 *Vanderbilt J Transnatl L* 793, 809–10 ('[T]he relevant time for the fulfilment of the nationality requirement is that date when the consent to jurisdiction is effective for both parties. It also means that any change in the nationality of a juridical person after that date is immaterial for the purposes of ICSID's jurisdiction, regardless of how inappropriate such an alignment would have been initially.'). *Contra*: G. Delaume, 'Le Centre International pour le Règlement des Différends Relatifs aux Investissements (CIRDI)' (1982) 109 *Journal du droit international* 797.

111 *Loewen v USA* (Merits) 7 ICSID Rep 442, 484/220–40. Referring to the specific rule in Art. 25 (2)(b) of the ICSID Convention, Loewen argued that the standing requirements of NAFTA Chapter 11 should be the same regardless of whether a claimant proceeds under the ICSID Convention (currently not possible because neither Mexico nor Canada are signatories), the ICSID Additional Facility Rules or the UNCITRAL Arbitration Rules. This contention was rejected by the Tribunal (*ibid*. 488/235).

112 Fifth Opinion of Sir Robert Jennings, cited in Counter-Memorial of the Loewen Group, Inc. on Matters of Jurisdiction and Competence (29 March 2002) para. 69, available at: www.state.gov/documents/organization/9360.pdf. Sir Robert Jennings also noted the 'surprising regressive tendency of the United States' argument' which relies on cases 'stem[ming] from the period between the two world wars when solely States were the "subjects" of international law and there was no possibility for individuals or corporations to have direct rights in international law or to be parties to international litigation' (*ibid*. para. 65).

113 E. Borchard, *The Diplomatic Protection of Citizens Abroad or The Law of International Claims* (1915) 372, 799.

114 *North American Dredging Co. (USA v Mexico)* 4 RIAA 26, 29 (1926); D. Shea, *The Calvo Clause* (1955) 217; D. O'Connell, *International Law* (Vol. 2, 1970, 2nd edn) 1061; *Oppenheim's International Law* (Vol. 1, 1992, 9th edn by R. Jennings & A. Watts) 930–1; K. Lipstein, 'The Place of the Calvo Clause in International Law' (1945) 22 *BYBIL* 130, 139 and cases cited at note 4; Borchard, *Diplomatic Protection of Citizens Abroad*, 809–10.

investor's consent to a Calvo Clause raises a presumption in diplomatic protection proceedings that the rule on the exhaustion of local remedies should be applied strictly.[115]

52. The limited effect given by international tribunals to a Calvo Clause is naturally predicated upon the national state's own interest and right in pursuing a diplomatic protection claim to enforce the minimum standards for the protection of aliens in general international law.[116] The status of forum selection clauses in investment agreements between the investor and host state on the admissibility of claims before an international treaty tribunal is a controversial subject that will be dealt with in detail in Chapter 10. Less controversial, however, is the possibility that an investor can foreclose its procedural right to have its treaty claims heard by an international tribunal by instituting proceedings with respect to those claims before a municipal court of the host state. This is the effect of the so called 'fork in the road' provision in many BITs, which affords the investor the option of selecting between several different judicial fora in the presentation of its claims based on the minimum standards of protection in the treaty.[117] By choosing to litigate in a municipal court, for instance, the investor takes a positive step down one of the paths leading from this junction with no right of return. This does not exclude the possibility that a new claim for denial of justice may ripen if the investor is denied a minimum standard of procedural fairness before the municipal court. In this instance, the investor would simply return to the same fork in the road but now in a different vehicle (perhaps relying on a breach of the fair and equitable standard of treatment), and this time would predictably select the path to a hearing before an international tribunal. The point is, however, that upon the initial election by the investor to institute proceedings before a domestic court, there is no residual interest in the claim as pleaded that survives on an international level for the national state.[118] If the investor were in reality invoking the procedural right of its national state in advancing an investment treaty claim, this would be a curious result.

(4) The applicable procedural law

53. The law applicable to questions of procedure in arbitrations between states is generally international law.[119] This is certainly the case for a diplomatic protection claim submitted to arbitration by a special agreement or

[115] O'Connell, *International Law* (Vol. 2) 1062.
[116] C. Amerasinghe, *State Responsibility for Injuries to Aliens* (1967) 60.
[117] See the commentary to Rule 21 below.
[118] Furthermore, if the treaty obligation is owed directly to the national state of the investor, the investor should not be able to compromise its national state's corresponding right by a forum selection in the first place.
[119] Simpson and Fox, *International Arbitration, Law and Practice*, 128–30; F.A. Mann, 'State Contracts and International Arbitration' (1967) 42 *BYBIL* 1, 2.

a diplomatic protection claim is made on its behalf.[123] This interest was described by the International Court in the *Interhandel* case[124] in the following terms:

> Before resort may be made to an international court in such a situation, it has been considered necessary that the State where the violation occurred should have an opportunity to redress it by its own means, within the framework of its own domestic legal system.[125]

57. The local remedies rule is thus a concession to the sovereign independence of the host state, which must be presumed in the first instance to be capable of rendering justice by its own courts.[126] It also gives effect to the principle that foreign nationals or entities going abroad are subject to the municipal law of the host state and the means of redress available under this law for any injury to their person or property.[127]

58. Several commentators have latched onto the local remedies rule as evidence that diplomatic protection obligations are owed to the individual rather than the national state. If the rights of the national state were infringed directly, then its remedy could not, as the argument goes, be conditional upon exhaustion of local remedies by the individual.[128] But this contention ignores the reality that the national state also has a strong interest in the observance of the local remedies rule itself because it acts as a 'sieve' to prevent any grievance of its national from being transformed into an international dispute with the host state.[129] States are often vigilant about insisting on the observance of the rule by their own nationals to limit the burden of international litigation as far as possible and the concomitant political ramifications on the bilateral relationship with the host state concerned.

59. In the absence of a specific provision in the investment treaty,[130] investment treaty tribunals have uniformly dispensed with the local remedies rule as a procedural impediment to proceedings before an international arbitral tribunal otherwise with jurisdiction over the investor's claims.[131] This conclusion is

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123 C. Amerasinghe, *Local Remedies in International Law* (1990) 69–72. The exhaustion of local remedies rule is codified in Arts. 14 and 15 of the ILC's Draft Articles on Diplomatic Protection: ILC, *Report of the Fifty-eighth Session* (2006) UN Doc A/CN 4/L 684.

124 (*Switzerland v USA*) 1956 ICJ Rep 6.

125 *Ibid*. 27.

126 C. Amerasinghe, *Local Remedies in International Law* (1990) 71, citing C. de Visscher, 'Denial of Justice in International Law' (1935) 52 *Hague Recueil* 422; *Ambatielos* (*Greece v UK*) 12 RIAA 119 (1956).

127 E. Borchard, *The Diplomatic Protection of Citizens Abroad or The Law of International Claims* (1915) 817–18.

128 D. O'Connell, *International Law* (Vol. 2, 1970, 2nd edn) 1031.

129 A. McNair, *International Law Opinions* (Vol. 2, 1956) 197; C. Amerasinghe, *Local Remedies in International Law* (1990) 68.

130 A provision requiring the exhaustion of local remedies in the Argentina/Spain BIT was considered in: *Maffezini v Spain* (Preliminary Objections) 5 ICSID Rep 396.

131 See the arbitral awards cited at Chapter 2 note 277 below.

without prejudice to the situation where the host state's conduct only attains the requisite threshold for a breach of a treaty standard upon a denial of justice in the judicial system of the host state. In this sense, the local remedies rule is a *substantive* requirement for liability rather than a *procedural* precondition for the presentation of claims to an international court or tribunal.[132] By dispensing with the local remedies rule as a procedural requirement for the investor's treaty claims, the contracting states have also abandoned their interests that are protected by the rule. If they had a legal interest at stake in an investment treaty claim then this would be a surprising concession.

(6) The assessment of damages

60. Whilst it is true that damages are most often assessed on the basis of the loss suffered by the national in a diplomatic protection claim, other considerations can play a part, such as the nature of the international obligation that has been breached. The Permanent Court of International Justice stated the position succinctly in the *Chorzów Factory* case:[133]

> The reparation due by one State to another does not, however, change its character by reason of the fact that it takes the form of an indemnity for the calculation of which the damage suffered by a private person is taken as the measure. The rules of law governing the reparation are the rules of international law in force between the two States concerned, and not the law governing relations between the State which has committed a wrongful act and the individual who has suffered the damage. Rights or interests of an individual the violation of which rights causes damage are always in a different plane to rights belonging to a State, which rights may also be infringed by the same act. The damage suffered by an individual is never therefore identical in kind with that which will be suffered by a State; it can only afford a convenient scale for the calculation of the reparation due to the State.[134]

61. As far as investment treaty claims are concerned, damages awarded to an investor do not take into account any independent interest of the national state which may have been prejudiced by the breach. For instance, it would be inconceivable that an investment treaty tribunal would increase the amount of damages to account for the fact that the host state had breached its obligations

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[132] E.g. *Generation Ukraine v Ukraine* (Merits) 10 ICSID Rep 240; *Mondev v USA* (Merits) 6 ICSID Rep 192; *Waste Management v Mexico (No. 2)* (Merits) 11 ICSID Rep 361. The debate as to whether the rule on the exhaustion of local remedies is a procedural precondition to the admissibility of an international claim, or a substantive precondition with the result that no breach of international law is committed until local remedies have been exhausted, has been summarised with extensive citation of authorities by J. Dugard, 'Second Report on Diplomatic Protection' (2001) UN Doc A/CN.4/514, paras. 32–62.

[133] *Chorzów Factory* (*Germany v Poland*) 1928 PCIJ (Ser. A) No. 17 (Merits).

[134] *Ibid*. 28.

under a BIT on several occasions in relation to different investors of the same nationality. Damages in an investment treaty claim are assessed purely on the basis of the harm caused to the economic interests of the investor by the host state, without regard for any factors in the relationship between the host state and the national state of the investor.[135] This supports the conclusion that the investor is not vindicating 'public' or 'international' interests by bringing an investment treaty claim.

(7) The challenge to and enforcement of awards

62. A truly international judgment or award, such as a judgment of the International Court of Justice, owes its existence and binding force to the international legal order and is impervious to any challenge or review before a municipal court.[136] Only an international court or tribunal is competent to hear applications pertaining to the validity of a truly international judgment or award that has settled a public controversy between states. Thus, for instance, Nicaragua challenged the validity of an award rendered in favour of Honduras on the demarcation of their maritime boundary before the International Court,[137] as did Guinea-Bissau in relation to an award that favoured Senegal's position in a maritime boundary dispute.[138]

63. Awards rendered by international arbitral tribunals in investor/state disputes are not truly international awards and as a result they may be subject to challenge and review in accordance with municipal and international legislative instruments dealing with international commercial arbitral awards. Municipal courts have been seised of challenges to investment treaty awards pursuant to legislation on international commercial arbitration,[139] and the drafters of investment treaties have expressly recognised that investor/state awards fall within the purview of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards or the Inter-American Convention on International Commercial Arbitration.[140]

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[135] In *S.D. Myers v Canada* (Merits) 8 ICSID Rep 18, the tribunal distinguished 'lawful' expropriations pursuant to Art. 1110 from 'unlawful' breaches of the NAFTA under other provisions of the NAFTA. The tribunal found that: 'The standard of compensation that an arbitral tribunal should apply may in some cases be influenced by the distinction between compensating for a lawful, as opposed to an unlawful, act. Fixing the fair market value of an asset that is diminished in value may not fairly address the harm done to the investor' (*ibid*. 62/308).

[136] *Chorzów Factory* (*Germany v Poland*) 1928 PCIJ (Ser. A) No. 17 (Merits) 33; See O. Schachter, 'The Enforcement of International Judicial and Arbitral Decisions' (1960) 54 *AJIL* 1, 12–5. Art. 36 of the ILC's Final Draft Articles on Arbitral Procedure for arbitrations between states provides that the ICJ shall have jurisdiction over any challenge to the validity of an award where the state parties have not agreed to another tribunal: 'Model Rules on Arbitral Procedure with a General Commentary' *YB of Int L Commission* (Vol. 2, 1958) 86.

[137] *Arbitral Award Made by the King of Spain on 23 December 1906* (*Honduras v Nicaragua*) 1960 ICJ Rep 192.

[138] *Arbitral Award of 31 July 1989* (*Guinea-Bissau v Senegal*) 1991 ICJ Rep 53.

[139] See the commentary to Rule 13 below.

[140] *Ibid*.

64. If the investor were vindicating the rights of its national state in bringing an investment treaty claim, one would expect that the resulting decision of the tribunal could be properly characterised as a public international award and binding as between the national state and the host state on the inter-state plane. The fact that investor/state awards are capable of being classified as 'commercial' is not consistent with them having a truly public international law status because it suggests that the primary relationship between the disputing parties is private rather than public or sovereign. Furthermore, investor/state awards are not binding on the national state of the investor.[141]

C. CONCLUSIONS ON THE NATURE OF THE INVESTOR'S RIGHTS: TWO ALTERNATIVE 'DIRECT' MODELS

65. The foregoing analysis of the principal features of diplomatic protection under general international law and investment treaty arbitration reveals their essential divergence. Given that the *raison d'être* of the investment treaty mechanism for the presentation of international claims may well be a response to the inadequacies of diplomatic protection,[142] this should come as no surprise.[143] The fundamental assumption underlying the investment treaty regime is clearly that the investor is bringing a cause of action based upon the vindication of its own rights rather than those of its national state.[144] In these circumstances it is untenable to superimpose the *Mavrommatis* formula of diplomatic protection over a triangular relationship between investor, its national state and the host state of the investment for a rationalisation of investment treaty arbitration. In this respect, the International Law Commission's treatment of the relationship between diplomatic protection and 'special regimes for the

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[141] Article 1136(7) of NAFTA is explicit: 'An award made by a Tribunal shall have no binding force except between the disputing parties and in respect of the particular case.' See Appendix 3.

[142] J. Kokott, 'Interim Report on the Role of Diplomatic Protection in the Field of the Protection of Foreign Investment' in International Law Association, *Report of the Seventieth Conference, New Delhi* (2002) 27.

[143] The novelty of the investor's cause of action under investment treaties was emphasised by Justice Kelen of the Federal Court in Ottawa, on this occasion in relation to NAFTA: 'NAFTA provides, unlike its predecessor, the Canada–U.S. Free Trade Agreement, a mechanism which allows individual investors to settle disputes with respect to alleged discriminatory treatment. This creates a powerful and significant new cause of action to protect investors.' The context for this statement was a challenge to a NAFTA award in *Attorney General of Canada v S.D. Myers, Inc* (Decision, 13 January 2004) 2004 FC 38, 8 ICSID Rep 194, 201/32.

[144] This statement made in Z. Douglas, 'The Hybrid Foundations of Investment Treaty Arbitration' (2003) *BYBIL* 151, 182, was quoted with approval by the English Court of Appeal in *Occidental Exploration & Production Company v Republic of Ecuador* [2005] EWCA Civ 1116; [2006] QB 432; 12 ICSID Rep 129, 137/20. It was further endorsed in: *Czech Republic v European Media Ventures SA* [2007] EWHC 2851 (Comm); [2008] 1 Lloyd's Rep 186, para. 52.

protection of foreign investors provided for in bilateral and multilateral investment treaties'[145] is highly relevant. The Special Rapporteur proposed a *lex specialis* exception to the application of rules of diplomatic protection for corporations or shareholders because:

> There is a clear inconsistency between the rules of customary international law on the diplomatic protection of corporate investment, which envisage protection only at the discretion of the national State and only, subject to limited exceptions, in respect of the corporation itself, and the special regime for foreign investment established by bilateral and multilateral investment treaties, which confers rights on the foreign investor, either as a corporation or as a shareholder, determinable by an international arbitration tribunal.[146]

66. In the *Case Concerning Ahmadou Sadio Diallo*,[147] the International Court of Justice affirmed that investment treaties create a *lex specialis* so that the wider protection afforded to shareholders under such treaties could not affect the rules of admissibility of diplomatic protection.[148]

67. A number of investment treaty awards[149] and the writings of publicists[150] also support the notion of international treaty rights conferred directly upon investors of the contracting state to the investment treaty.

68. What, then, are the conceptual alternatives to the 'derivative model' based on the *Mavrommatis* formula? It was previously stated that there is no theoretical impediment in international law to the conferral of rights upon private entities by an international treaty instrument. The clearest support for this proposition is to be found in the seminal judgment of the Permanent Court of International Justice in the *Jurisdiction of the Courts of Danzig* case.[151] A treaty between Poland and Danzig (called the 'Beamtenabkommen') regulated the employment conditions for employees of the Danzig railways who had passed

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145 J. Dugard, 'Fourth Report on Diplomatic Protection' (2003) UN Doc A/CN.4/530.

146 *Ibid*. para. 112.

147 (*Republic of Guinea v Democratic Republic of the Congo*) Preliminary Objections, 24 May 2007.

148 *Ibid*. paras. 88, 90.

149 *CMS v Argentina* (Preliminary Objections) 7 ICSID Rep 494, 503/45 ('To some extent, diplomatic protection is intervening as a residual mechanism to be resorted to in the absence of other arrangements recognising the direct right of action by individuals.'). The tribunal cited the ICSID Convention as one such arrangement, but clearly had in mind other treaties dealing with foreign investment as well. The investor was described as the 'beneficiary' of substantive BIT rights in *AMT v Zaire* (Merits) 5 ICSID Rep 14, 29/6.06.

150 Writers supporting the 'direct' theory, at least in relation to the procedural right of an investor to bring arbitration proceedings against the host state, include: G. Burdeau, 'Nouvelles perspectives pour l'arbitrage dans le contentieux économique intéressant l'Etat' (1995) *Revue de l'arbitrage* 3, 12 *et seq*.; J. Paulsson, 'Arbitration Without Privity' (1995) 10 *ICSID Rev – Foreign Investment LJ* 232, 256; T. Wälde, 'Investment Arbitration under the Energy Charter Treaty' (1996) *Arbitration Int* 429, 435–7.

151 (*Advisory Opinion*) 1928 PCIJ (Ser. B) No. 15.

into the service of the Polish Railways Administration and an issue arose as to whether the Danzig employees could sue the Polish Railways directly in the Danzig Courts to recover compensation based on the provisions of the treaty. Poland's submission that the treaty only created rights and obligations as between the state parties was dismissed by the Permanent Court:

> [I]t cannot be disputed that the very object of an international agreement, according to the intention of the contracting Parties, may be the adoption by the Parties of some definite rules creating individual rights and enforceable by the national courts. That there is such an intention in the present case can be established by reference to the terms of the *Beamtenabkommen*.[152]

69. Hersch Lauterpacht interpreted this passage as clear authority to the effect that 'there is nothing in international law to prevent individuals from acquiring directly rights under a treaty provided that this is the intention of the contracting parties'.[153] More recently, the International Court of Justice in the *LaGrand* case[154] decided that Article 36(1)(b) of the Vienna Convention on Consular Relations 'creates individual rights', whether or not these fall to be classified as human rights.[155] This treaty provision obliged the United States to inform Germany through the proper diplomatic channels that two of its nationals were committed to prison in the United States. The United States failed to do so and the German nationals were later executed. The Court attached significance to the final sentence of Article 36(1)(b) that the prison authorities 'shall inform the person concerned without delay of *his rights* under this subparagraph'.[156]

70. Investment treaties also adopt terminology consistent with the vesting of rights in foreign nationals and legal entities directly. The substantive obligations relating to minimum standards of investment protection are couched in terms of a legal relationship between the host state and the foreign investor. The United States Model BIT (2004), for instance, prescribes in Article 3 that:

> Each Party shall accord to investors of the other Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory.[157]

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[152] *Ibid*. 17–19.

[153] H. Lauterpacht, 'Survey of International Law in Relation to the Work of Codification of the International Law Commission' (1949) UN Doc A/CN.4/1/Rev.1, 19–20, reprinted in *Collected Papers of Hersch Lauterpacht* (Vol. 1, 1970) 469. A concise and lucid critique of the 'positivist' conception of the subjects of international law is provided by: R. Higgins, *Problems and Process: International Law and How We Use It* (1994) 49 *et seq*.

[154] (*Germany v USA*) 2001 ICJ Rep 466.

[155] *Ibid*. paras 75–8.

[156] *Ibid*. para. 77. The Court affirmed this finding in *Avena and Other Mexican Nationals* (*Mexico v USA*) 2004 ICJ Rep 12, at para. 40.

[157] See Appendix 11.

71. The Austria Model BIT employs language that is even more direct: 'An investor of a Contracting Party which claims to be affected by expropriation by the other Contracting Party *shall have the right* …'[158]

72. A textual analysis of investment treaties thus appears to be consistent with the conclusion that the substantive investment protection obligations proclaimed by the state parties are owed to investors directly, who then have the means of enforcing their corresponding rights pursuant to the investor/state arbitration procedure stipulated in the treaty.

73. Another possible approach to a direct theory of rights under investment treaties is to distinguish between the substantive obligations of investment protection and the obligation to submit to investor/state arbitration upon the filing of a notice of claim by the claimant investor. The substantive obligations might be said to exist purely on the *inter* state plane and as such opposable only by one contracting state to another. These obligations do not pertain to investments of specific investors, which often are not reasonably in the contemplation of host states,[159] but instead require states to establish a particular regime *in abstracto*. In contradistinction, the procedural obligation is directly enforceable by the claimant investor. Upon the claimant's filing of a notice of arbitration, the claimant investor perfects the host state's unilateral offer to arbitrate, and the two parties thus enter into a direct legal relationship in the form of an arbitration agreement. At the same time, the claimant becomes a counterparty to the host state's obligation to submit to international arbitration for an assessment of its conduct towards the claimant's investment on the basis of the norms of investment protection set out in the treaty. This obligation encompasses the duty of the host state to pay compensation if the international tribunal adjudges its conduct to be violative of these norms. The minimum standards of investment protection could thus be characterised as the applicable adjudicative standards for the claimant's cause of action rather than binding obligations owed directly to the investor.

74. The English Court of Appeal preferred the first of these two rationalisations by the present writer of the 'direct' model, as being the more 'natural' and 'preferable'.[160] That the first model is the more 'natural' is no doubt correct, but the full ramifications of that approach need to be explored.

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[158] Austria Model BIT, Art. 5(3) (emphasis added), UNCTAD Compendium, (Vol. VII) 262.

[159] And thus perhaps distinguishable from human rights obligations.

[160] [2005] EWCA Civ. 1116, [2006] QB 432, 12 ICSID Rep 129, 136/18. When the case came back to Aitken J, however, he stated that the issue remained open: *Republic of Ecuador v Occidental Exploration & Production Co (No. 2)* [2006] EWHC 345 (Comm), [2006] 1 Lloyd's Rep 773, 776 at para. 9 ('In its judgment on the "justiciability" issue, the Court of Appeal held that the present BIT confers or creates direct rights in international law in favour of investors. The point at which these rights are created or conferred might be in issue; but, at the least, it is at the point when investors pursue claims in one of the ways provided by article VI of the BIT.').

75. The investment treaty obligations of states are not coterminous with their human rights obligations. Human rights deserve a special status; they are inalienable because their protection is fundamental to the dignity of every human being. They are not susceptible to being waived. On the other hand, if the substantive obligations in investment treaties are owed to investors directly, then it should follow that investors are capable of waiving *their* rights.[161] The arguments employed to defeat the Calvo Clause in the diplomatic protection context are inapposite, for this is no longer an instance of a foreign investor waiving the international rights properly vested in its national state. In the investment treaty context, the investor is master of its own destiny and keeper of its own rights. Logic would seem to dictate that an investor can sign away its substantive rights under an applicable investment treaty in a contract with the host state.

76. The second model, on the other hand, would rule out the possibility of waiver. The investor's procedural right to have the host state's conduct adjudged according to the investment treaty standards is only perfected upon the filing of a notice of arbitration. At that point the investor is free to waive its procedural right and this of course is common practice whenever an investment treaty claim is settled and withdrawn.[162] The substantive obligations cannot be waived by the investor because they are not directly vested.

76C. Occidental Exploration & Production Company v The Republic of Ecuador[163]

It will be recalled that in *Loewen v USA*,[164] the tribunal propounded the following conception of the investment treaty regime:

> [C]laimants are permitted for convenience to enforce what are in origin the rights of Party states.[165]

In other words, according to this *dictum*, investment treaties confer standing upon investors to bring what is in essence a diplomatic protection claim on behalf of their own state.

This was precisely the argument that was made before the English Court of Appeal in *Occidental v Ecuador*. Occidental was not relying upon the diplomatic protection rationalisation of an investment treaty claim to invoke nationality of claims rules. Instead, Occidental employed this argument to

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161 See *TSA Spectrum v Argentina* (Preliminary Objections) paras. 62–3.

162 *Eureko v Poland* (Merits) 12 ICSID Rep 335, 372/175 ('International law thus recognizes that an investor may, after a claim against a State has arisen, enter into a settlement agreement with that State and commit to a final waiver of those claims. The State can subsequently rely on that waiver and assert it as a defense against the investor, should such investor attempt to raise those claims again.').

163 [2005] EWCA Civ 1116, [2006] QB 432, 12 ICSID Rep 129.

164 (Merits) 7 ICSID Rep 442.

165 *Ibid*. 488/233.

resist the jurisdiction of the English court in proceedings commenced by Ecuador. Ecuador had applied under section 67 of the English Arbitration Act to challenge the arbitral award rendered in Occidental's favour in an arbitration pursuant to the USA/Ecuador BIT. The seat of the arbitration had been London.[166]

Ecuador moved to have the award set aside on the grounds that the tribunal had exceeded its jurisdiction by ruling upon a taxation matter. Article 10 of the BIT carved out taxation matters from the tribunal's jurisdiction subject to three exceptions.[167] One of those exceptions concerned disputes about taxation obligations under an investment agreement, and it was this exception that the tribunal invoked upon its own motion. That is to say, neither the claimant, nor the respondent, had characterised the dispute as one relating to 'the observance and enforcement of terms of an investment agreement'.[168] The tribunal went out on this limb because, in its view, the dispute touched upon the scope of the clause dealing with Occidental's tax liability in its production sharing agreement with Ecuador.[169] The clause in the PSA was known as Factor X. The tribunal thus concluded that the dispute could be characterised as a dispute about whether Occidental had been refunded its VAT payments under Factor X,[170] even though Ecuador had never defended Occidental's claim for VAT reimbursement on that basis.

So for jurisdictional purposes, the claim was characterised by the tribunal as a taxation dispute arising out of the terms of an investment agreement. But on the merits, the tribunal found that Occidental was not refunded for its VAT payments under Factor X of the PSA.[171] This perhaps explains why Occidental did not formulate its claim as a breach of an entitlement under a contract. Instead, the tribunal held that Occidental was entitled to a refund of its VAT payments under the *general* tax law of Ecuador.[172] But if the claim had been characterised as a dispute about the tax liability of Occidental under the general law of Ecuador, the tribunal would not have had jurisdiction by virtue of Article 10 of the Treaty.

Occidental was awarded more than USD 75 million by the tribunal and naturally wished to resist any challenge to the award. Occidental's argument before Aikens J and then the Court of Appeal was that Ecuador's section 67 application should not be heard at all because it was not justiciable before an English Court. Occidental maintained that, in the arbitration against Ecuador, it was claiming no more than to enforce the rights

166 *Ibid*. 129/2.
167 Namely, expropriation, transfers and the observance and enforcement of terms of an investment agreement or authorisation: *Occidental v Ecuador* (Merits) 12 ICSID Rep 59, 70/64.
168 *Ibid*. 72/72–3.
169 *Ibid*. 72–3/74.
170 *Ibid*.
171 *Ibid*. 80–1, 82/110, 115.
172 *Ibid*. 87/143.

which the United States would have under the investment treaty against Ecuador.[173] Therefore, in reviewing the jurisdiction of the arbitral tribunal, the English court would be compelled to 'adjudicate upon the transactions of foreign sovereign states'. And this, following Lord Wilberforce's speech in *Buttes Gas and Oil Co v Hammer*,[174] would not be justiciable.

The Court of Appeal found that international treaty instruments can create rights and obligations for non-state actors and the investment treaty is such an instrument. An investor does not step into the shoes of its national state in bringing an investment treaty arbitration; rather, an investor has a direct procedural right to invoke the substantive obligations in the treaty against the state that is host to its investment. The Court of Appeal adopted the present writer's analysis of this point:

> The fundamental assumption underlying the investment treaty regime is clearly that the investor is bringing a cause of action based upon the vindication of its own rights rather than those of its national State.[175]

It followed that neither the investor/state arbitration proceedings, nor the arbitration agreement giving rise to the arbitration, could be characterised as transactions between foreign states.[176] Certainly, when the English Court later ruled upon Ecuador's challenge to the award under section 67 of the Arbitration Act, it was obliged to interpret the provisions of the investment treaty in order to review the tribunal's decision on its own jurisdiction.[177] But this interpretive task does not transform the substance of the legal relationship between Occidental and Ecuador into a transaction between foreign states:

> The case is not concerned with an attempt to invoke at a national legal level a Treaty which operates only at the international level. It concerns a Treaty intended by its signatories to give rise to rights in favour of private investors capable of enforcement, to an extent specified by the Treaty wording, in consensual arbitration against one or other of its signatory States.[178]

The Court of Appeal was careful to note that the situation would be different with respect to an arbitration between the contracting state parties to the treaty, for which there is of course a wholly separate dispute resolution mechanism.[179]

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[173] 12 ICSID Rep 129, 133–4/11.
[174] [1982] AC 888, 931.
[175] 12 ICSID Rep 129, 137–8/20; Z. Douglas, 'The Hybrid Foundations of Investment Treaty Arbitration' (2003) *BYBIL* 151, 182.
[176] 12 ICSID Rep 129, 144–5/32.
[177] *Republic of Ecuador v Occidental Exploration & Production Co (No. 2)* [2006] EWHC 345 (Comm), [2006] 1 Lloyd's Rep 773; *Republic of Ecuador v Occidental Exploration & Production Co (No. 2)* [2007] EWCA Civ 656, [2007] 2 Lloyd's Rep 352.
[178] 12 ICSID Rep 129, 147–8/37.
[179] *Ibid*. 147/39.