



## **General Public International Law and International Investment Law**

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DOI:

[10.25673/76735](https://doi.org/10.25673/76735)

*Publication date:*  
2011

*Document Version*  
Publisher's PDF, also known as Version of record

[Link to publication](#)

*Citation for published version (APA):*

Tams, C. J., Braun, T. R., Lorz, R. A., Schill, S. W., Tietje, C., & Behring, J. (2011). *General Public International Law and International Investment Law: A Research Sketch on Selected Issues*. (Beiträge zum Transnationalen Wirtschaftsrecht; Vol. 105). Martin-Luther-Universität Halle-Wittenberg. <https://doi.org/10.25673/76735>

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**ILA German Branch / Working Group**

General Public International  
Law and International  
Investment Law  
– A Research Sketch on  
Selected Issues –

**Heft 105**

**March 2011**

**General Public International Law and  
International Investment Law  
– A Research Sketch on Selected Issues –**

**The International Law Association  
German Branch  
Sub-Committee on Investment Law**

by

**The Working Group on General Public International Law and International  
Investment Law:**

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This publication was made possible with the financial support of  
GfA – Gesellschaft zur Förderung von Auslandsinvestitionen e.V., Berlin.

Christian Tietje/Gerhard Kraft/Matthias Lehmann (Hrsg.), Beiträge zum Transnationalen Wirtschaftsrecht, Heft105

Bibliografische Information der Deutschen Bibliothek

Die Deutsche Bibliothek verzeichnet diese Publikation in der Deutschen Nationalbibliografie; detaillierte bibliografische Daten sind im Internet unter <http://www.dnb.ddb.de> abrufbar.

ISSN 1612-1368 (print)

ISSN 1868-1778 (elektr.)

ISBN 978-3-86829-324-1

Nominal Charge: 5 Euro

The „Essays on Transnational Economic Law“ may be downloaded free of charge at the following internet addresses:

<http://institut.wirtschaftsrecht.uni-halle.de/de/node/23>

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## PREFACE

### **Introductory Preface to the Two Working Group Papers Published by the Subcommittee on Investment Law of the German Branch of the International Law Association**

*Prof. Dr. Dr. Rainer Hofmann, Prof. Dr. Richard Kreindler*

The two working group papers, published under the titles “General Public International Law and International Investment Law – A Research Sketch on Selected Issues“ and “The Determination of the Nationality of Investors under Investment Treaties – A Preliminary Report”, present the fruits, common positions and recommendations of the members of the Subcommittee on Investment Law of the German Branch of the International Law Association, after intensive research and discussions during the past 18 months. The two papers aim to contribute to the development of international investment law in general and to the formulation of German positions and interests in particular.

The Subcommittee on Investment Law of the German Branch of the International Law Association was established in 2008 by Prof. Dr. Dr. Rainer Hofmann and Prof. Dr. Richard Kreindler. The Subcommittee had its origins in a discussion within the Board of the German Branch of the International Law Association in Heidelberg in Summer 2007. As a result of that discussion, the Board favored the creation of a new Subcommittee on Investment Law, modeled after the Subcommittee on Air and Space Law, which had been established by Prof. Dr. Karl-Heinz Böckstiegel and is currently headed by Prof. Dr. Stephan Hobe.

The Subcommittee on International Investment Law was founded against the background of the increasing significance of international investment law both globally and as relates to Germany. It was concluded that this development called for a focus on issues and interests from a German perspective in the form of a standing committee. The aim of the Subcommittee on Investment Law is to bring together German interests in the field of investment law and to identify and elaborate common positions, notably from the viewpoint of German investors, the German Government and German academia respectively, including in the context of the interest in a well-conceived and properly functioning system of dispute resolution through investment-related arbitration. With its establishment within the framework of the German Branch of the International Law Association, the Subcommittee also seeks to serve as a source of continuing education and expertise for the German Branch’s members in the field of investment law and investment arbitration.

The working group initially consisted of some 20 practitioners, professors, in-house counsels and other representatives of government, academia and industry in

Germany whose activities and expertise materially touch on issues of international investment law and arbitration. The Subcommittee meets twice a year in Frankfurt Main and has as its goal discussion, research and writing on one or two comprehensive topics each year. The present publication is the result of the Subcommittee's initial work. The working group on "General Public International Law and International Investment Law" was headed by Prof. Dr. Christian Tietje and the working group on "The Determination of the Nationality of Investors under Investment Treaties" by Robert Hunter. The papers prepared by each working group were intensively discussed during the plenary sessions of the Subcommittee and reflect both the commonality and diversity of opinions and positions within the Subcommittee.

The papers were first published in draft form on the occasion of the "50 Years BITs" conference in Frankfurt Main in December 2009. Both papers were part of the handout distributed to all participants. The Subcommittee sought thereby to elicit comments from a wide range of colleagues in the field, to be reflected in the final version of the working group papers.

In its session of April 2010, the Subcommittee on Investment Law decided to enlarge its current basis of members. It now consists of some 30 experts in the field of investment law who in the upcoming year will address two closely interrelated topics: "Legality of the Investment" and "Investment Law and Corruption." The working group on "Legality of the Investment" will be headed by Dr. Sabine Konrad, while the working group on "Investment Law and Corruption" will be headed by Prof. Hilmar Raeschke-Kessler and Dr. Marie Louise Seelig.

We hope that this current publication contributes to the further development of international investment law in Germany and elsewhere, and we welcome comments on the Subcommittee's work. Finally, we express our gratitude to Prof. Dr. Christian Tietje and Robert Hunter, who have worked tirelessly towards achieving this comprehensive work-product in the form of the working group papers. We also thank each of the Subcommittee members for their contributions to the working papers, the related discussions, and the overall work product represented in the pages that follow.

Frankfurt am Main, Germany, December 2010.

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## A. Introduction

International investment law enjoys growing practical as well as scholarly attention. With increasing numbers of bilateral and multilateral investment treaties, investment provisions in preferential trade agreements, and investment treaty arbitrations, international law scholars, legal practitioners, civil society, investment law policy makers, international organizations, and investment treaty negotiators increasingly focus their interest on this field of international law. At the same time, many conceptual questions relating to international investment law remain insufficiently studied. This gap in scholarship notably holds true for the interpretation of substantive standards of international investment law, the choice of remedies including the calculation of damages, the procedural law of investor-state arbitration, and increasingly questions concerning the relationship of obligations of host states under international investment law and other international law, *e.g.* human rights or environmental treaties.

Not surprisingly, arbitral tribunals regularly deplore the lack of definitions and analysis of standard concepts of international investment protection, and states and investors are wary of the unpredictability of decisions by arbitral decisions. This unpredictability is apparent as various investment tribunals navigate through issues of substantive standards, remedies, and procedure without a clear conceptual framework of the nature and function of international investment law and investor-state arbitration. In addition, since arbitral tribunals are constituted separately for every dispute and are therefore constantly different, the system faces the constant threat of inconsistent decisions and fragmentation.<sup>1</sup>

It is purported that one of the reasons for the tensions in the implementation of the international legal framework for investment relations is the clash within investment treaty arbitration between commercial arbitration and public international law approaches. Public international lawyers conceptualize international investment law within general international law. Indeed, historically, international investment law has long been seen as an aspect of public international law, and therefore, international public lawyers consider this application to be obvious. Yet, public international law scholarship still rarely situates international investment law firmly within the matrix of general (public) international law.<sup>2</sup> Conversely, practitioners from a commercial arbitration background rarely conceptualize investment treaty arbitration within the matrix of public international law. For many arbitration practitioners, there are few, if any, differences in the functioning of investment treaty arbitration and commercial arbitration, and their paramount concern is the settlement of disputes in the sole interest of the two parties. Accordingly, these practitioners view the governing law of investor-state disputes less as providing a legal order for international investment relations but instead reduce international law to mere arguments and counterarguments in an adversarial proceeding. Public international

<sup>1</sup> See *Schill*, *The Multilateralization of International Investment Law*, 281-293.

<sup>2</sup> See, however, *e.g.*, *McLachlan*, *ICLQ* 58 (2008), 361 *et seq.*

law scholars and practitioners, in turn, tend to neglect the role of adversarial arbitral proceedings in shaping rules and defining specific characteristics of international investment law.<sup>3</sup> Even though public and private law perspectives mostly merge in investment treaty arbitration, there remains a divide in the conceptual frameworks of private and public law perspectives and in the epistemic communities of commercial arbitration and public international lawyers. Overall, the situation today is similar to what has been stated by *Wetter* in 1979 and *Caron* in 1986:

“Commercial lawyers regard arbitrations between states as wholly irrelevant; and public international teachers, advocates and officials view commercial arbitration as an essentially alien process ...”<sup>4</sup>

“Although both public and private international arbitrations are concerned with legal resolution of disputes arising in an international context, these two processes have remained quite distinct”.<sup>5</sup>

Faced with these still clashing approaches, *i.e.*, the commercial arbitration framework, on the one side, and the abstract public international law character, on the other, developing a comprehensive conceptual framework for international investment law remains a challenge. It is not surprising that there are sharply distinct approaches regarding the extent that general public international law should be taken into account by arbitral tribunals while dealing with a specific bilateral investment treaty.<sup>6</sup>

This paper tries to overcome this conceptual divide from the perspective of public international law. The authors depart from the premise that public international lawyers are able to and indeed should seek to underline the public (international) law nature of many of the critical issues in investment law and arbitration, and to embed these issues firmly in public international law rationales and concepts. The main reason for this is simple: international investment law is part of public international law. This connection is established once the source of law in an investment dispute is established in a bilateral investment treaty, an instrument of public international law; the connection extends to both arbitral procedure and the merits of the dispute. Moreover, the historical roots of international investment protection law are extensively found in the law concerning the treatment of aliens as a classical area of public international law.<sup>7</sup> It therefore follows that certain aspects of general public international law are applicable in international investment law and arbitration. The most notable examples are the customary rules of treaty interpretation as enshrined in

<sup>3</sup> Cf. *Wälde*, in: Binder/Kriebaum/Reinisch/Wittich (eds.), *International Investment Law for the 21st Century*, 724 (discussing the differences in approaches to treaty interpretation among public international lawyers and lawyers with a background in commercial law and arbitration).

<sup>4</sup> *Wetter*, *International Arbitral Process*, Vol. I, xxiv.

<sup>5</sup> *Caron*, *ZaöRV* 1986, 465 (472).

<sup>6</sup> See, *e.g.*, on the one hand *Waste Management Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Final Award of 20 April 2004, para. 85 (no room for implying into the treaty additional requirements of general public international law), and on the other *Enron Corporation and Ponderosa L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Decision on Jurisdiction of 14 January 2004, para. 46 (“Each instrument must be interpreted autonomously in the light of its own context and in the light of its interconnections with international law.”).

<sup>7</sup> For details see, *e.g.*, *Vandeveldde*, in: Sauvants/Sachs (eds.), *The Effects of Treaties on Foreign Direct Investment*, 3 *et seq.*

Articles 31-33 of the Vienna Convention on the Law of Treaties<sup>8</sup> and the rules of customary international law concerning state responsibility as largely laid down in the ILC Articles on State Responsibility.<sup>9</sup>

Of course, not all rules of general international law are equally applicable to a specialised sub-area such as international investment law. However, there is a clear relationship between treaties governing investment law and other sources of general international law. Until now, attempts to clarify this relationship have focused mainly on the role of customary international law, which may guide the interpretation of broadly formulated treaty standards and conversely be shaped by a concordant treaty practice. Some attempts have also been made to clarify the relationship between obligations of host states under an investment treaty, on the one hand, and under other public international law, namely other international treaties, on the other. However, scholarly research in this regard has mostly concentrated on very specific questions or cases, or on the more general question whether the number of existing BITs in conjunction with the practice of arbitral tribunals has actually established certain rules of investment protection law as customary international law.<sup>10</sup>

This research project takes up the already existing debate on the relationship between general public international law and international investment law. In doing so, the project starts on the basis of certain premises: First, as already indicated, the authors conduct their research from a perspective of public international law based on the fact that at least BIT-based investment law has its roots in public international law; Second, it is the firm belief of the authors that the complexity of the relationship between general public international law and international investment law can only be understood if one asks not only how public international law influences investment law, but also tries to analyse how investment law has an impact on principles and rules

<sup>8</sup> 1155 U.N.T.S. 331; on the application of the VCLT see, .e.g., *Continental Casualty Company v. The Argentine Republic*, ICSID Case No. ARB/03/9, Decision on the Claimant's Preliminary Objection to Argentina's Application for Annulment of 23 October 2009, para. 23.

<sup>9</sup> On the application of the ILC Articles on State Responsibility see, .e.g., *Chevron Corporation (U.S.A.) and Texaco Petroleum Corporation (U.S.A.) v. The Republic of Ecuador*, UNCITRAL Arbitration, Interim Award of 1 December 2008, para. 118.

<sup>10</sup> See, .e.g., *McLachlan*, ICLQ 58 (2008), 361 *et seq.*; *Schwebel*, The Influence of Bilateral Investment Treaties on Customary International Law, ASIL Proceedings 98 (2004), 27; ICJ, *Ahmadou Sadio Diallo (Republic of Guinea v. DR Congo)*, 24 May 2007, General List No. 103; *Gazzini*, JWIT 8 (5, 2007), 691 *et seq.*; *Pope & Talbot Inc. v. Government of Canada*, Award in Respect of Damages of 31 May 2002, ILM 41 (2002), 1347, paras. 55 *et seq.*; *United Parcel Service of America Inc v. Government of Canada*, Award on Jurisdiction of 22 November 2002, paras. 86 *et seq.*; for a possible supposition: *Lowenfeld*, International Economic Law, 584; *Mann*, BYIL 52 (1981), 241 (249); *Wälde*, in: Kahn/Wälde (eds.), New Aspects of International Investment Law, 96 *et seq.*; *Schwebel*, Suffolk Transnational Law Review 32 (2009), 263 *et seq.*: ("In view of the immense number of treaties and predominant consistency of their terms, there is room for the view that they have reshaped the body of customary international law in respect of the treatment and taking of foreign investment. ... Certain core provisions ... by the fact of being prescribed in some 2800 treaties, have seeped into the corpus of customary international law, with the result that they are binding on all states including those not parties to BITs."); *cautious*: *Schwebel*, The Influence of Bilateral Investment Treaties on Customary International Law, Proc. 98<sup>th</sup> Annual Meeting of the ASIL (2004), 27; *Sornarajah*, The International Law of Foreign Investment, 206; *Hindelang*, JWIT 5 (2004), 789; *Kishoiyian*, Northwestern Journal of International Law and Business (1993), 14 (327); *Faruque*, Indian J. Int'l L. 44 (2004), 292; *Griebel*, Internationales Investitionsrecht, 109 *et seq.*

of general public international law. Thus, this research project tries to enlarge the perspective by bringing together different concepts of general public international law and their relation to international investment law. The goal of this attempt is to show how international investment law is shaped and influenced by general public international law and *vice versa*. This approach will enable us to think in a broader perspective of public international law rationales and concepts while discussing specific aspects of international investment law. Embedding international investment law firmly in public international law helps to broaden the focus beyond questions of treaty interpretation and arguably helps to legitimize investment treaties and investor-state arbitration by drawing on the public international law framework and its function not only to limit states in their interaction with each other, but also to facilitate inter-state and investor-state cooperation and therefore empower states.

Furthermore, it is the belief of the authors that the ‘internationalization of the rule of law’ and the legalisation of trans-border economic transactions accompanying bilateral investment treaties and investor-state arbitral proceedings do not only serve the interests of investors. They also equally serve the interests of the states and the international community as a whole in providing a basis for legal settlements in investment disputes between host states and investors, as well as in the enforcement of international law. In this regard, exceeding the concrete case at hand, international investment law also fulfils an *ordering function* for international investment relations.<sup>11</sup> The legal implementation of international investment law can itself be described as a *global public good*.<sup>12</sup> Bilateral investment treaties and investor-state arbitration as an institutionalized form of an ‘investment law culture’ remain committed to the common aim of promoting international economic exchange and development through the rule of law. Contracting state parties, including Germany, as well as arbitral tribunals themselves,<sup>13</sup> bear the responsibility for assuring the reasonable form and functionality of this system of international investment arbitration.

<sup>11</sup> See generally *Schill*, *The Multilateralization of International Investment Law*, 17 (“Investment treaties are ... not designed to function like private law contracts that order the relationship between a limited number of parties and contain the exchange of specific transactions, but have a constitutional function in providing a legal framework within which international investment activities can take shape and expand. As such, investment treaties are embedded in a larger framework of international law that overarches the individual bilateral treaty relations and establishes uniform rules for the conduct of host States that consist in adopting a liberal attitude vis-à-vis market mechanisms and that accept the limited role of the State vis-à-vis the economy.”).

<sup>12</sup> Classically: *Samuelson*, *Review of Economics and Statistics* 36 (1954), 387; *Kaul/Grünberg/Stern*, *Global Public Goods, International Cooperation in the 21st Century*; referring to international economic law: *Tietje*, in: *Tietje* (ed.), *Internationales Wirtschaftsrecht*; *Meesen*, in: *Meesen/Bungenberg/Puttler* (eds.), *Economic Law as an Economic Good*, 3.

<sup>13</sup> *M.C.I. Power Group and New Turbine v Republic of Ecuador*, ICSID Case No. ARB/03/6, Decision on Annulment of 19 October 2009, para. 24 (“*The responsibility for ensuring consistency in the jurisprudence and for building a coherent body of law rests primarily with the investment tribunals.*”; para. 25: “*Although there is no hierarchy of international tribunals, as acknowledged in SGS v. Philippines, the Committee considers it appropriate to take those decisions into consideration, because their reasoning and conclusions may provide guidance to the Committee in settling similar issues arising in these annulment proceedings and help to ensure consistency and legal certainty of the ICSID annulment mechanism, thereby contributing to ensuring trust in the ICSID dispute settlement system and predictability for governments and investors.*”).

Based on the aforementioned thoughts, this paper identifies areas of international law which provide a basis for how general public international law and international investment law influence each other. This premise is analysed by first examining ways in which general public international law can have an influence on principles and rules of international investment law (B.), and second discussing examples of how investment law has an influence on rules and principles of general public international law (C.). The separation of those two perspectives is, however, done only in order to provide transparency; it is not meant to indicate that one should think in separate categories. To the contrary, it is a central thesis of this paper that there is a mutual influence of general public international law and international investment law. Some conceptual aspects of this mutual influence are discussed in the concluding section of this paper (D.).

## **B. General Public International Law Influencing International Investment Law**

The following two sections discuss areas of international investment law that are influenced by public international law. The first example demonstrates this influence using the principle of “fair and equitable treatment”. The section describes how this principle has been addressed in the practice of arbitral tribunals and how this practice can be conceptualized and further concretized by drawing on an often neglected source of international law, namely general principles of law. Fair and equitable treatment, in this context, serves as an example for how public international law and its concepts can be used as a means of concretizing international investment law and of bringing more certainty to the process of defining and applying the broad principles of international investment law. The second section considers the problem of nationality of corporations, and specifically how the nationality of a corporation is determined. The section elucidates how in certain instances a substantive relationship between a corporation and the respective home state is necessary and how this requirement emerges from larger principles of customary international law.

### **I. International Investment Law and General Principles of Law**

*Stephan Schill*

While some work has already been done on the relationship of customary international law and standards of treatment in investment treaties,<sup>14</sup> other sources of general public international law largely have been neglected by arbitral tribunals in interpreting substantive principles of international investment law, namely general principles of law in the sense of Article 38(1)(c) of the Statute of the International Court of Justice.<sup>15</sup> By contrast, general principles of law have played quite a significant

<sup>14</sup> See, for example, references cited *supra* note 10.

<sup>15</sup> But see *International Thunderbird Gaming Corporation v. The United Mexican States*, UNCITRAL/NAFTA, Arbitral Award of 26 January 2006, Separate Opinion by Thomas Wälde.

role in determining the parties' substantive obligations in the oil concession arbitrations in the pre-BIT era,<sup>16</sup> and in order to fill gaps in the substantive and procedural law applicable in investor-state arbitrations, including under the ICSID Convention.<sup>17</sup>

Yet, general principles of law arguably can also be used in order to elucidate complex questions involving the interpretation of broadly formulated substantive standards of treatment, such as fair and equitable treatment, or the concept of indirect expropriation, or as a basis to develop solutions for procedural issues that investment tribunals face, for example developing and concretizing the appropriate standards of review.<sup>18</sup> Overall, this section suggests that a focus on general principles of law can help arbitral tribunals to develop more robust views on a theory of principles of international investment law and arbitration, including their relation to theories of state liability under domestic legal orders and under other international legal regimes. Making more use of general principles as a proper source of international law, or at least drawing inspiration and guidance from the comparative legal analysis underlying the development of general principles, for the interpretation of substantive investment treaty obligations may also be a way to counter the wide-spread critique that there exists a problem in formulating investor rights as broad principles and entrusting arbitral tribunals with their application to and concretization for specific cases. How such an approach can be conceptualized and put into practice will be analysed with respect to the fair and equitable treatment standard; but it equally applies to the other standard investor rights, including the concept of indirect expropriation, full protection and security, national treatment, or the interpretation of umbrella clauses.

### *1. Concretizing Investor Rights through General Principles*

Many of the standard investor rights contained in bilateral investment treaties are extremely vague and ambiguous. The principle of fair and equitable treatment, for example, while it is emerging as one of the core concepts of international investment protection and is frequently invoked and applied by arbitral tribunals, is characterized by a lack of clarity concerning the principle's normative content and scope.<sup>19</sup> The standard of fair and equitable treatment does not have a precise content that can easily be applied. Apart from consensus on the fact that fair and equitable treatment

<sup>16</sup> See *Newcombe/Paradell*, *Law and Practice of Investment Treaties*, 25-26 (with further references).

<sup>17</sup> See *Schreuer/Malintoppi/Reinisch/Sinclair*, *The ICSID Convention*, Art. 42, paras. 178-182.

<sup>18</sup> See, for example, *Schill/Briese*, *Max Planck Ybk of UN Law* 13 (2009), 61 (120-138).

<sup>19</sup> There is a vivid debate whether and to which extent the fair and equitable treatment standard is equivalent to the customary international law minimum standard. See *Dolzer/Schreuer*, *Principles of International Investment Law*, 124-128. Most recently also *Glamis Gold, Ltd. v. United States of America*, UNCITRAL/NAFTA, Award of 8 June 2009, paras. 598-618. In my view, this controversy, however, does not lead far in concretizing the content of what fair and equitable treatment requires, as, even if it is tied to customary international law, its content remains vague, as the customary international law minimum standard itself is rather amorphous. I am thus critical as to whether it is feasible to draw sensible distinctions between a standard that equates fair and equitable treatment with customary international law and an autonomous interpretation of fair and equitable treatment.



constitutes a standard that is independent from the domestic legal order and does not require state conduct in bad faith,<sup>20</sup> it is hardly substantiated by state practice or elucidated by *travaux préparatoires* and difficult to narrow down by traditional means of interpretation. An interpretation of the ordinary meaning may replace the terms “fair and equitable” with similarly vague and empty phrases such as “just”, “even-handed”, “unbiased” or “legitimate”,<sup>21</sup> but does not succeed in clarifying its normative content.<sup>22</sup> Above all, the semantics of fair and equitable treatment do not clarify as against which standard “fairness and equitableness” has to be measured. It could equally refer to notions of equality or substantive justice, or to less grand notions of procedural due process.

Likewise, a teleological interpretation hardly provides a more specific meaning even if the purpose of international investment treaties points to the protection and promotion of foreign investment and the deepening of the mutual economic relations between the contracting states.<sup>23</sup> While narrowing down the possible understandings of fair and equitable treatment to an economic framework, a purposive interpretation does not enable tribunals to directly translate the broad language into specific guarantees for foreign investors in the sense of hard and fast rules. It is difficult, in other words, to foresee whether a wide interpretation of an international investment treaty will actually encourage investment flows or have the opposite effect of chilling the investment climate if host states in reaction admit less foreign investment.<sup>24</sup>

The traditional methods of treaty interpretation therefore prove to be relatively ineffective in clarifying the meaning of fair and equitable treatment. Understandably then, investment tribunals do not follow a uniform methodology.<sup>25</sup> Some tribunals follow an approach that extensively describes the facts of a case and simply characterizes them as a violation of fair and equitable treatment.<sup>26</sup> The problem with this approach is that it does not elucidate the normative content of fair and equitable

<sup>20</sup> Concerning the independence of fair and equitable treatment from domestic law see, for example, *Dolzer*, Int'l Law. 39 (2005), 87 (88); on independence from bad faith see *Schreuer*, JWIT 6 (2005), 357 (384 *et seq.*).

<sup>21</sup> Compare *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Award of 25 May 2004, para. 113.

<sup>22</sup> It rather confirms that a terminological approach does not succeed in substantiating and clarifying what fair and equitable refers to. In this sense *Saluka Investments BV v. The Czech Republic*, UNCITRAL, Partial Award of 17 March 2006, para. 297; differently *Dolzer*, Int'l Law. 39 (2005), 87 (88).

<sup>23</sup> On the object and purpose of investment treaties and the statements contained in the treaties' preambles see *Dolzer/Stevens*, *Bilateral Investment Treaties*, 11 *et seq.*, 20 *et seq.*

<sup>24</sup> Accordingly, the Tribunal in *Noble Ventures, Inc. v. Romania*, ICSID Case No. ARB/01/11, Final Award of 12 October 2005, para. 52 warned that a teleological interpretation should not automatically lead to an interpretation of bilateral investment treaties *in dubio pro investore*.

<sup>25</sup> See *Dolzer*, Int'l Law. 39 (2005), 87 (93 *et seq.*) (discerning the three lines of reasoning addressed in the text).

<sup>26</sup> From the early arbitral jurisprudence, see for example *Mondev v. United States of America*, ICSID Case No. ARB(AF)/99/2 (NAFTA), Award of 11 October 2002, para. 118 (stressing that “[a] judgment of what is fair and equitable cannot be reached in the abstract; it must depend on the facts of the particular case”). See also the little normative, but very fact-intensive approach in *Eastern Sugar B.V. v. The Czech Republic*, SCC Case No. 88/2004, Partial Award of 27 March 2007, paras. 222-343.

treatment and leaves the legal reasoning underlying the decision obscure. Other tribunals simply posit an abstract standard as part of fair and equitable treatment and subsequently subsume the facts of the case under this standard.<sup>27</sup> While this way of reasoning is closer to the traditional legal syllogism, the tribunals nevertheless fail to properly justify how they ground the abstract standards they posit in the treaty standard of fair and equitable treatment. Finally, most tribunals, in particular with increasing numbers of arbitral awards available, apply fair and equitable treatment with a strong reference to prior arbitral jurisprudence.<sup>28</sup> This approach has the benefit of allowing tribunals to approach the interpretation of fair and equitable treatment in a case-sensitive way, while taking account of the fact that arbitral jurisprudence, including on fair and equitable treatment, is a source of expectations investors and states develop regarding the future application of the standard principles of international investment law, even if arbitral precedent is not formally binding. Nevertheless, this approach prompts the criticism that earlier decisions have themselves applied a problematic methodology in terms of failing to grasp the normative content of fair and equitable treatment.

By failing to establish a clear normative content of fair and equitable treatment, arbitral tribunals run the risk of facing the reproach that they handle the standard as a malleable tool of *ex post facto* control of host states' measures based on the arbitrators' personal conviction and understanding about what is fair and equitable.<sup>29</sup> Some commentators therefore suggest that fair and equitable treatment constitutes "an intentionally vague term, designed to give adjudicators a quasi-legislative authority to articulate a variety of rules necessary to achieve the treaty's object and purpose in particular disputes".<sup>30</sup>

<sup>27</sup> From the early arbitral jurisprudence, see for example *S.D. Myers, Inc. v. Government of Canada*, UNCITRAL, Partial Award of 13 November 2000, para. 134.

<sup>28</sup> From the early arbitral jurisprudence, see for example *Waste Management v. Mexico*, *supra* note 6, paras. 89 *et seq.* Meanwhile virtually all tribunals define and apply fair and equitable treatment in relation to the statements contained in earlier arbitral jurisprudence.

<sup>29</sup> The assumption that personal convictions, instead of prescriptive legal standards, play a major role in applying fair and equitable treatment is nourished by the frequent reference to treatment that "shocks, or at least surprises, a sense of juridical propriety" as a yardstick for the standard's application. See for example *Técnicas Medioambientales Tecmed S.A. v. The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award of 29 May 2003, para. 154 (quoting the decision of the International Court of Justice in *Elettronica Sicula S.p.A. (ELSI) (United States of America v. Italy)*, Judgment of 20 July 1989, I.C.J. Reports 1989, 15, para. 128). For criticism of the ICJ's test for arbitrariness in the *ELSI* case see *Hamrock*, *Tex. Int'l L. J.* 27 (1992), 837 (849 *et seq.*) (highlighting the prevalence of subjective elements in the Court's test). See also *UNCTAD, Fair and Equitable Treatment*, 10 (noting the "inherently subjective" trait of the concepts of fairness and equitableness); *Yannaca-Small*, OECD Working Papers on International Investment, No. 2004/3 (2004), 2 *et seq.* (mentioning the concern of "a number of governments ... that, the less guidance is provided for arbitrators, the more discretion is involved and the closer the process resembles decisions *ex aequo et bono*, *i.e.* based on the arbitrators' notions of 'fairness' and 'equity'."), available at: <<http://www.oecd.org/dataoecd/22/53/33776498.pdf>> (last visited on 20 December 2010).

<sup>30</sup> *Brower*, *Columb. J. Transnat'l L.* 40 (2001), 43 (56). Similarly *Franck*, *Fordham L. Rev.* 73 (2005), 1521 (1589) (arguing that the interpretative openness of fair and equitable treatment may be better than "over-definition"); *Vandeveldt*, *United States Investment Treaties*, 76. See also *Dolzer*, *Int'l Law.* 39 (2005), 87 (89) (suggesting that states deliberately included this general standard as a gap-filling clause). Similarly, other commentators support the view that the

In particular, to the extent arbitral tribunals generate unpredictable, or even worse inconsistent, decisions, dispute settlement by arbitration appears unsatisfactory from the perspective of both host states, who need to evaluate the way they exercise public authority without violating investment treaty obligations,<sup>31</sup> and foreign investors who desire a stable and predictable investment climate and need to know beforehand from which political risks and government interference they are protected by the respective investment treaty. Inconsistencies in the application of essentially identical standards in investment treaty arbitration further is problematic as investment treaty awards regularly become public and exercise influence on the future decision-making of arbitral tribunals. Inconsistencies, then, go to the core of challenging the ability of international law to stabilize expectations.

An alternative approach to conceptualizing and interpreting fair and equitable treatment in investment treaty arbitration could therefore lie in drawing parallels to public law standards used in both domestic law and other international law regimes. The conceptual idea would be to tackle problems arising under international investment treaties by means of a comparative methodology, focusing on comparative administrative and comparative constitutional law, as well as cross-regime analysis, for example as regards WTO law or human rights law. This approach could serve the purpose of concretizing and clarifying the interpretation of the often vague standards of investment protection, such as the concept of indirect expropriation or fair and equitable treatment, by assessing which commonalities exist on the level of domestic legal systems and other international regimes in dealing with certain questions of public law that empower and/or restrict the state in its relations with private individuals and corporate actors. Such an approach suggests drawing, in a comparative perspective, on the functions of public law to limit, but also to legitimize, state action *vis-à-vis* private actors.

The methodological basis for importing comparative public law into international investment law can be found at the level of international law. There are two gateways in international law for a comparative public law approach to international investment law. The first gateway is the concept of “general principles of law” as recognized by Article 38(1)(c) of the Statute of the International Court of Justice as one of the sources of international law (albeit in antiquated language infused by euro-centric structures of international law formulated as “the general principles of law recognized by civilized nations”). The second gateway for the impact of comparative public law

interpretative problems posed by the principle’s vagueness should be solved by simply letting tribunals do the work in developing more precise elements of fair and equitable treatment. See, for example, *Schreuer*, JWIT 6 (2005), 357 (365) (explaining that fair and equitable treatment “is susceptible of specification through judicial practice”); *Dolzer*, Int’l Law. 39 (2005), 87 (105) (concluding that the task with respect to fair and equitable treatment is “developing a body of jurisprudence tailored to the specific structures of foreign investment and acceptable to investors, the host state and the home state”). But see *Porterfield*, U. Pa. J. Int’l Econ. L. 27 (2006), 79 (103 *et seq.*) (questioning whether states intended such a broad delegation of powers to international tribunals).

<sup>31</sup> Alternatively, host states may even abstain from regulation due to this insecurity. International investment treaties would then result in a “regulatory chill”, possible even in areas where regulation is not only necessary but possible even in the interest of foreign investors. In this sense *Franck*, AJIL 99 (2005), 675 (678).

approaches lies in Article 31(3)(c) of the Vienna Convention on the Law of Treaties, which recognizes that international treaties have to be interpreted by taking into account “any relevant rules of international law applicable in the relations between the parties”.

This approach would include general principles of law recognized under Article 38(1)(c) of the ICJ Statute. Notably, such a comparative law approach already explicitly forms part of the 2004 United States Model BIT that defines fair and equitable treatment as “includ[ing] the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world.”<sup>32</sup> But this methodology could equally be applied to concretize the fair and equitable treatment standard, as well as other standards of treatment, in German investment treaties, or in fact the investment treaties of most other countries, that usually contain broadly formulated grants of fair and equitable treatment and other standards without the concrete definitions contained in the U.S. Model BIT.<sup>33</sup>

In the following section, an attempt is made to provide a normative framework of analysis for the interpretation and application of fair and equitable treatment which can then be used as a conceptual framework for applying general principles of law. The methodology, in this context, is of a dual nature. In a first step, it is inductive by looking at arbitral jurisprudence and reconstructing fair and equitable treatment in a comparative law framework and arguing that it can be understood as the concept of the rule of law (*Rechtsstaat, état de droit*) as it is found in many domestic legal systems and increasingly in international legal regimes. In a second step, concrete subsets of fair and equitable treatment can be refined and concretized by engaging in comparative analysis of subsets of the rules of law as it is understood by domestic and international legal regimes in a manner that is typical for the development of general principles.

## 2. *Fair and Equitable Treatment as an Embodiment of the Rule of Law*

The rule of law is a wide-spread positive legal concept that can be found with similar characteristics in most legal systems that adhere to liberal constitutionalism.<sup>34</sup>

<sup>32</sup> U.S. Model BIT (2004), Article 5(2)(a), reprinted in *Dolzer/Schreuer*, Principles of International Investment Law, 385-419.

<sup>33</sup> See, for example, Article 3(1) of the Agreement between the People’s Republic of China and the Federal Republic of Germany on the Encouragement and Reciprocal Protection of Investments, signed on 1 December 2003, entered into force 11 November 2005 (providing that “[i]nvestments of investors of each Contracting Party shall at all times be accorded fair and equitable treatment in the territory of the other Contracting Party”).

<sup>34</sup> See *Schulze-Fielitz*, in: Dreier (ed.), *Grundgesetz – Kommentar*, Vol. II, Art. 20, paras. 1-33 (describing the development of the concept of the rule of law as a central principle of constitutionalism). See also the contributions in *Hofmann/Marko/Merli/Wederin* (eds.), *Rechtsstaatlichkeit in Europa*; *von Bogdandy/Cruz Villalón/Huber* (eds.), *Ius Publicum Europaeum*, Vol. I; *Sellers/Tomaszewski* (eds.), *The Rule of Law in Comparative Perspective*.

Relying on a common tradition,<sup>35</sup> the main thrust of the rule of law is the aspiration to subject public power to legal control.<sup>36</sup> In the words of *F. A. Hayek*,

“stripped of all technicalities this means that government in all its actions is bound by rules fixed and announced beforehand – rules which make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances, and to plan one’s individual affairs on the basis of this knowledge.”<sup>37</sup>

The rule of law primarily refers to the formal quality of law as providing guidance for human affairs and comprises the institutional aspiration that government has to use law as a means of exercising power.<sup>38</sup> This abstract principle of the rule of law translates into procedural requirements for the deployment of legal processes<sup>39</sup> and mandates that “individuals whose interests are affected by the decisions of ... officials have certain rights”, such as

“the right to a hearing before a decision is made, the right to have the decision made in an unbiased and impartial fashion, the right to know the basis of the decision so that it can be contested, the right to reasons for the official’s decision, and the right to a decision that is reasonably justified by all relevant legal and factual considerations.”<sup>40</sup>

Hence, the rule of law requires that the affected individual is recognized as a subject with certain rights that have to be taken into account in the decision-making process of public authorities. In addition to the recognition of procedural rights, the rule of law is often also at the origin of the idea of proportionality, referring to the proper balance between the interests of the individual and competing public interests.<sup>41</sup> Finally, the rule of law has implications for the institutional design of government. It mandates a basic separation of powers and the possibility to seek review of public acts by an independent judiciary.<sup>42</sup> Essentially it is this primarily formal understanding of the rule of law that prevails in many domestic legal traditions.<sup>43</sup>

<sup>35</sup> On the development of the rule of law in its politico-philosophical background see *Tamanaha*, *On the Rule of Law*. For the thesis that the rule of law is a concept common to civil and common law see also *Zolo*, in: *Costa/Zolo* (eds.), *The Rule of Law*, 3.

<sup>36</sup> *Dyzenhaus*, *Law & Contemp. Prob.* 68 (2005), 127 (130); similarly *Waldron*, *Law & Philosophy* 21 (2002), 137 (158); *Hesse*, in: *Forsthoff* (ed.), *Rechtsstaatlichkeit und Sozialstaatlichkeit*, 557 (560 *et seq.*). As such, it should also be distinguished from other concepts of good and desirable government, such as human rights, democracy or justice. See *Raz*, *L. Quart. Rev.* 93 (1977), 195 *et seq.*

<sup>37</sup> *Hayek*, *The Road to Serfdom*, 54.

<sup>38</sup> On the formalist ideal of the rule of law see *Fallon*, *Columb. L. Rev.* 97 (1997), 1 (14 *et seq.*).

<sup>39</sup> On the “legal process ideal” of the rule of law see *ibid.*, 1 (18 *et seq.*).

<sup>40</sup> *Dyzenhaus*, *Law & Contemp. Prob.* 68 (2005), 127 (129).

<sup>41</sup> On this thrust that has been developed particularly in the German tradition and has been taken up in the reasoning of other domestic courts as well as international dispute settlement bodies, including the European Court of Human Rights, the European Court of Justice and the WTO Dispute Settlement Body see *Stone Sweet/Mathews*, *Columb. J. Transnat’l L.* 47 (2008), 72.

<sup>42</sup> *Dyzenhaus*, *Law & Contemp. Prob.* 68 (2005), 127 (130 *et seq.*).

<sup>43</sup> See on the primarily formal tradition in Germany for example *Schulze-Fielitz*, in: *Dreier* (ed.), *Grundgesetz – Kommentar*, Vol. II, Art. 20, paras. 13 *et seq.* Similarly, the due-process clause of the U.S. Constitution has mainly found a procedural interpretation; see *Shell*, in: *Tohidipur* (ed.),

In this sense, fair and equitable treatment can be conceptualized as embodying the concept of the rule of law that host states have to embrace when dealing with foreign investors. While this concept may not seem like much of a concretization given different historical developments and thrusts of the rule of law in different national legal systems, and in light of the fact that the exact content and the requirements of the rule of law are often debated,<sup>44</sup> it nevertheless constitutes, it is argued, a viable approach to explain the normative content of fair and equitable treatment. A comparative view of municipal law reveals certain common ideas and standards that are understood as part of the rule of law and that can serve as standards a state has to conform to in order to comply with the concept of “fairness and equitableness” in international investment law.

Five clusters of normative principles can be discerned that occur in recurring fashion in the reasoning of arbitral tribunals and are presented as elements of fair and equitable treatment.<sup>45</sup> These principles are (1) the requirement of stability, predictability and consistency of the legal framework, (2) the protection of legitimate expectations, (3) the requirement to grant procedural and administrative due process and the prohibition of denial of justice, (4) the requirement of transparency, and (5) the requirement of reasonableness and proportionality. These principles also figure prominently as sub-elements or expressions of the concept of the rule of law in domestic legal systems.

#### a) *Stability, Predictability, Consistency*

Investment tribunals have repeatedly associated fair and equitable treatment with stability, predictability and consistency of the host state’s legal framework. The Tribunal in *CMS v. Argentina*, for example, stated that “there can be no doubt ... that a stable legal and business environment is an essential element of fair and equitable treatment.”<sup>46</sup> Predictability of the legal framework governing the activity of foreign investors has received comparable emphasis. The Tribunal in *Metalclad v. Mexico*, for example, based its finding of a violation of Article 1105(1) NAFTA, *inter alia*, on the argument that Mexico had “failed to ensure a ... predictable framework for

Der bürgerliche Rechtsstaat, 377 *et seq.* On the decline of the substantive understanding of due process by the Supreme Court and the emphasis on procedure see also Kantor, Law & Practice Int’l Courts & Tribunals 5 (2006), 231.

<sup>44</sup> See only Waldron, Law & Philosophy 21 (2002), 137.

<sup>45</sup> What follows draws on Schill, IILJ Working Paper 2006/6 (Global Administrative Law Series), available at: <<http://www.iilj.org/publications/2006-6Schill.asp>> (last visited on 20 December 2010).

<sup>46</sup> *CMS Gas Transmission Company v. The Argentine Republic*, ICSID Case No. ARB/01/8, Award of 12 May 2005, para. 274. Similarly, *Occidental Exploration and Production Company (OPEC) v. The Republic of Ecuador*, UNCITRAL, LCIA Case No. UN3467, Final Award of 1 July 2004, para. 183; *LG&E Energy Corp, LG&E Capital Corp, LG&E International Inc v Argentine Republic* ICSID Case No. ARB/02/1, Decision on Liability of 3 October 2006, para. 124. See also *PSEG Global Inc., The North American Coal Corp., and Konya İngin Elektrik Üretim ve Ticaret Ltd Şirketi v. Republic of Turkey*, ICSID Case No. ARB/02/5, Award of 19 January 2007, paras. 250 *et seq.* (finding a breach of fair and equitable treatment by what the Tribunal described as “the ‘roller-coaster’ effect of the continuing legislative changes”).

*Metalclad's* business planning and investment.”<sup>47</sup> Similarly, the Tribunal in *Tecmed v. Mexico* considered that the foreign investor needs to “know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices and directives, to be able to plan its investment and comply with such regulations.”<sup>48</sup>

Some tribunals have added that a lack of clarity of the legal framework or excessively vague rules can violate fair and equitable treatment.<sup>49</sup> Equally, consistency in the government’s conduct found strong emphasis in the jurisprudence. Thus, the Tribunal in *Tecmed* emphasized the need for consistency in the decision-making of a national agency in order to conform to fair and equitable treatment.<sup>50</sup> Likewise, in *MTD v. Chile*, the Tribunal found a violation of fair and equitable treatment due to “the inconsistency of action between two arms of the same Government *vis-à-vis* the same investor.”<sup>51</sup>

Taken together, these dicta embody several elements of the basic requirements for law as adumbrated in *Lon Fuller's* “internal morality of law.”<sup>52</sup> Many national legal systems place similar emphasis on legal certainty and legal security, perhaps most firmly instantiated in the German concept of *Rechtssicherheit*.<sup>53</sup> This core aspect of normativity of law allows individuals and entities to adapt their behavior to the requirements of the legal order and form stable social and economic relationships. It is an aspiration of most legal systems, certainly under democratic conditions of advanced capitalism. International law and the legal institutions of global governance may well be directed toward promoting and helping realize this aspiration.

Yet, stability and predictability cannot and should not mean that the legal framework will never change, nor do they in themselves provide a business guarantee

<sup>47</sup> See *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1 (NAFTA), Award of 30 August 2000, para. 99. See further *BG Group plc v. Republic of Argentina*, Final Award of 24 December 2007, para. 307; *Parkerings-Compagniet AS v. Republic of Lithuania*, ICSID Case No. ARB/05/8, Award of 11 September 2007, para. 333; *Duke Energy Electroquil Partners & Electroquil S.A. v. Republic of Ecuador*, ICSID Case No. ARB/04/19, Award of 18 August 2008, para. 347.

<sup>48</sup> *Tecmed v. Mexico*, *supra* note 29, para. 154.

<sup>49</sup> See for example *OEPC v. Ecuador*, *supra* note 46, para. 184 (criticizing the vagueness of a change in the domestic tax law that did not “provid[e] any clarity about its meaning and extent”).

<sup>50</sup> *Tecmed v. Mexico*, *supra* note 29, paras. 154 and 162 *et seq.* See also *OEPC v. Ecuador*, *supra* note 46, para. 184. Similarly, *Ronald S. Lauder v. The Czech Republic*, UNCITRAL, Final Award of 3 September 2001, paras. 292 *et seq.*

<sup>51</sup> *MTD v. Chile*, *supra* note 21, para. 163. Similarly, *Tecmed v. Mexico*, *supra* note 29, paras. 154 and 162 *et seq.* See also *OEPC v. Ecuador*, *supra* note 46, para. 184; *PSEG v. Turkey*, *supra* note 46, paras. 246 and 248; *LG&E v. Argentina*, *supra* note 46, para. 131; *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award of 24 July 2008, para. 602.

<sup>52</sup> *Fuller*, *The Morality of Law*, 4. See also *Kingsbury*, *Eur. J. Int'l L.* 20 (2009), 23.

<sup>53</sup> This aspect of the rule of law is recognized, mostly as a constitutional standard, in many domestic legal systems. See, for example, for its implementation in the German Constitution *Schulze-Fielitz*, in: Dreier (ed.), *Grundgesetz – Kommentar*, Vol. II, Art. 20, paras. 129 *et seq.*; see further *Fallon*, *Columb. L. Rev.* 97 (1997), 1 (14 *et seq.*) (with references to U.S. constitutional practice); more generally see also *Raz*, *L. Quart. Rev.* 93 (1977), 195 (198). On legal certainty as a principle of EU law, see *Tridimas*, *The General Principles of EU Law*, 242-251.

to investment projects.<sup>54</sup> Similarly, domestic regulatory frameworks are seldom completely free of inconsistencies.<sup>55</sup> In addition, the degree of stability in each legal order will vary with the circumstances the state is facing and the nature of inconsistencies. Likewise, a serious crisis or even an emergency situation may call for different reactions than the normal deployment of public power.<sup>56</sup> Stability, predictability, and consistency will thus have to be implemented in view of the circumstances of the case at hand as well as in light of, and balanced against, legitimate competing policy concerns.

*b) The Protection of Confidence and Legitimate Expectations*

The Tribunal in *Saluka v. Czech Republic* referred to the concept of legitimate expectations as “the dominant element of [the fair and equitable treatment] standard.”<sup>57</sup> The concept is found, in different forms, in many national legal systems<sup>58</sup> and perhaps in general international law.<sup>59</sup> Its main thrust is the protection of confidence, which is induced by government conduct, against administrative and legislative conduct that frustrates legitimate expectations. Thus, the Tribunal in *Tecmed v. Mexico* held that fair and equitable treatment requires “provid[ing] to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investors to make the investment.”<sup>60</sup> Similarly, the Tribunal in *International Thunderbird Gaming v. Mexico* explained that

<sup>54</sup> See *Emilio Agustín Maffezini v. The Kingdom of Spain*, ICSID Case No. ARB/97/17, Award of 13 November 2000, para. 64 (“emphasiz[ing] that Bilateral Investment Treaties are not insurance policies against bad business judgments”); *Marvin Roy Feldman Karpa v. The United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award of 15 December 2002, para. 112 (noting “that not every business problem experienced by a foreign investor is an indirect or creeping expropriation under Article 1110, or a denial of due process or fair and equitable treatment under Article 1110(1)(c)”).

<sup>55</sup> Cf. *Franck*, AJIL 99 (2005), 675 (678).

<sup>56</sup> See, for example, the *ELSI* case, *supra* note 29, para. 74 (stating that “[c]learly the right [to control and manage a company] cannot be interpreted as a sort of warranty that the normal exercise of control and management shall never be disturbed. Every system of law must provide, for example, for interferences with the normal exercise of rights during public emergencies and the like.”).

<sup>57</sup> *Saluka v. Czech Republic*, *supra* note 22, para. 301. See also *Snodgrass*, ICSID Review – FILJ 21 (2006), 1.

<sup>58</sup> See *Dyzenhaus*, Law & Contemp. Probs. 68 (2005), 127 (133 *et seq.*) (with reference to case law in Australia and the United Kingdom); *Schulze-Fielitz*, in: Dreier (ed.), Grundgesetz – Kommentar, Vol. II, Art. 20, paras. 146 *et seq.* (concerning German constitutional law); *Schonberg*, Legitimate Expectations in Administrative Law (on English, French and EC/EU law); *Dyer*, in: Groves (ed.), Law and Government in Australia, 184 *et seq.* (on Australian law); see also *Woehrling*, in: Bridge (ed.), Comparative Law Facing the 21st Century, 815 *et seq.* (summarizing a comparative study by the XVth International Congress of Comparative Law, Bristol in 1998).

<sup>59</sup> See *Müller*, Vertrauensschutz im Völkerrecht. See more specifically in the context of the law of expropriation of aliens *Dolzer*, AJIL 75 (1981), 553 (579 *et seq.*).

<sup>60</sup> *Tecmed v. Mexico*, *supra* note 29, para. 154. The Tribunal’s approach was also taken up in a number of other cases. See *ADF Group Inc. v. United States*, ICSID Case No. ARB(AF)/00/1 (NAFTA), Final Award of 9 January 2003, para. 189; *MTD v. Chile*, *supra* note 21, paras. 114 *et seq.*; *OEPC v. Ecuador*, *supra* note 46, para. 185; *CMS v. Argentina*, *supra* note 46, para. 279; *Eureko B.V. v. Republic of Poland*, Partial Award of 19 August 2005, paras. 235 and 241.



“the concept of ‘legitimate expectations’ relates ... to a situation where a Contracting Party’s conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages.”<sup>61</sup>

Various limitations in the scope and applicability of this doctrine require further clarification. Ordinarily, such expectations can arise only through explicit or implicit representations made by the host state (potentially including agency, ratification, and other structures of connection to the state).<sup>62</sup> In addition, as the Tribunal in *Eureko v. Poland* suggested, a breach of basic expectations may not be a violation of fair and equitable treatment if good reasons existed why the expectations of the investor could not be met.<sup>63</sup> Similarly, the Tribunal in *Saluka v. Czech Republic* specifically warned of the danger of taking the idea of the investor’s expectation too literally since this would “impose upon host states’ [sic] obligations which would be inappropriate and unrealistic.”<sup>64</sup> Instead, the Tribunal considered departing from legitimate expectations of an investor as possible and legitimate to the extent such departures are proportional as “[t]he determination of a breach of [fair and equitable treatment] requires a weighing of the Claimant’s legitimate and reasonable expectations on the one hand and the Respondent’s legitimate regulatory interests on the other.”<sup>65</sup> Against this background, the concept of legitimate expectations requires careful comparative law analysis, and a sophisticated methodology of application.

<sup>61</sup> *International Thunderbird Gaming v. Mexico*, *supra* note 15, para. 147 (internal citation omitted). On the protection of legitimate expectations as part of fair and equitable treatment, see also *Metalpar S.A. and Buen Aire S.A. v. Argentine Republic*, ICSID Case No. ARB/03/5, Award on the Merits of 6 June 2008, paras. 182-185; *MCI Power Group LC and New Turbine Inc. v. Republic of Ecuador*, ICSID Case No. ARB/03/6, Award of 31 July 2007, paras. 279 and 325; *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic*, ICSID Case No. ARB/97/13, Award of 20 August 2007, para. 7.4.42; *Parkerings v. Lithuania*, *supra* note 47, paras. 329 *et seq.*; *BG v. Argentina*, *supra* note 47, para. 310; *Biwater v. Tanzania*, *supra* note 51, para. 602; *Rumeli Telekom AS and Telsim Mobil Telekomikasyon Hizmetleri AS v. Kazakhstan*, ICSID Case No. ARB/05/16, Award of 29 July 2008, para. 609; *Duke Energy v. Ecuador*, *supra* note 47, para. 347; *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Decision on Annulment of 21 March 2007, para. 69; *National Grid plc v. Argentine Republic* UNCITRAL, Award of 3 November 2008, paras. 173-175; *Jan de Nul NV and Dredging International NV v. Arab Republic of Egypt*, ICSID Case No. ARB/04/13, Award of 6 November 2008, para. 186; *Glamis Gold v. United States*, *supra* note 19, para. 766; *Bayindir Insaat Turizm Ticaret Ve Sanayi AS v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/29, Award of 27 August 2009, para. 179. See also *Mairal*, in: Schill (ed.), *International Investment Law and Comparative Public Law*, 413.

<sup>62</sup> On the link between legitimate expectations and government conduct see *ADF v. United States*, *supra* note 60, para. 189.

<sup>63</sup> See *Eureko v. Poland*, *supra* note 60, paras. 232 *et seq.*

<sup>64</sup> *Saluka v. Czech Republic*, *supra* note 22, para. 304.

<sup>65</sup> *Ibid.*, para. 306.

c) *Administrative Due Process and Denial of Justice*

As long-standing customary international law recognizes, and as many tribunals applying investment treaties have decided, fair and equitable treatment embraces elements of due process specifically, administrative and judicial due process.<sup>66</sup> Fair and equitable treatment is thus closely connected to the proper administration of civil and criminal justice.<sup>67</sup> The Tribunal in *Waste Management v. Mexico*, for example, defined a violation of fair and equitable treatment as “involv[ing] a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process.”<sup>68</sup> Similarly, for the Tribunal in *S.D. Myers v. Canada* fair and equitable treatment, among other elements, included “the international law requirements of due process.”<sup>69</sup> The Tribunal in *International Thunderbird Gaming v. Mexico* held that the proceedings of a government agency “should be tested against the standards of due process and procedural fairness applicable to administrative officials.”<sup>70</sup>

Issues closely connected to due process are also reflected in the jurisprudence linking fair and equitable treatment to the prohibitions of arbitrariness and discrimination. The Tribunal in *Loewen v. United States*, for example, stated in obiter that fair and equitable treatment is violated by “[a] decision which is in breach of municipal law and is discriminatory against the foreign litigant.”<sup>71</sup> Similarly, the Tribunal in *Waste Management v. Mexico* suggested that “fair and equitable treatment is infringed by conduct attributable to the state and harmful to the claimant if the

<sup>66</sup> The national legislator, so far, has not been subjected to any due process notions in investment arbitration. This could, however, be conceivable in the context of legislative expropriations since most BITs explicitly require host states to grant affected investors due process. See *Dolzer/Stevens*, *Bilateral Investment Treaties*, 106 *et seq.*

<sup>67</sup> Comprehensively on the closely related concept of denial of justice in international law see *Paulsson*, *Denial of Justice in International Law*. Recently, both an explicit reference to due process and the concept of denial of justice as part of fair and equitable treatment have been included in the treaty practice of the United States. See, for example, Article 10.5(2)(a) of the Dominican Republic – Central America – United States Free Trade Agreement, signed 5 August 2004, for instance, stipulates that “fair and equitable treatment includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world.”, available at: <<http://www.ustr.gov/trade-agreements/free-trade-agreements/cafta-dr-dominican-republic-central-america-fta>> (last visited on 20 December 2010).

<sup>68</sup> *Waste Management v. Mexico*, *supra* note 6, para. 98.

<sup>69</sup> *S.D. Myers v. Canada*, *supra* note 27, para. 134.

<sup>70</sup> *International Thunderbird Gaming v. Mexico*, *supra* note 15, para. 200. See also *Rumeli v. Kazakhstan*, *supra* note 61, paras. 609 and 617; *Jan de Nul v. Egypt*, *supra* note 61, para. 187; *Glamis Gold v. United States*, *supra* note 19, para. 616; *Bayindir v. Pakistan*, *supra* note 61, paras. 178 and 344.

<sup>71</sup> *Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3 (NAFTA), Award of 26 June 2003, para. 135. *Cf.* also *S.D. Myers v. Canada*, *supra* note 27, para. 266.

conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice.”<sup>72</sup>

What is not yet fully defined, however, is how exactly the requirements of due process blend an international law standard with the controlling local law. Thus, in *Metalclad v. Mexico*, for instance, the Tribunal focused on the apparent misapplication of a construction law by a local municipality as one element for finding a violation of fair and equitable treatment.<sup>73</sup> Similarly, in *Pope & Talbot v. Canada* the Tribunal referred to a lack of competence of a particular agency under national law to initiate administrative proceedings against a foreign investor. Instead of relying “on naked assertions of authority and on threats that the Investment’s allocation could be cancelled, reduced or suspended for failure to accept verification,” the Tribunal said, “before seeking to bludgeon the Investment into compliance, the SLD [i.e., the Canadian administrative agency involved] should have resolved any doubts on the issue and should have advised the Investment of the legal basis for its actions.”<sup>74</sup> Likewise, the Tribunal in *GAMI Investments, Inc. v. Mexico* deduced from fair and equitable treatment an obligation not only to abide by, but also to enforce existing provisions of national law.<sup>75</sup> In *Tecmed v. Mexico* the Tribunal underscored that host states have to make use of “the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments.”<sup>76</sup>

Conversely, the conformity of a state administrative measure with the relevant domestic legal rules has in some cases been referred to by tribunals as indicative that there has not been a violation of the fair and equitable treatment standard. In *Noble Ventures v. Romania*, for example, the Tribunal observed that certain bankruptcy proceedings “were initiated and conducted according to the law and not against it”<sup>77</sup> and accordingly denied a violation of fair and equitable treatment. Similarly, in *Lauder v. Czech Republic* the Tribunal emphasized that a violation of fair and equitable treatment was usually excluded in case of a “regulatory body taking the necessary actions to enforce the law.”<sup>78</sup> This set of cases broadly aligns with the democratic requirement that public power derives its authority from a legal basis and

<sup>72</sup> *Waste Management v. Mexico*, *supra* note 6, para. 98; similarly *Eureko v. Poland*, *supra* note 60, para. 233 (finding that the state “acted not for cause but for purely arbitrary reasons linked to the interplay of Polish politics and nationalistic reasons of a discriminatory character” and therefore breached fair and equitable treatment). See also *Parkerings v. Lithuania*, *supra* note 47, paras. 287-288; *Victor Pey Casado and President Allende Foundation v. Republic of Chile*, ICSID Case No. ARB/98/2, Award of 8 May 2008, paras. 670-673; *Biwater v. Tanzania*, *supra* note 51, para. 602; *Continental Casualty Co. v. Argentine Republic*, ICSID Case No. ARB/03/9, Award of 5 September 2008, para. 261; *Rumeli v. Kazakhstan*, *supra* note 61, para. 609; *Glamis Gold v. United States*, *supra* note 19, para. 616; *Bayindir v. Pakistan*, *supra* note 61, para. 178.

<sup>73</sup> *Metalclad v. Mexico*, *supra* note 47, para. 93.

<sup>74</sup> *Pope & Talbot, Inc. v. The Government of Canada*, UNCITRAL/NAFTA, Award on the Merits of Phase 2 of 10 April 2001, paras. 174 *et seq.*

<sup>75</sup> *GAMI Investments, Inc. v. The Government of the United Mexican States*, UNCITRAL/NAFTA, Final Award of 15 November 2004, para. 91.

<sup>76</sup> *Tecmed v. Mexico*, *supra* note 29, para. 154.

<sup>77</sup> *Noble Ventures v. Romania*, *supra* note 24, para. 178.

<sup>78</sup> *Lauder v. Czech Republic*, *supra* note 50, para. 297.

that it must be exercised along the lines of pre-established procedural and substantive rules. As such, the violation of domestic law can translate, but does not need to, into a violation of the fair and equitable treatment standard; the international law standard of fair and equitable treatment is not simply a mirror of whatever the national law provides.

*d) Transparency*

Traditional customary international law on treatment of foreigners and of foreign investments is quite underdeveloped with regard to transparency of governmental information and decision processes. In international law more broadly, the crafting and application of international legal standards for national governmental transparency has been an important direction of legal development. However, it remains a challenging branch of international legal practice, whether in the WTO or international human rights jurisprudence. Many countries, particularly transitional and developing countries, struggle to meet their existing obligation in this respect, and some have adopted legislation to try to hasten both the change of bureaucratic culture and the practical processes of making information available. Furthermore, defining the proper limits on transparency requirements, such as the protection of privacy interests, of commercial confidentiality, or of national security, is complex.

Accordingly, for investment tribunals to pursue such an intricate agenda through the very underspecified fair and equitable treatment standard is far from easy, even though several tribunals have done so. Thus, the Tribunal in *Metalclad v. Mexico* concluded that Mexico breached Article 1105 NAFTA because “Mexico failed to ensure a transparent and predictable framework for *Metalclad’s* business planning and investment.”<sup>79</sup> The reference in this holding to a transparency requirement was set aside by the Supreme Court of British Columbia exercising jurisdiction under the British Columbia International Arbitration Act.<sup>80</sup> While that court decision can be contested in some respects, it does indeed seem justified to cast doubt on the breadth for the arbitral tribunal’s statements

“that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments ... should be capable of being readily known to all affected investors” and that the host state is required “to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that they are acting in accordance with all relevant laws.”<sup>81</sup>

Statements of such breadth indeed could result in redefining the position and function of administrative agencies, by obliging them to reorient their priorities and

<sup>79</sup> *Metalclad v. Mexico*, *supra* note 47, para. 99 (emphasis added).

<sup>80</sup> See Supreme Court of British Columbia, *The United Mexican States v. Metalclad Corporation*, 2001 BCSC 644.

<sup>81</sup> *Metalclad v. Mexico*, *supra* note 47, para. 76 (for both citations).

function so as to act as consultative units and even as de facto insurers for the implementation of foreign investment projects.<sup>82</sup>

Similar concerns could be expressed about the dictum in *Tecmed v. Mexico* that connected the element of legitimate expectations to the requirement of transparency in reasoning:

“The foreign investor expects the host state to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations.”<sup>83</sup>

Yet, a more restrictive reading of a transparency requirement under the “fair and equitable treatment” standard seems possible and more readily defensible. In the *Tecmed* case, in fact, transparency was mainly applied to procedural aspects of administrative law, such as the requirement to give sufficient reasons<sup>84</sup> and the obligation to act in a comprehensible and predictable way.<sup>85</sup> These framings buttress the reasonable procedural position of foreign investors in administrative proceedings. Transparency can thus be important even if it is not yet a well-developed additional substantive requirement. Furthermore, it has significant specific functions, such as in assisting procedurally to resolve uncertainty in the domestic law, in which connection it interacts closely with the burden of proof. Comparative law methodology, and the sophisticated analysis and use of normative standards from other areas of international law, potentially has much to contribute in this area.

#### e) Reasonableness and Proportionality

Finally, investment arbitration tribunals link fair and equitable treatment to the concepts of reasonableness and proportionality. Like proportionality, but with much less methodological precision, reasonableness can be used to control the extent to which interferences of host states with foreign investments are permitted. Thus, the Tribunal in *Pope & Talbot v. Canada* repeatedly referred to the reasonableness of the

<sup>82</sup> *Schill*, TDM 3 (2006), 15.

<sup>83</sup> *Tecmed v. Mexico*, *supra* note 29, para. 154; similarly, *Maffezini v. Spain*, *supra* note 54, para. 83; *LG&E v. Argentina*, *supra* note 46, para. 131; *Biwater v. Tanzania*, *supra* note 51, para. 602; *Rumeli v. Kazakhstan*, *supra* note 61, paras. 609 and 617; *Bayindir v. Pakistan*, *supra* note 61, para. 178.

<sup>84</sup> See *Tecmed v. Mexico*, *supra* note 29, para. 123 (stating that “administrative decisions must be duly grounded in order to have, among other things, the transparency required so that persons that disagree with such decisions may challenge them through all the available legal remedies”). Similarly, *ibid.*, para. 164.

<sup>85</sup> See *Tecmed v. Mexico*, *supra* note 29, para. 160 (stating that “[t]he incidental statements as to the Landfill’s relocation in the correspondence exchanged between INE and Cytrar or Tecmed ... cannot be considered to be a clear and unequivocal expression of the will of the Mexican authorities to change their position as to the extension of the Permit so long as Cytrar’s business was not relocated, nor can it be considered an explicit, transparent and clear warning addressed to Cytrar from the Mexican authorities that rejected conditioning the revocation of the Permit to the relocation of Cytrar’s operations at the Landfill to another place.”).

conduct of an administrative agency in declining to find a violation of fair and equitable treatment.<sup>86</sup> The element of reasonableness can also be incorporated into a proportionality test, as in *Tecmed v. Mexico*'s dictum that "[t]here must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure."<sup>87</sup> Likewise, the Tribunal in *Saluka v. Czech Republic* applied proportionality analysis as part of the fair and equitable treatment standard, albeit as a way to balance the host state's interest with the expectations of the foreign investor.<sup>88</sup>

Although integrating proportionality analysis into the principle of fair and equitable treatment allows, to a certain extent, for a substantive control of host state conduct, the proportionality requirement also clarifies that fair and equitable treatment is not an inflexible standard, but allows for balancing the interests of host states and foreign investors. As long as sufficient leeway is given for the implementation of domestic policies, and as long as tribunals refrain from using it in order to establish an intrusive standard of review, proportionality analysis constitutes a concept that helps to counter fears about the dominance of investor rights over the interests of host states.

### 3. Refining General Principles for Specific State Conduct

Understanding fair and equitable treatment as an embodiment of the rule of law does not only clarify its normative content, it also suggests a specific methodology investment tribunals and international investment law doctrine should follow in concretizing the standard and in solving conflicts between the sometimes competing interests of host states and foreign investors. Instead of primarily relying on prior arbitral decisions, an approach that is of little help in particular when disputes concern novel circumstances, or positing the content of fair and equitable treatment in an abstract way without sufficient justification, tribunals should use a comparative method that draws on domestic and international law regarding the concept of the rule of law. These bodies of law encompass both the understanding of the rule of law and its implications under domestic legal systems, as well as the jurisprudence of other international tribunals, for example in the human rights or international trade context, and the international treaties it is based on.

The purpose of a comparative approach to the concept and understanding of rule of law standards contained in the major domestic legal systems adhering to a liberal tradition would be to attempt to extract general principles of law in order to concretize fair and equitable treatment. This approach has also been proposed in order to concretize the concept of indirect expropriation under international law and its

<sup>86</sup> See *Pope & Talbot v. Canada*, *supra* note 74, paras. 123, 125, 128, 155; see also *MTD v. Chile*, *supra* note 21, para. 109 (with a reference to an expert opinion by Steven Schwebel).

<sup>87</sup> *Tecmed v. Mexico*, *supra* note 29, para. 122. It is possible that an independent jurisprudence of reasonableness can be established and given detailed content. See *Corten*, *L'utilisation du raisonnable par le juge international: discours juridique, raison et contradictions*.

<sup>88</sup> See *supra* notes 64 and 65 and accompanying text.

distinction from non-compensable regulation.<sup>89</sup> With respect to the concept of the rule of law, such an approach can be made equally fruitful concerning the interpretation of fair and equitable treatment. Arbitral tribunals should therefore engage in a comparative analysis of the major domestic legal systems in order to grasp common features that those legal systems establish for the exercise of public power.

Such a comparative analysis may influence the interpretation of fair and equitable treatment in two respects. First, it may enable investment tribunals to positively deduce institutional and procedural requirements from domestic rule of law standards for a context-specific interpretation of fair and equitable treatment. A comparative analysis of domestic legal systems and their understanding of the rule of law may, for example, be used to justify the standards administrative proceedings affecting foreign investors have to meet.<sup>90</sup> Secondly, a comparative analysis of the implications of the rule of law under domestic law may be used to justify the conduct of a state *vis-à-vis* a foreign investor. If similar conduct, for instance the repudiation of an investor-state contract in an emergency situation, is generally accepted by domestic legal systems as being in conformity with their understanding of the (national) rule of law, investment tribunals could transpose such findings to the level of international investment treaties as an expression of a general principle of law.

An additional approach, with similar functions as the first, would rely on a cross-regime comparison with other international law regimes that incorporate rule of law standards. A particularly promising field for such an approach is the comparative evaluation of the jurisprudence developed by international courts in the human rights context that address specific elements of the rule of law. One example in this context is the jurisprudence of the European Court of Human Rights (ECtHR) concerning Art. 6 of the European Convention on Human Rights (ECHR). This provision can be viewed as an expression of a more general standard of an institutional and procedural understanding of the rule of law.<sup>91</sup> The rich jurisprudence of the ECtHR could thus be used to further concretize fair and equitable treatment, for example with respect to the timely administration of justice or the right to a fair trial. Similarly, comparative analysis could encompass the emerging principles of European administrative law<sup>92</sup> or the jurisprudence of the WTO Appellate Body in order to

<sup>89</sup> Dolzer, Eigentum, Enteignung und Entschädigung im geltenden Völkerrecht, 213 *et seq.* Dolzer, ICSID Review – FILJ 1 (1986), 41. Similarly *Salacuse/Sullivan*, Harv. Int'l L. J. 46 (2005), 67 (115).

<sup>90</sup> See also *della Cananea*, Eur. Publ. L. 9 (2003), 563 (575) (explaining that the WTO Appellate Body in the *Shrimps* Case has “subsumed from national legal orders some general or ‘global’ principles of administrative law” in order to impose procedural rule of law elements on the exercise of public power of the WTO Member states).

<sup>91</sup> This approach has occasionally already played a role in investment arbitration. See *Mondev v. United States*, *supra* note 26, where parallels were considered between Art. 7 ECHR (freedom from non-retrospective effect of penal legislation) and Art. 1105 NAFTA (*ibid.*, para. 138) and between the assessment of granting immunity to a state agency under Art. 1105 NAFTA and Art. 6 ECHR (*ibid.*, paras. 141 *et seq.*). Another example of an investment tribunal that drew a parallel to the jurisprudence of the European Court of Human Rights and the Inter-American Court of Human Rights in the context of indirect expropriation is *Tecmed v. Mexico*, *supra* note 29, paras. 166 and 122.

<sup>92</sup> See, for example, *Schwarze*, Europäisches Verwaltungsrecht.

further develop the rule of law requirements with respect to the exercise of public power by host states.<sup>93</sup>

The comparative analysis of rule of law understandings under both domestic legal systems and other international law regimes should be able to give examples for the effect of the rule of law and the scope of restrictions it imposes on states and thus further clarify the content of fair and equitable treatment in international investment law. Yet, it will always be necessary to keep in mind the specific context of international investment treaties, which aim at protecting and promoting foreign investment between the contracting state parties. Notwithstanding, engaging in a quest for the existence of general principles of law and engaging in a comparative exercise, both as regards domestic public law as well as other international law regimes, arguably helps to benefit from the experience those legal regimes have developed not only in limiting the exercise of state powers, but also in empowering the state; they thus may help in legitimizing the implementation and interpretation of international investment law.

Endorsing the suggested comparative methodology may also further buttress approaches in investment treaty-making, such as the one endorsed by Germany, that confidently draw up the principal investment treaty obligations as broadly stated principles and entrust arbitral tribunals with the elaboration of these principles, rather than attempt to increasingly concretize investor rights, an approach that can be problematic given the increasingly complex structure of foreign investment projects and the difficulties to predict the occasionally creative rent-seeking conduct of states that can negatively affect foreign investments. Arguably, with the proposed comparative methodology a fair balance between investment protection and regulatory leeway for the furtherance of non-investment policies, which is acceptable to both host states and investors, can be reached by arbitral tribunals.<sup>94</sup>

<sup>93</sup> See *della Cananea*, Eur. Publ. L. 9 (2003), 563, (575).

<sup>94</sup> See *Brower/Schill*, Chi. J. Int'l L. 9 (2009), 471 (483-489) (with further references).



## II. Beyond Formal Criteria: Determining Nationality of Corporations in ‘Hard Cases’

*Christian Tietje/Jürgen Bering*

### 1. Introduction

In modern trade and investment, corporations with a legal personality independent of their shareholders play a crucial part. The role of such businesses is even more significant in the context of international trade and investment. Of the many facets of legal importance in this regard, the national character of a corporation, *i.e.* which State it is attributed to, has a key function as a growing number of business transactions are structured in ways so as to benefit from the particular characteristics of specific legal systems. Besides the obvious attraction of a low tax regime, a crucial aspect is the level of legal protection offered by a State. In this regard, falling under the protecting shield of a Bilateral Investment Treaty (BIT) is extremely desirable. Recent practice has shown that, for example, U.S. corporations have incorporated in Mauritius in order to protect their transactions with India, because Mauritius has concluded a BIT with India<sup>95</sup> whereas the U.S. has not. In how far this form of forum shopping is actually viable depends on the respective BIT and relevant jurisprudence of international investment arbitral tribunals.<sup>96</sup> However, in a broader context it seems to be important not only to look at international investment protection law and practice in a narrow sense, but to broaden up the perspective and to ask whether general public international law requires not only that a corporation is incorporated in a specific State, but also that – at least in problematic (*i.e.* ‘hard’) cases – some additional substantial requirements must be fulfilled in order to legally determine the nationality of a corporation.

According to Article 31(3)(c) of the Vienna Convention on the Law of Treaties (VCLT), customary international law has to be considered when interpreting the provisions of an international treaty. Disregarding, for the purpose of this paper, details on the precise relevance of Art. 31 (3) (c) VCLT in investment arbitration, it seems at least to be plausible to assess whether customary international law requires the presence of some sort of substantial elements in order to establish nationality in relation of the respective State of incorporation and the corporation concerned. If this question can be answered positively, it is necessary to further assess what specifically determines such substantial elements. In this paper, only the first question shall be answered.

<sup>95</sup> *Peterson*, INVEST-SD News Bulletin, 26 September 2003, available at: <[http://www.iisd.org/pdf/2003/investment\\_investsd\\_sept\\_2003.pdf](http://www.iisd.org/pdf/2003/investment_investsd_sept_2003.pdf)> (last visited on 20 December 2010).

<sup>96</sup> For details on the specific aspects of international investment protection law and practice of arbitral tribunals see *Bering*, Die rechtliche Behandlung von ‘Briefkastenfirmen’ nach Art. 17 ECT und im allgemeinen internationalen Investitionsschutzrecht, Heft 81 (2008), available at: <<http://telc.jura.uni-halle.de/de/node/23>> (last visited on 6 March 2011).

## 2. *International Law and Nationality of Corporations*

In public international law, the national character of a corporation is most significant in the area of diplomatic protection. Historically, this entailed the assertion of a state's own rights. Hence, an injury to a legal person must qualify as a violation of these rights. The circumstances under which such a qualification exists has become highly debated since the ICJ held that Liechtenstein could not espouse a claim of *Nottebohm*, a Liechtenstein citizen, as it lacked a genuine link between the natural person and the State.<sup>97</sup> Ever since, this *ratio* has been considered to apply beyond natural persons.<sup>98</sup> In regard to corporations, the most significant statement was made by the ICJ in its *Barcelona Traction* decision, where it stipulated that there can be no analogy between the *Nottebohm* decision and the case it was to decide upon.<sup>99</sup> In a similar vein, the ILC has chosen not to incorporate a genuine link test in its Draft Articles on Diplomatic Protection.<sup>100</sup> While this gives a *prima facie* view that a State is indeed free to decide which criteria to use without the necessity of a genuine link or some other substantive criteria, further scrutiny reveals a rather equivocal nature of both the *Barcelona Traction* judgment (1) and the Draft Articles (2) which is further strengthened by an analysis of the State Practice in regard to corporations (3). Lastly, it is suggested that the requirement of some form of substantive connection between a corporation and a (home) State is not a legal principle of its own but in fact is based on general principles of public international law (4).

### a) *Barcelona Traction*

*Barcelona Traction* was a company incorporated in Canada which performed transactions in Spain where it allegedly suffered injuries through a Spanish bankruptcy proceeding. Belgium tried to espouse this claim as it submitted that 88% of *Barcelona Traction* was owned by Belgian nationals and that these shareholders' rights were violated by the Spanish acts. The ICJ denied its jurisdiction on the grounds that the shareholders were not entitled to protection.

<sup>97</sup> ICJ, *Nottebohm Case* (Liechtenstein v. Guatemala), Second Phase, Judgment of 6 April 1955, I.C.J. Report 1955, 4 (23). While the ICJ clearly formulated that "...nationality is a legal bond as its basis a social fact of attachment, a genuine connection of existence..." it has been widely doubted that this statement was supposed to pronounce a rule of customary international law because of the specific character of the case. First, *Nottebohm* merely abandoned his German nationality and sought Liechtenstein nationality in order to qualify as a neutral citizen during World War II. Second, while having no connection to Liechtenstein besides his formal nationality, he had strong ties to Guatemala. Third, it was against Guatemala that the claim was directed. Such a criterion was also not included by the ILC in its Draft Articles on Diplomatic Protection.

<sup>98</sup> *de Visser*, RdC 102 (1961 I), 399 (446 *et seq.*).

<sup>99</sup> ICJ, *Case concerning the Barcelona Traction, Light and Power Company, Limited* (New Application: 1962) (Belgium v. Spain) Second Phase, Judgment of 5 February 1970, I.C.J. Reports 1970, 3.

<sup>100</sup> *International Law Commission*, Report of the fifty-eighth session 2006, A/61/10, 31 *et seq.*, available at: <<http://untreaty.un.org/ilc/reports/2006/2006report.htm>> (last visited on 20 December 2010).

As to the statement of the Court about there being no analogy between *Nottebohm* and *Barcelona Traction*, three issues have to be taken into consideration. First, the statement had no direct bearing on the case, as *Barcelona Traction's* Canadian character was not in contention. Second, the issue was highly debated among the Judges as is evidenced by the separate and dissenting opinions. Third, the court nevertheless elaborated on the ties between *Barcelona Traction* and Canada.

### (1) *Context of the Statement*

In the first application, Belgium was indeed trying to espouse the claim on behalf of *Barcelona Traction* itself. However, this proposal was dropped when Belgium filed its second application. It then only sought to protect the rights of *Barcelona Traction's* shareholders, which were allegedly of Belgian nationality. Hence, it was not questioned by Spain nor by Belgium that *Barcelona Traction* had Canadian national character. The uncontested nationality was pointed out by Judge *Tanaka*<sup>101</sup> as well Judge *Petren* and Judge *Onyeama* who stated that “the Court has not in this case to consider the question whether the genuine connection principle is applicable to the diplomatic protection of juristic persons...”<sup>102</sup>

### (2) *Opinions of Individual Judges*

As is shown by the separate and dissenting opinions, the lack of a genuine link requirement was not generally accepted among the Judges. According to Judge *Nervo*, “‘nationality’ expresses a link of legally belonging to a specific state. The requirement for juridical persons as for natural persons, is that the existence of the link of legally belonging to a specific country must, if it is to serve as a plea at the international level, be accompanied by that of a ‘real’ link with the same country.”<sup>103</sup>

Thus, a purely artificial link could not suffice. Judge *Jessup* discussed this aspect in great detail concluding that a genuine link was indeed necessary between a corporation and a State.<sup>104</sup> In fact, he reasoned that Canada lacked such a link and therefore would not have been entitled to claim on behalf of *Barcelona Traction*.<sup>105</sup>

<sup>101</sup> *Case concerning the Barcelona Traction, Light and Power Company, Limited* (New Application: 1962) (Belgium v. Spain) Second Phase, Separate Opinion by Judge Tanaka of 5 February 1970, 128 *et seq.*

<sup>102</sup> *Case concerning the Barcelona Traction, Light and Power Company, Limited* (New Application: 1962) (Belgium v. Spain) Second Phase, Joint Declaration by Judge Petren and Judge Onyeama of 5 February 1970, 52.

<sup>103</sup> *Case concerning the Barcelona Traction, Light and Power Company, Limited* (New Application: 1962) (Belgium v. Spain) Second Phase, Separate Opinion of Judge Nervo of 5 February 1970, 254.

<sup>104</sup> *Case concerning the Barcelona Traction, Light and Power Company, Limited* (New Application: 1962) (Belgium v. Spain) Second Phase, Separate Opinion by Judge Jessup of 5 February 1970, 182 *et seq.*

<sup>105</sup> *Ibid.*, 170.

Judge *Fitzmaurice*,<sup>106</sup> Judge *Gros*<sup>107</sup>, and Judge *Riphagen*<sup>108</sup> similarly articulated the possibility of Canada being prevented from espousing the claim if it lacked a genuine link to the corporation.

However, other Judges readily accepted the Canadian character of *Barcelona Traction*, stemming out of the acceptance by both Belgium and Spain.<sup>109</sup> Only Judge *Ammoun* explicitly argued against the necessity of a genuine link.<sup>110</sup>

These opinions clearly show that the requirement of a genuine link was highly debated among the Judges, which is quite contrary to the very general statement contained in the Judgment itself about there being no analogy between *Nottebohm* and *Barcelona Traction*. Against this background it appears that if the Court truly wanted to deny a requirement of a genuine link in regard to corporations, it would have made further elaborations for reaching such a conclusion.

### (3) *Barcelona Traction's Close and Permanent Connection to Canada*

The third aspect shedding doubt on the general nature of the statement lies in the directly following elaboration of the various ties between Canada and *Barcelona Traction*. These ties consisted of incorporation, the location of the registered office, accounts and share registers, the holding of board meetings, and being listed in the records of the Canadian tax authorities. The Court concluded that “a close and permanent connection has been established” and that “*Barcelona Traction's* links with Canada are thus manifold”.<sup>111</sup> Furthermore, it then went on to find that the Canadian character was generally recognized.<sup>112</sup> The fact that this immediately followed the finding that there is “no absolute test of a genuine connection”<sup>113</sup> decreases the unconditional nature of this statement. However, it does make coherent sense, when seen in connection to other considerations of the Court. When addressing the rule that shareholders’ indirect rights cannot be protected in customary international law, possible exceptions were turned to. One of these hypothetical exceptions was the

<sup>106</sup> *Case concerning the Barcelona Traction, Light and Power Company, Limited* (New Application: 1962) (Belgium v. Spain) Second Phase, Separate Opinion by Judge Fitzmaurice of 5 February 1970, 66 fn. 3.

<sup>107</sup> *Case concerning the Barcelona Traction, Light and Power Company, Limited* (New Application: 1962) (Belgium v. Spain) Second Phase, Separate Opinion by Judge Gros of 5 February 1970, 180 *et seq.*

<sup>108</sup> *Case concerning the Barcelona Traction, Light and Power Company, Limited* (New Application: 1962) (Belgium v. Spain) Second Phase, Dissenting Opinion by Judge Riphagen of 5 February 1970, 346 *et seq.*

<sup>109</sup> *Case concerning the Barcelona Traction, Light and Power Company, Limited* (New Application: 1962) (Belgium v. Spain) Second Phase, Separate Opinion by Judge Tanaka of 5 February 1970, 141; Joint Declaration by Judge Petren and Judge Onyeama 5 February 1970, 52.

<sup>110</sup> *Case concerning the Barcelona Traction, Light and Power Company, Limited* (New Application: 1962) (Belgium v. Spain) Second Phase, Separate Opinion by Judge Ammoun of 5 February 1970, 295 *et seq.*

<sup>111</sup> *Case concerning the Barcelona Traction, Light and Power Company, Limited* (New Application: 1962) (Belgium v. Spain) Second Phase, Judgment of 5 February 1970, para. 71.

<sup>112</sup> *Ibid.*, paras. 72 *et seq.*

<sup>113</sup> *Ibid.*, para. 70.

situation in which the national State lacks the capacity to act on behalf of the corporation.<sup>114</sup> The Court gave no explanation when such a situation can arise. However, it needs to be noted that Canada had not acted on behalf of *Barcelona Traction* for 18 years.<sup>115</sup> This – alongside the discretionary nature of diplomatic protection – shows that the exception does not arise when a State simply omits to espouse a claim. This only leaves the possibility that a State is legally prevented from espousing such a claim, evidencing that a State can be denied the ability to protect a corporation even though it fulfills the formal criteria for protection.<sup>116</sup>

#### (4) Conclusion

In the light of the above findings it becomes very doubtful whether the ICJ in fact wanted to establish a general rule that no genuine link requirement exists in regard to corporations. In fact, the wording used by the Court is open to a different interpretation.

The statement that “no absolute test of the ‘genuine connection’ has found general acceptance” must not necessarily refer to there being no requirement of a genuine link. It could just as well address the second question needed to be asked, *i.e.* what exactly forms such a general link. None of the Judges has stated that there can be any clear criteria for such a determination. Instead, a variety of factors has been proposed that should generally be weighed in the specific circumstances in each case.

The second statement worth assessing is that the Court was “of the opinion that there can be no analogy with the issues raised or the decision given in” *Nottebohm* and *Barcelona Traction*. In *Nottebohm*, the Court was called to decide whether Liechtenstein could claim on behalf of *Nottebohm* for the lack of a genuine link between the two. However, in *Barcelona Traction* neither Spain nor Belgium contested that Canada was barred from espousing the claim. Rather, the Court had to decide on the issue of whether *Barcelona Traction*’s shareholders could nevertheless be protected by their national State. Hence, the question of a genuine link was not at issue in *Barcelona Traction*, showing this case and the *Nottebohm* case were not analogous.

Therefore, the Court was not trying to address the existence of a requirement of a genuine link in regard to corporations. It was merely stating what was outlined by several Judges in their separate and dissenting opinions, *i.e.* that it is unclear what exactly amounts to a genuine link and that Canada’s right to diplomatic protection was in no manner questioned by the parties.

<sup>114</sup> *Ibid.*, para. 92.

<sup>115</sup> On this see *Case concerning the Barcelona Traction, Light and Power Company, Limited* (New Application: 1962) (Belgium v. Spain) Second Phase, Separate Opinion by Judge Jessup of 5 February 1970, 176.

<sup>116</sup> *Mann*, AJIL 67 (1973), 259 (273).

b) *Draft Articles on Diplomatic Protection*

Nevertheless, the ILC in its Draft Articles on Diplomatic Protection<sup>117</sup> declined to include an explicit genuine link requirement for corporations, based on the Decision in *Barcelona Traction*. Article 9 of the Draft Articles reads as follows:

“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.”<sup>118</sup>

In interpreting this rule, it first needs to be noted that while the general rule is in fact that incorporation is chosen, and thereby a merely formal connection, the ILC clearly found that an exception exists when there are no factual ties in the form of business activities or domestic control. However, the requirements for the exception are rather strict as both the seat of management and the financial control must be located in a second State in order to apply. Hence, even though no factual ties exist between the State of incorporation and the corporation, it will still be regarded as the State of nationality when the seat of management is located in a second, the financial control in a third State. This condition seems problematic when considering the structures of modern corporations which have ties to various States.

The requirements stipulated by the ILC were largely based on an analysis of the *Barcelona Traction* decision: The ILC held:

“The Court in *Barcelona Traction* was not, however, satisfied with incorporation as the sole criterion for the exercise of diplomatic protection. Although it did not reiterate the requirement of a ‘genuine connection’ as applied in the *Nottebohm* case, and acknowledged that ‘in the particular field of the diplomatic protection of corporate entities, no absolute test of the “genuine connection” has found general acceptance,’ 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 the diplomatic protection and the corporation.”<sup>119</sup>

Hence, albeit not including an explicit requirement, the ILC sought the permanent and close connection to be satisfied by including the exception.

Throughout the drafting process on the Articles on Diplomatic Protection, the genuine link requirement was nevertheless considered.<sup>120</sup> However, certain problems were connected with the requirement. First, in Article 4 regarding diplomatic protection of natural persons, the ILC had not followed the approach in the

<sup>117</sup> *Supra* note 100.

<sup>118</sup> *International Law Commission*, Report of the fifty-eighth session 2006, A/61/10, 18 *et seq.*, available at: <<http://untreaty.un.org/ilc/reports/2006/2006report.htm>> (last visited on 20 December 2010).

<sup>119</sup> *Ibid.*, 53 (footnotes omitted).

<sup>120</sup> *International Law Commission*, Report of the fifty-fifth session 2003, A/58/10, 58.

*Nottebohm* decision and therefore found it illogical to proceed in such a manner regarding corporations.<sup>121</sup> Second, it feared the results of introducing a genuine link requirement “thereby introducing a test that would, in effect, be based on economic control as measured by majority shareholding.”<sup>122</sup> In the opinion of the ILC, a genuine link between a corporation and a State was determined by control. Using a control criterion, though, leads to two problems. First, in economic reality international business structures become increasingly nontransparent, thereby creating problems to prove actual control. Second, control is rarely concentrated in one State possibly allowing for the attribution to various States. Hence, the ILC refrained from introducing such a criterion in its Draft Articles. Nevertheless, it clearly found that some form of factual connection must exist between a corporation and a State and felt this requirement to be satisfied by incorporating the second sentence to Article 9.

c) *International Practice*

Relevant practice supporting requirements in order to determine nationality of a corporation beyond the formal criteria of incorporation can be found in three areas. First, the *Nottebohm* reasoning has been expanded beyond natural persons. Second, modern treaties concluded by States allow for other determinations of nationality. And third, the practice of States regarding which corporations to protect internationally extends beyond those corporations formally incorporated in the State. It needs to be noted that in order to illuminate the recent trends in this regard only a very limited summary of the international practice can be given at this place.

(1) *Genuine Link beyond Nottebohm*

Most notably, the genuine link principle has found application in regard to vessels. Article 5(1) of the 1958 Convention on the High Seas requires that “there must exist a genuine link between the State and the ship...”<sup>123</sup> The same requirement is set out in the 1982 Convention on the Law of the Seas (Art. 91(1) UNCLOS).<sup>124</sup> Similarly in the *I’m Alone* case, no compensation had been awarded for the *I’m Alone* – a British ship of Canadian registry which was sunk by a United States Coast guard ship – as it was *de facto* owned, controlled, and managed by United States citizens.<sup>125</sup>

Such an application of the genuine link principle to vessels can be seen as a strong indication for corporations, as both lack the natural ties that exist between a natural

<sup>121</sup> *Ibid.*, 59.

<sup>122</sup> *International Law Commission*, Report of the fifty-fifth session 2003, A/58/10, 59. It was in fact argued that only control (and thereby shareholding) could show “l’allégeance politique” and should therefore be used for determining the national character of a corporation, see *Harris*, ICLQ 18 (1969), 275 (296).

<sup>123</sup> Convention of the High Seas of 29 April 1958, German Bundesgesetzblatt 1972 II, 1089.

<sup>124</sup> See further *Seidl-Hohenveldern*, Corporations in and under International Law, 11.

<sup>125</sup> “*I’m Alone*” Case, Joint Final Report of the Commissioners of 5 January 1935. See further *Feliciano*, RdC 118 (1966 II), 209 (289).

person and a State. Moreover, both feature the same phenomenon of choosing a national character for tax or similar reasons of convenience.<sup>126</sup>

## (2) Treaty Practice

While international treaty practice is not unequivocal it can be pointed out that there is at least a certain tendency towards adopting some form of requirement beyond mere incorporation.

Ever since 1948, the United States has demanded a certain amount of economic interest in a corporation for it to be eligible for protection.<sup>127</sup> Such a restrictive policy was also adopted by Switzerland and Italy.<sup>128</sup> Recent practice of the United Kingdom appears to be headed in the same direction.<sup>129</sup>

Regarding the realm of international investment treaties, the criterion of incorporation is rarely used exclusively. Instead, further criteria are used alternatively, cumulatively, or negatively, thereby requiring a more factual connection between the corporation and the State.<sup>130</sup>

However, it needs to be noted that such treaty practice can only give a limited indication of what is seen by States to be the general rule, as treaties can also be seen as *lex specialis* and therefore as deviations from a general rule.

## (3) Further State Practice

Two aspects of further state practice are of importance when considering whether criteria beyond the purely formal aspect of incorporation exist: first, under which circumstances States have chosen to espouse a claim, and second, how exactly corporations are determined to be foreign in municipal law.

Regarding the criteria set out by States for claiming on behalf of corporations, the practice of the United States and the United Kingdom is of note. Albeit some statements that they are formally entitled to protect any corporation incorporated in their territory, actual practice depicts the opposite.

The United States Government clearly maintains that it is entitled to claim on behalf of a foreign corporation if there is a substantial United States (shareholding) interest in such corporation. Consequently, it has declined to espouse claims which lack such a substantial interest, even though the corporation is incorporated in the United States and has allowed for claims if a substantial interest in a United States

<sup>126</sup> ICJ, *Case concerning the Barcelona Traction, Light and Power Company, Limited* (New Application: 1962) (Belgium v. Spain) Second Phase, Separate Opinion by Judge Jessup of 5 February 1970, 187 *et seq.*

<sup>127</sup> *Harris*, ICLQ 18 (1969), 275, (280).

<sup>128</sup> *Brownlie*, Principles of Public International Law, 483.

<sup>129</sup> *Harris*, ICLQ 18 (1969), 275 (286).

<sup>130</sup> See *Acconci*, JWIT 5 (No. 1, 2004), 139 (149 *et seq.*) for a detailed view.



corporation was of foreign origin.<sup>131</sup> The United Kingdom has also denied protection to corporations with only artificial ties, demanding British interest or the location of the seat of control.<sup>132</sup> Similar practice is exemplified by *inter alia* Switzerland and Mexico.<sup>133</sup> Developing countries have also frequently argued that a corporation cannot be protected by State without having any connection besides incorporation.<sup>134</sup> Hence, States rarely depend upon a mere formal connection when considering which corporations to protect.

Similarly, when identifying which corporations to qualify as foreign for tax or similar reasons, much weight is given to factual connections. The United States for instance chooses to disregard sole incorporation in connection with *inter alia* tax avoidance, competition, and bankruptcy.<sup>135</sup> The European Community also departs from applying only formal criteria when considering the nationality of a corporation.<sup>136</sup>

In regard to Germany, it first needs to be noted that the *siège social* criterion, which is widely used in civil law countries, by itself constitutes a stronger factual tie than mere incorporation.<sup>137</sup> Therefore, the necessity for a genuine link only exists when the regular criterion is deviated from. This is specifically the case for two Treaties of Friendship, Commerce and Navigation – with the USA and Spain – in which incorporation is the chosen criterion for purposes of defining nationality.<sup>138</sup> Despite the small number of exceptions, especially the Treaty with the USA has led to a number of decisions in regard to a genuine link criterion. Nevertheless, the German Federal Court of Justice has to date always accepted the possible requirement to be satisfied and hence avoided discussing the consequences of a missing genuine link.<sup>139</sup> However, lower courts<sup>140</sup> as well as German legal scholars<sup>141</sup> have widely accepted the existence of a genuine link requirement, even though its extension beyond public international law is still under debate.<sup>142</sup>

<sup>131</sup> *Case concerning the Barcelona Traction, Light and Power Company, Limited* (New Application: 1962) (Belgium v. Spain) Second Phase, Separate Opinion of Judge Jessup of 5 February 1970, 198 *et seq.*

<sup>132</sup> *Harris*, ICLQ 18 (1969), 275 (305 *et seq.*).

<sup>133</sup> *Brownlie*, Principles of Public International Law, 483.

<sup>134</sup> *Staker*, BYIL 61 (1990), 155 (158).

<sup>135</sup> *Acconci*, JWIT 5 (No. 1, 2004), 139 (147).

<sup>136</sup> *Ibid.*, 139 (147 *et seq.*).

<sup>137</sup> *de Visscher*, RdC 102 (1961 I), 399 (437 *et seq.*).

<sup>138</sup> *Ebenroth/Bippus*, DB 1988, 842 (843 *et seq.*).

<sup>139</sup> German Federal Court of Justice (BGH), Judgment of 5 July 2004 – II ZR 389/02; Judgment of 13 October 2004 – I ZR 245/01.

<sup>140</sup> OLG Düsseldorf, Judgment of 15 December 1994 – 6 U 59/94; OLG Sachsen-Anhalt (Naumburg), Judgment of 19 December 1995 – 7 U 146/95; OLG Düsseldorf Judgment of 1 October 1997 – 15 U 173/96; critically OLG Koblenz Judgment of 16 October 2003 – 2 U 55/99.

<sup>141</sup> *Ebenroth/Kemmer/Willburger*, ZIP 1995, 972, (975); *Ulmer*, IPRax 1996, 100 (103).

<sup>142</sup> For details see *Kindler*, in: Münchener Kommentar zum BGB, Volume 11, para. 322 *et seq.*; for a critical assessment of the jurisprudence see *Lach/Schill*, Commentary on BGH, Judgment of 13 October 2004 – I ZR 245/01, MittBayNot 2005, 243 *et seq.* Critically *Neumann*, Das genuine link-Kriterium, 84 *et seq.*; *Bungert*, WM 1995, 2125 (2133).

Thus, municipal law is not blind to the factual circumstances of a corporation and in certain cases looks beyond these to the factual ties.

#### d) *Principles of International Law*

While at first glance, the introduction of a requirement of some form of a substantial connection between a corporation and a State may appear to shorten States' sovereignty, this can in fact be based upon two general principles of international law that define the boundaries of sovereignty from the outset. These are the doctrine of abuse of rights and the prohibition of intervention.

##### (1) *Abuse of Rights*

As a subcategory of the principle of good faith<sup>143</sup> the doctrine finds its origin in the Roman law principle *sic utere iure tuo ut alienum non leadas*.<sup>144</sup> It has found acceptance both in general international law as well as municipal legal systems.<sup>145</sup> According to *Oppenheim*

“an abuse of rights occurs when a State avails itself of its rights in an arbitrary manner in such a way as to inflict upon another State an injury which cannot be justified by a legitimate consideration of its own advantage.”<sup>146</sup>

This description clearly envisions the abuse of rights by States. Indeed, even a State's right to assign national character to a legal person can in theory constitute an abuse of rights, *i.e.* if truly arbitrary means are chosen.

“There is no right, however well established, which could not, in some circumstances, be refused recognition on the ground that it has been abused.”<sup>147</sup>

Moreover, in connection with modern tendencies to accept subjects of international law beyond States, these new actors conceive both rights and obligations under international law. It is one such obligation to abstain from abusing the given rights. Hence, any legal person exercising its right to choose its national character in accordance with municipal law is prohibited to thereby circumvent the rules of international law.<sup>148</sup>

Nevertheless, as is the case for the question of what denotes a genuine link, there exists no clear threshold for which circumstances amount to an abuse of rights. However, any corporation with a genuine link to its Host State will have exercised its right legitimately, evidencing that no abuse of rights has occurred.

<sup>143</sup> *Cheng*, General Principles of Law as applied by International Courts and Tribunals, 121.

<sup>144</sup> *Kiss*, in: Encyclopaedia of Public International Law (1984), 4.

<sup>145</sup> *Brownlie*, Principles of Public International Law, 444.

<sup>146</sup> *Oppenheim's International Law*, Volume 1 (9<sup>th</sup> Edition), 407.

<sup>147</sup> *Lauterpacht*, Development of International Law by the International Court, 164.

<sup>148</sup> See further *Sloane*, Harv. Int'l L. J. 50 (No. 1, 2009), 1 (20 *et seq.*).

However, the situation of a lawful but abusive exercise of a right needs to be distinguished from the acquisition of a national character by fraud or bribery. International law demands that a national character has been acquired in accordance with municipal law.<sup>149</sup> Hence in the latter scenario, the right is voidable and therefore cannot from the outset be asserted under international law.<sup>150</sup>

## (2) *Prohibition of Intervention*

The prohibition of intervention constitutes a corollary of State sovereignty and State equality.<sup>151</sup> While on the outset States are themselves sovereign and thereby also equal, a tension exists between these two characteristics. As a balance, the prohibition of intervention denotes a duty of each State to non-interfere with another State's domestic realm. In regard to the national character of both natural and legal persons, a clear attribution to one State is rarely possible. Hence, States are free to choose which persons to confer their national character upon. However, as this entails conferring jurisdiction over these persons, a State might infringe another State's rights when imparting a national character upon persons that are more closely connected to another State. These persons would traditionally be considered part of the other State's jurisdiction and hence its domestic realm. International law has accepted a variety of different connecting factors, which represent some form of link between both the State and the person thereby balancing the interests of the States. However, an arbitrary conferral – *i.e.* one without some form of a substantive connection between a corporation and a (home) State – would impinge on other States jurisdiction, violating the prohibition of intervention.<sup>152</sup>

While the direct result of the prohibition of intervention only regards the duties of States, it indirectly also affects the status of a corporation's national character. Even though the corporation has itself not violated International Law by acquiring a national character without a substantive connection to the respective home State, its nationality is nevertheless contrary to International Law and thereby does not need to be accepted by another State. Hence, a State has no obligation to accept a corporation's national character if there is no form of a substantive connection between the corporation and the State claiming nationality.

## 3. *Conclusion*

Even though State Practice is far from unequivocal with regard to the treatment of corporations, it must be noted that mere formal ties are rarely sufficient to establish the national character of a corporation. However, neither the ICJ nor the ILC has acknowledged an explicit genuine link principle concerning corporations. It is

<sup>149</sup> *Brownlie*, Principles of Public International Law, 383.

<sup>150</sup> *Ibid.*, 398 *et seq.*, 417.

<sup>151</sup> *Ibid.*, 292 *et seq.*

<sup>152</sup> See further *Ziegenhain*, Extraterritoriale Rechtsanwendung und die Bedeutung des Genuine-Link Erfordernisses, 21 *et seq.*

understandable that both refrained from stating a general rule in this regard as it is still open for debate what exactly denotes such a link and moreover whether reference to any doctrine of genuine link is actually merely an application of the general principle of abuse of rights.<sup>153</sup> However, independent of the language used in this connection, both the ICJ and the ILC have indeed required some form of connection between a corporation and a State beyond mere formal ties. The existence of such a requirement is furthermore supported by State practice. Thus, one could make a strong argument that general public international law at least in 'hard cases' requires not only for natural persons, but also for corporations some form of a substantive connection to the respective home State.

In case the home state domestically applies the principle of *siège social*, problems of a sufficient substantive connection of that state and the respective corporation do not occur. But this might be different with regard to an exclusive application of the incorporation principle. In case of a determination of the nationality of a corporation based on the place of incorporation, it might very well be that next to the formal criterion of registration no substantive connection between the State and the respective corporation exists. As, however, public international law demands some form of substantive connection, the question arises of how to determine this connection. If one considers that due to a long standing international legal practice, the determination of nationality both for natural and for juridical persons is first within the sovereign regulatory autonomy of a respective state, a principle of rebuttable presumption in favor of legitimate nationality based on a purely formal criterion such as incorporation must be accepted. Still, it has been demonstrated that general international law does not preclude and in certain circumstances actually demands that this presumption is rebutted. The substantive test applicable to such a rebuttal of a given presumption should be the doctrine of abuse of rights.<sup>154</sup>

In addition, it must be emphasized that any direct application of substantive criteria beyond formal aspects of incorporation in a specific investment dispute depends on the relationship of a given BIT and general public international law as well. Even though recent awards increasingly factor in both abuse of rights<sup>155</sup> and the factual control<sup>156</sup> of a corporation, arbitral tribunals generally tend to limit their focus

<sup>153</sup> For details see *Sloane*, Harv. Int'l L. J. 50 (No. 1, 2009), 1 *et seq.*

<sup>154</sup> For details on this approach see *Hunter*, Is a corporation's Entitlement to the Protection of an Investment Treaty a Question only of form or is it also a question of substance to be decided in accordance with principles of international law?, in: ILA German Branch/Working Group, The Determination of the Nationality of Investors under Investment Protection Treaties – A Preliminary Report, Halle 2011.

<sup>155</sup> *Phoenix Action, Ltd. v. The Czech Republic*, ICSID Case No. ARB/06/5, Award of 15 April 2009, paras. 93 *et seq.*; *Mobil Corporation, Venezuela Holdings, B.V., Mobil Cerro Negro Holding, Ltd., Mobil Venezolana de Petróleos Holdings, Inc., Mobil Cerro Negro, Ltd., and Mobil Venezolana de Petróleos, Inc. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/27, Decision on Jurisdiction of 10 June 2010, para. 167 *et seq.*; different, however, *The Rompetrol Group N.V. v. Romania*, ICSID Case No. ARB/06/3, Decision on Respondent's Preliminary Objections on Jurisdiction and Admissibility of 18 April 2008, para. 85.

<sup>156</sup> *Tokios Tokelès v. Ukraine* ICSID Case No. ARB/02/18, Dissenting Opinion by Prosper Weil of 29 April 2004; *TSA Spectrum de Argentina S. A. v. Argentine Republic* (ICSID Case No. ARB/05/5), Award of 19 December 2008, para. 114 *et seq.*

on the respective BIT. This approach precludes the possibility to engage into a broader discussion of public international law with regard to the nationality of corporations.<sup>157</sup> If this approach is convincing – something we will not discuss in this paper – a quite substantive gap will exist between public international law and treaty based international investment law. In order to ensure coherence and consistency in law it therefore seems necessary to adjust the respective language in BITs.

### C. International Investment Law Influencing General Public International Law

The interrelation between international investment law and general international law is not a one-way street. Having surveyed examples of how the general influences the special (or particular), the following three sections establish that, in several respects, international investment law is now influencing aspects of general public international law. The first section considers the how BITs have expanded the concept of international law from a law between sovereigns to a law that also protects individuals, namely investors. The second section uses the local remedies provision as an example of how a very prominent principle of general public international law is modified and actually loses its significance by legal developments in international investment law. Similar to this, the final section uses the defence of necessity to explain how international investment law is changing the way that certain concepts are considered in general public international law.

#### I. Investors as Subjects of Public International Law

*Tillmann Rudolf Braun*

Classically, sovereign states were viewed as the main<sup>158</sup> legal subjects of international law. This law pertained to the states, and only they were subjects in international law. Therefore, international law basically consisted of regulations that had been agreed on between the states and applied to dealings between equals.<sup>159</sup> According to the understanding of international law existing at that time as *ius inter gentes* it was thought that:

<sup>157</sup> See, e.g., recently *The Rompetrol Group N.V. v. Romania*, ICSID Case No. ARB/06/3, Decision on Respondent's Preliminary Objections on Jurisdiction and Admissibility of 18 April 2008, paras. 86 *et seq.*

<sup>158</sup> In addition to the states these include the Holy. See, the Knights Hospitler, the International Committee of the Red Cross and the international organizations created by states beginning with the Mannheim Act 1815/1831, the International Telegraph Union of 1865, the World Post Association of 1874 up to the formation of the League of Nations.

<sup>159</sup> PCIJ, *Lotus Case*, (France v. Turkey), P.C.I.J. Reports 1927 Ser. A No. 10, 18 ["International law governs relations between independent states"].

“States solely and exclusively are the subjects of International law. This means that the Law of Nations is the law for the international conduct of States, and not of their citizens.”<sup>160</sup>

However, it is to be noted that this understanding came to dominate only since the advent of the *de Vattel* concept of sovereignty, so that the Westphalian system focused on the states as the relevant actors on an international level. Prior to the emergence of *de Vattel*'s principles of sovereignty, international law, *e.g.* in the writings of *de Vitoria* and *Grotius*, definitely conceded certain rights to the individual under international law.<sup>161</sup>

Thus according to the classical understanding, individuals were of importance in international law, and therefore for the states, only in the case that the home state interceded on their behalf in disputes with other countries. A classical expression of this can be found in the context of diplomatic protection where a home state can enforce a violation of a minimum standard of the law relating to aliens on the part of a host country as its own right:

“Whoever offends the state, injures its rights, disturbs its tranquility, or does it a prejudice in any manner whatsoever, declares himself its enemy, and exposes himself to be justly punished for it. Whoever uses a citizen ill, indirectly offends the state, which is bound to protect this citizen; and the sovereign of the latter should avenge his wrongs, punish the aggressor, and, if possible, oblige him to make full reparation; since otherwise the citizen would not obtain the great end of the civil association, which is, safety.”<sup>162</sup>

“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.”<sup>163</sup>

Even though this understanding of a violation of the state's *own* rights has been challenged time and again<sup>164</sup>, including the recent attempt of the Special Rapporteur of the *International Law Commission*, *Dugard* (“A State does not in ‘reality’ – to quote *Mavrommatis* – assert its own right only. In reality it also asserts the right of its injured

<sup>160</sup> *Oppenheim*, *International Law – A Treatise*, para. 13, (19); see also paras. 20, 25, 341.

<sup>161</sup> *Remec*, *The Position of the Individual in International Law According to Grotius and Vattel*, 59, 127-200; *Cutler*, *Review of International Studies* 27 (2001), 133; *Bederman*, *Emory L.J.* 54 (2005), 53 (67-69).

<sup>162</sup> *de Vattel*, *The Law of Nations or the Principles of Natural Law Applied to the Conduct and to the Affairs of Nations and Sovereigns* III (English translation: 1916), 136; see also *Borchard*, *The Diplomatic Protection of Citizens Abroad or the Law for International Claims* [354: “*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.*”].

<sup>163</sup> PCIJ, *The Mavrommatis Palestine Concessions*, (Greece v. Britain), P.C.I.J. Reports 1924 Ser. A, No. 2, 12; PCIJ, *Payment of Various Serbian Loans Issued in France*, (France v. Serbia), P.C.I.J. Reports 1929 Ser. A, No. 20, 41; PCIJ, *The Panevezys-Saldutiskis Railways Case*, (Estonia v. Lithuania), P.C.I.J. Reports 1939 Ser. A/B, No. 76.

<sup>164</sup> See for example the failed attempt of the first ILC Special Rapporteur for state responsibility, *Garcia Amador* (1956-1961), Third Report on International Responsibility, Yearbook of the International Law Commission, 1958, Vol II; Sixth Report on International Responsibility; Yearbook of the International Law Commission (1961).

national”<sup>165</sup>), the Commission nevertheless deliberately left this question open in its suggested Article 1 of the Draft Articles on Diplomatic Protection: “Draft article 1 is formulated in such a way as to leave open the question whether the State exercising diplomatic protection does so in its own right or that of its national – or both”.<sup>166</sup>

Currently, international law is still essentially viewed as a law between states, and the states are understood to be the fundamentally most important actors in the legal system of *international law*, but the extension of the circle of subjects in international law<sup>167</sup>, and the resulting immediate access to international law, is possible in principle.<sup>168</sup> In a departure from the principle of the interstate mediation of the individual, natural and legal persons can also be partial subjects in international law because international law directly confers rights and duties upon them. For example, “*Privatization*”<sup>169</sup>, “*Individualization*”<sup>170</sup> and “*Humanization*”<sup>171</sup> are characterized by the transition of international law from a interstate law that serves the protection of states’ interests to a law of the international community that is able to reflect a wide range of interests.

Such a conferring of rights for individuals in international law can result from international treaties. For this purpose the norm under international law has to be “self-executing”, *i.e.* executable without any further implementary action by state organs.<sup>172</sup> Secondly, the concluding states have not only to want to create interstate obligations but also to constitute rights to be enjoyed directly by the noninvolved individual as a third party beneficiary. Whether, thirdly, a possibility must exist for the enforcement<sup>173</sup> of these rights as a decisive and mandatory criteria, is a question

<sup>165</sup> *International Law Commission*, Report of the fifty-eighth session, 2006, A/61/10, 25, [Draft Articles on Diplomatic Protection], available at: <<http://untreaty.un.org/ilc/reports/2006/2006report.htm>> (last visited on 20 December 2010).

<sup>166</sup> Report, *supra* footnote 165; others went further: *International Law Association*, Diplomatic Protection of Persons and Property-Final Conference Report 2006 [4: “The state may still act as a conduit, an agent, or on BEHALF of the individual, but no longer substituting for his rights”], available at: <<http://www.ila-hq.org/en/committees/index.cfm/cid/14>> (last visited on 20 December 2010).

<sup>167</sup> *Mosler*, ZaöRV 22 (1962), 1 *et seq.*

<sup>168</sup> *Hobe*, Einführung in das Völkerrecht, 14, (166); *Hobe*, in: Hofmann (ed.), Non-State Actors as New Subjects of International Law, 115 *et seq.*; *Epping*, in: Ipsen, Völkerrecht, 95 *et seq.*; *Delbrück/Wolfrum/Dahm*, Völkerrecht, Vol. 1/2, 260 *et seq.*, 266; *Brownlie*, Principles of Public International Law, 554 *et seq.*; *McCorquodale*, in: Evans (ed.), International Law, 307 *et seq.*, 320; *Jennings/Watts*, in: Oppenheim's International Law, Vol 1, Band 2-4, 847/848; *Shaw*, International Law, 232; *Higgins*, Problems and Process, 48 (50).

<sup>169</sup> *Dörr*, JZ 60 (2005), 905.

<sup>170</sup> *Slaughter/Burke-White*, Harv. Int'l L. J. 43 (2002), 1 (13).

<sup>171</sup> *Meron*, The Humanization of International Law; *Mennecke*, GYIL 44 (2001), 430; *Pergantis*, ZaöRV 66 (2006), 351.

<sup>172</sup> *Buergenthal*, RdC 235 (1992 IV), 301 *et seq.* – To clarify the terminology: The term „self-executing is not being used here as it would be in the context of the question whether dualistic systems embrace transformative acts that give national validity to international LAW and would then, for example, allow individuals to invoke international law within a national legal framework.

<sup>173</sup> Claiming the possibility of the right's enforcement: *Epping*, in: Ipsen, Völkerrecht, 97; *Verdross/Simma*, Universelles Völkerrecht, 256; different opinion and with it to let the granting of the right sufficient for subjectivity under international law: English Court of Appeals, Judgment 2005 EWCA 1116 (Civ), 9 September 2005, Recital 18; *Hobe*, Einführung in das Völkerrecht, 167; *Higgins*, Problems and Process – International Law and How We Use it, 48 (53); *Lauterpacht*, International Law and Human Rights, 27.

that can be set aside at least if and because such a procedural entitlement of the individual, as an essential indication<sup>174</sup> of the states' commitment to constitute rights of the individuals, has already been established.

In international investment law, this commitment has taken the form of modern bilateral investment treaties in which the states grant the investor concrete material rights along with associated formal enforcement procedures. The states thereby enable the investor to independently claim treaty standards in international law against the host state directly at the level of international law. This essential innovation in comparison to customary international law has rightly been described as a 'paradigm shift' in international law.<sup>175</sup>

The first German bilateral investment protection treaty to include an investor-state clause was the German – Romanian treaty of 1979,<sup>176</sup> which only covered the case of a dispute concerning the amount of compensation. After this initially restricted clause, a genuinely comprehensive investor-state arbitration clause was included in the German – Nepalese Bilateral Investment Treaty of 1986.<sup>177</sup> And, of the large emerging and developing countries, China first introduced an investor-state arbitration clause with an industrial state in its bilateral protection treaty with Germany in 2003.<sup>178</sup> Almost two-thirds<sup>179</sup> of Germany's currently valid bilateral investment treaties include such an investor-state clause, as do all treaties currently being ratified.

There are three possible relevant issues (1) Admissibility of a Waiver through 'Exclusive Jurisdiction Clauses', (2) Admissibility of countermeasures, and (3) Suspension of law in state of emergency. These issues all concern practical consequences of the investor's partial subjectivity in international law, the first issue, Admissibility of a Waiver through 'Exclusive Jurisdiction Clauses', shall be highlighted briefly.

When modern bilateral investment treaties grant material rights, the question arises regarding the actual quality of these rights, namely, whether these rights are

<sup>174</sup> *Spiermann*, *Arbitration International* 20 (No. 2, 2004), 179 (186); *Douglas*, *BYIL* 74 (2003), 151 (181); *Hoffmann*, *ICSID Review – FILJ* 22 (No. 1, 2007), 69 (91); *Tietje*, *Grundstrukturen und aktuelle Entwicklungen des Rechts der Beilegung internationaler Investitionsstreitigkeiten*, Heft 10 (2003), 16, available at: <<http://telc.jura.uni-halle.de/de/node/23>> (last visited on 20 December 2010); *Delbrück/Wolfrum/Dahm*, *Völkerrecht*, Vol. I/2, 261.

<sup>175</sup> *Schreuer*, in: *Hummer* (ed.), *Paradigmenwechsel im Völkerrecht zur Jahrtausendwende*, 237; *Salacuse/Sullivan*, *Harv. Int'l L. J.* 46 (2005), 67, (88) ("revolutionary innovation [whose] ...uniqueness and power should not be overlooked"); *BG v Argentina*, UNCITRAL, Award of 24. December 2007, Recital 145 [„The proliferation of bilateral investment treaties has effected a profound transformation of international investment law. Most significantly, under these instruments investors are entitled to seek enforcement of their treaty rights by directly bringing action against the State in whose territory they have invested. Investors may seek redress in arbitration without securing espousal of their claim or diplomatic protection. The Argentina-U.K. BIT is a paradigm of this evolution.“].

<sup>176</sup> Art. 3 Paragraph 3 ICSID Arbitration Clause, *BGBI.* 1980 II, 1157 *et seq.*; in the meantime a new German – Romanian bilateral investment treaty signed on 25 June 1996 has been in effect since 12 December 1998, available at: <<http://www.dis-arb.de/materialien/indexbiinvest.html>> (last visited on 20 December 2010).

<sup>177</sup> On 20 October 1986, *BGBI.* 1988 II, 262 *et seq.*; in effect since 07 July 1988; available at: <<http://www.dis-arb.de/materialien/indexbiinvest.html>> (last visited on 20 December 2010).

<sup>178</sup> *Braun/Schonard*, *ICSID Review – FILJ* 22 (No. 2, 2007), 258-279.

<sup>179</sup> 82 of the 125 *valid* bilateral investment treaties as of 2008.



actually the investor's own rights. Determining the status of these rights is crucial for deciding whether an investor can waive his rights arising from a modern bilateral investment treaty in international law and the assertion of those rights in an investor-state arbitration through a private contractual agreement with the host state ("*Exclusive Jurisdiction Clause*"). On the one hand there is the opinion that each party that has been granted direct rights, "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,"<sup>180</sup> can dispose of them – including waiving them – as they see fit.<sup>181</sup> On the other hand, the opposite view can be held, *i.e.* that partial subjectivity in international law is only granted by the treaty states which are party to the bilateral investment treaty, "[t]here 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,"<sup>182</sup> and, therefore, it cannot be affected by an investor.<sup>183</sup> Subjectivity in international law can, therefore, not only be described as "partial" to the extent that it may be construed to contain only rights and no duties, but also because, although it allows the exercise of rights, it does not allow them to be affected.<sup>184</sup>

<sup>180</sup> *Occidental Exploration and Production Co. v. Republic of Ecuador*, English Court of Appeal (2005), EWCA Civ. 1116, para. 20; (2005) 2 Lloyd's Rep. 707; see also: *SGS v. Philippines*, Declaration by Arbitrator Crivellaro, recital 9 ["(...) is a beneficiary third party in respect of the BIT"]; *AMT v Republic of Zaire* Award of 21 February 1997, Case No.ARB/93/1, 5 ICSID Rep 14, para 6.06; *Paulsson*, ICSID Review: FILJ 10 (No. 2, 1995), 232 (256); *Wälde*, *Arbitration International* 12 (1996), 429 (435-437).

<sup>181</sup> In the end: *Aguas del Tunari S.A. v. Republic of Bolivia*, Decision on Respondent's Objections to Jurisdiction of 21. October 2005, paras. 115 *et seq.*; *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, Decision on Objections to Jurisdiction of 29 January 2004, para 138, 154 *et seq.*; *Occidental Exploration and Production Co. v. Republic of Ecuador*, English Court of Appeal (2005), EWCA Civ. 1116, para 20; (2005) 2 Lloyd's Rep. 707.

<sup>182</sup> *The Loewen Group Inc. (Can.) v. United States*, ICSID Case No. ARB(AF)/98/3, Award of 2003, para. 233; 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. ["The obligations listed in Section A of NAFTA chapter Eleven are not owed 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."]; *Crawford*, *AJIL* 96 (2002), 874 (888), : [Bilateral investment treaties "institutionalize and reinforce" the system of diplomatic protection]; *Sornarajah*, *J of World Trade L* 20 (1986), 79 (83) ["The breach of the treaty creates an international obligation between state parties to the treaty and no benefits or rights flow directly to the affected individual"].

<sup>183</sup> In the end, *Lanco International Inc. v. Argentina*, ICSID Case No. ARB/97/6, Decision on Jurisdiction of 8 December 1998, paras. 36, 39, 40; *Salini Construtorri S.p.A. and Italstrade S.p.A. v. Morocco*, ICSID Case No. ARB/00/4, 23 July 2001, Decision on Jurisdiction, paras. 25 *et seq.*; *CMS*, *supra* note 46, paras. 70, 76.

<sup>184</sup> "Derivative rights" (delegate espousal) – theory in comparison with "direct rights" (third party beneficiary)-theory, see *Douglas*, *BYIL* 74 (2003), 151 *et seq.*; *Spiermann*, *Arbitration International* 20 (No. 2, 2004), 179 *et seq.*; *Schreuer*, in: Reinisch/Kriebaum (eds.), *The Law of International Relations*, 355; *Douglas*, *Arbitration International* 22, (No. 1, 2006), 27 *et seq.*; *Bjorklund*, *US Davis Legal Studies Research Paper No. 124* (2007); *Hoffmann*, *ICSID Review – FILJ* 22 (No. 1, 2007), 69 *et seq.*; *Griebel*, *Internationales Investitionsrecht*, 102 (Konstellation III).

## II. Local Remedies Rule in Public International Law and in Investment Protection Law

Ralph Alexander Lorz

### 1. *The Local Remedies Rule as Part of International Law*

The requirement to exhaust local remedies is a traditional concept of international law, demanding that a natural or legal person must first have recourse to all means of redress available under the domestic law of a state before she can bring a claim for the violation of her rights through that state in an international forum. Developed originally in the context of diplomatic protection<sup>185</sup>, the concept of the exhaustion of local remedies has been retained in most procedures granting individuals direct access to such a forum, especially in the context of human rights.<sup>186</sup> The local remedies rule has thus become a widespread principle and also been implemented in situations different from those for which it was originally designed. As a general conclusion, one may state that local remedies are relevant in all settlements of a certain class of international disputes involving states.<sup>187</sup>

The corresponding rule has been frequently invoked in international litigation before both the ICJ and international arbitral tribunals. For example, the rule was relied upon by the respondent state in the *Interhandel* case, where the ICJ stated categorically that “the rule that local remedies must be exhausted before international proceedings may be instituted is a well-established rule of customary international law.”<sup>188</sup> The rule was also recognized by the tribunals as a relevant rule of international law in both the *Finnish Ships Arbitration*<sup>189</sup> and the *Ambatielos Claim*<sup>190</sup>. These examples show that most of the recent history of the rule has been concerned with the decisions of international tribunals or organs rather than the diplomatic practice of states. Just as in other fields of international law, the importance of judicial and quasi-judicial determination has thus been increasing.

However, one may also note a growing number of attempts – in the area of diplomatic protection or more specifically in the relationships between individuals and foreign states – to exclude the application of the rule of local remedies either by

<sup>185</sup> The requirement that local remedies should be resorted to seems to have already been recognized in the early history of Europe, even before the modern national state was born, in the relations between sovereign territories or individual communities when it came to the question of legitimate reprisals. See *Amerasinghe*, *Local Remedies in International Law* (2004), 22-28.

<sup>186</sup> See, e.g., Art 35 (1) of the European Convention on Human Rights which prescribes that “the Court may only deal with the matter after all domestic remedies have been exhausted, according to the generally recognized rules of international law and within a period of six months from the date when the final decision was taken.”

<sup>187</sup> See *Amerasinghe*, *Local Remedies in International Law*, 3.

<sup>188</sup> ICJ, *Interhandel Case* (Switzerland v. United States of America), I.C.J. Reports 1959, 6 (27).

<sup>189</sup> The *Finnish Ships Arbitration*, 3 UNRIAA 1479 (1934).

<sup>190</sup> The *Ambatielos Claim*, 12 UNRIAA 83 (1956).

express agreement or even by implication. Examples are the Claims Settlement Declaration by Algeria of 1981 relating to the agreement between the US and Iran<sup>191</sup> or the Convention on the Settlement of Investment Disputes between States and the nationals of other States (“ICSID Convention”).

The rationale for the rule centers on the interest of the respondent or host state. It is in the interest of the host state that it should have the opportunity to administer justice in its own way and to investigate the issues of law and fact which the claim involves through its own courts and tribunals in order to control and discharge its responsibility. Judge *Córdova* explained this in a separate opinion in the *Interhandel* case as follows:

“This principle... finds its basis and justification in reasons which are perhaps more important than the simple possibility of avoiding contradictory procedures and decisions. The main reason for its existence is the absolute necessity of harmonizing international and national jurisdictions – thus ensuring the respect due to the sovereign jurisdiction of States – to which nationals and foreigners are subject and in the diplomatic protection of governments to which only foreigners are entitled. This harmony and respect for the sovereignty of states is achieved by granting priority to the jurisdiction of the State’s domestic courts in cases where foreigners appeal against an act of its executive or legislative authorities. Such priority is in turn guaranteed only by respect for the principle of exhaustion of local remedies...”<sup>192</sup>

On the other hand, any alien or investor alleging an internationally wrongful act by a state has a sincere interest not only in quick and efficient adjudication but also in adjudication by a tribunal of guaranteed impartiality. Even in the states which adhere to the rule of law and the independence of their judges to the utmost extent, investors coming from abroad will always fear that in cases of doubt, domestic courts might tend to tip the balance in favor of “their” state and government as opposed to the alien person seeking redress before them<sup>193</sup>. These competing interests need to be balanced against each other when applying the local remedies rule, also taking into consideration the interest of the international community in the effective and peaceful settlement of disputes. However, they play out in a slightly different way when investment disputes are at stake, since host states also have a strong interest in attracting investments.

<sup>191</sup> Available at: <<http://www.iusct.org/claims-settlement.pdf>> (last visited on 20 December 2010).

<sup>192</sup> I.C.J. Reports 1959 at 45 *et seq.* See also the overview given by *Kriebaum*, in: Binder/Kriebaum/Reinisch/Wittich (eds.), *International Investment Law for the 21<sup>st</sup> Century*, 417 (421).

<sup>193</sup> This consideration might even apply between the entities of a federal state. In the U.S., for instance, diversity of citizenship (meaning two U.S. citizens coming from different states) is therefore a sufficient reason for federal jurisdiction.

## 2. *The Local Remedies Rule and Investment Treaties*

Most Bilateral Investment Treaties (“BITs”) do not deal with the local remedies rule. Only a few of those BITs that have been concluded since 1985 in fact require that aggrieved investors make use of local remedies before resorting to arbitration under the BIT. Traditionally, Romanian BITs deliberately introduce the local remedies rule. For example, the BIT between Romania and Sri Lanka includes the following provision in its seventh article:

“However, each Contracting Party hereby requires the exhaustion of local administrative or judicial remedies as a condition of its consent to conciliation or arbitration by the Centre.”<sup>194</sup>

Moreover, the Germany-Israel BIT includes the following provision:

“Local remedies shall be exhausted before any dispute is submitted to an arbitral tribunal.”<sup>195</sup>

Some BITs also explicitly provide that local remedies need not be exhausted<sup>196</sup>, thereby following the example of Article 26 ICSID Convention which states that states may make the exhaustion of local remedies a condition of consent to arbitration. In the absence of such a regulation, however, there is no requirement to resort to local courts or administrative agencies under the ICSID regime. Consequently, where the BIT incorporates ICSID arbitration either as the only dispute settlement procedure or as one alternative and allows for nothing else, there is much room for arguing that by virtue of Article 26 of the ICSID Convention the rule of local remedies is waived.<sup>197</sup>

A fourth group of BITs provides for resort to arbitration (mostly ICSID arbitration) if a dispute has not been settled through local remedies within a certain period of time.<sup>198</sup> A typical example of such a clause can be found in Article 10 of the Argentina-Germany BIT. It provides that if a dispute cannot be settled amicably it shall be submitted to the competent tribunals of the host state. The dispute is to be submitted to international arbitration at the request of one of the parties to the dispute if no decision on the merits of the claim has been rendered within a period of

<sup>194</sup> Art 7(2) of the Romania and Sri Lanka Agreement on the mutual promotion and guarantee of investments, 9 February 1981, available on the UNCTAD website.

<sup>195</sup> Art 10(5) of the Treaty between the Federal Republic of Germany and the State of Israel concerning the Encouragement and Reciprocal Protection of Investment, 24 June 1976, available on the UNCTAD website. Due to the political implications of the Middle East conflict, this treaty has never formally entered into force, but works very well as a provisionally applicable instrument.

<sup>196</sup> See, e.g., Article 11 of the BIT between Australia and the Czech Republic (Agreement between Australia and the Czech Republic on the Reciprocal Promotion and Protection of Investments, 30 September 1993, available on the UNCTAD website).

<sup>197</sup> This view is shared by *Amerasinghe*, *Local Remedies in International Law*, 269.

<sup>198</sup> Such a provision could, for example, be found in the first British model BIT, see *Dolzer/Stevens*, *Bilateral Investment Treaties*, 234. See also Article 8(1) of the Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Singapore, 22 July 1975, 15 ILM 593 (1976). For *Schreuer*, such clauses constitute “*children and grandchildren of the Calvo clause*”. See *Schreuer*, *Law & Practice Int’l Courts & Tribunals 4* (2005), 1; commented by *Kriebaum*, in: *Binder/Kriebaum/Reinisch/Wittich* (eds.), *International Investment Law for the 21<sup>st</sup> Century*, 417 (418 *et seq*).

18 months since the initiation of the court proceedings or if a decision has been rendered, but the dispute persists.<sup>199</sup>

Technically, this is not a requirement to exhaust local remedies, since the parties are free to turn to ICSID once the time has elapsed. In many cases, the stated period in such clauses is short and only amounts to three or four months<sup>200</sup> – a very unrealistic time limit for the exhaustion of local remedies. Only some BITs within this category provide for more generous time spans, among them the aforementioned Argentina-Germany BIT. The 1981 Sri Lanka-Switzerland BIT states that the parties have twelve months to settle their dispute “through pursuit of local remedies or otherwise” (in the original: “*par les voies de recours interne ou par une autre voie*”<sup>201</sup>).

Many BITs also include provisions stating that the choice of a particular dispute resolution procedure, once taken, forecloses the possibility of electing any other dispute resolution procedure potentially available. Such provisions are commonly referred to as “fork in the road provisions”, taking up the old Roman law maxim *una via electa non datur recursus ad alteram*.<sup>202</sup> These clauses constitute a sharp contrast to the requirement of exhaustion of local remedies. If a fork in the road provision applies, seeking a remedy before a domestic court would cause a claimant to lose its right to arbitrate under a BIT.<sup>203</sup>

### 3. German State Practice as an Example

It would be very interesting to conduct a statistical analysis of all existing BITs and thereby to determine empirically how many of them belong to each of the categories identified in theory, respectively. For the purposes of this paper that aims at a more precise description of the interdependence between general public international law and international investment law, though, a representative example may suffice. And it is appropriate to use Germany in that respect because, as is well-

<sup>199</sup> Cf. Vertrag zwischen der Bundesrepublik Deutschland und der Argentinischen Republik über die Förderung und den gegenseitigen Schutz von Kapitalanlagen, 9. April 1991, Spanish/German version available on the UNCTAD website.

<sup>200</sup> The UK-Singapore BIT includes a time limit of three months (*ibid*).

<sup>201</sup> See Accord entre le Gouvernement de la Confédération Suisse et le Gouvernement de la République socialiste de Sri Lanka concernant l’encouragement et la protection réciproque des investissements, 23 September 1981, available on the UNCTAD website.

<sup>202</sup> “Once a road is chosen, there is no recourse to the other.”.

<sup>203</sup> See *Schreuer*, JWIT 5 (2004), 231 (239 *et seq.*) for a more detailed discussion of these clauses. *Schreuer* argues that a decision in favor of domestic courts should not be presumed lightly because of the clear advantages international arbitration offers to most investors. According to *Schreuer*, when there is a doubt concerning an investor’s choice it should be presumed that the investor intends to arbitrate. See also *McLachlan/Shore/Weiniger*, *International Investment Arbitration*, 104 *et seq.* *McLachlan/Shore/Weiniger* introduce a dogmatic approach to fork in the road clauses: They conclude that the operation of the clause will be affected by the juridical nature of the dispute, meaning that if the claims asserted in the host state courts or before the arbitral tribunal are contractual and not treaty-based, the existence of a fork in the road clause will have no effect on the subsequent invocation of a treaty claim before an arbitral tribunal, since the fundamental basis of the claim is different. This distinction sounds persuasive at first glance. At a second glance, however, it becomes apparent that there is no clear-cut difference between treaty and contract claims.

known, it is not only the country with the first BIT in history, but also a typical capital-exporting country and the one with the highest number of BITs in force.<sup>204</sup>

One hundred and forty-eight BITs in fact represent a relatively comprehensive sample. It is thus very telling to note that nearly all of them fall into only two of the six categories mentioned above. By far the largest number (89) contains an explicit waiver of the local remedies rule, *i.e.* a clause stating that local remedies need not be exhausted. The second-largest group of German BITs (48) does not tell much simply because it does not contain any local remedies regulation at all. Only eight BITs provide for a certain period of time to pass, and three BITs state that local remedies “shall be exhausted”. As regards the remaining two categories, neither a “fork in the road” provision nor an explicit requirement of local remedies appear in any German BIT.

A look at the distribution of these BITs in the course of time reveals even more, namely, a clear tendency in the development of German BIT practice. In the first decade (1959-1969), no attention at all was paid to local remedies, so they were not mentioned in any German BIT. That persists throughout the 1970s as well, with the only exception that the three BITs providing that local remedies “shall be exhausted” were also concluded during that period. In the third decade (1980-1989), the BIT type waiving the local remedies requirement starts to appear; however, in terms of quantity the original type not mentioning local remedies at all stays on equal footing. That changes dramatically in the 90s when no such BIT is concluded any more; by the same token, though, almost all of the BITs stating time frames for local dispute settlement stem from this period. Finally, from 2000 onwards the picture becomes uniform again: in the last ten years, the only remaining type of BITs Germany has entered into contains the explicit waiver of local remedies.

This development sends a clear message as far as the behavior of one of the major players in the BIT field is concerned. At the beginning, local remedies were not really an issue for BITs. When the consciousness arose that it was important to take them into account, several models – first the “shall”-clause, then the time frames – were tried out. In the end, Germany settled for what it and its treaty partners considered the best option, namely, to waive local remedies altogether. This empirical determination allows for some interesting conclusions to be drawn below .

#### *4. MFN Clauses as a Means to Circumvent the Obligation to Resort to Local Courts?*

In practice, the treaty requirement of taking the dispute to the host state courts for a certain period of time<sup>205</sup> has not often proved to be an obstacle to arbitration. In

<sup>204</sup> An updated list of all German BITs can be found on the DIS homepage: <<http://www.dis-arb.de>> (last visited on 20 December 2010).

<sup>205</sup> As mentioned beforehand, these clauses are not “local remedies clauses” in a strict sense. The *Wintershall* tribunal has referred to them as “*local-remedies clauses with an opt-out provision*”. See *Wintershall Aktiengesellschaft v Argentine Republic*, ICSID Case No ARB/04/14, Decision on Jurisdiction of 8 December 2008 (*Nariman, Bernárdez & Bernardini*), para 116, available on the ICSID homepage.

both the *Maffezini*<sup>206</sup> and the *Siemens* case<sup>207</sup>, the claimants were able to rely on most favored nation (MFN) clauses to avoid this requirement. The tribunals seem to have felt that the requirement to attempt a settlement in the host state's domestic courts resembled a half-hearted attempt to introduce the local remedies rule and did not serve any justified purpose.

The most recent case dealing with such a provision, however, points in the opposite direction. In a development that underscores continuing uncertainty as to the meaning and scope of MFN clauses in investment treaties, an ICSID tribunal ruled that the German investor *Wintershall* may not invoke the MFN provision of the Germany-Argentina BIT in order to evade the requirement of Article 10 that claims be pursued for 18 months in the Argentine courts before being subjected to international arbitration.<sup>208</sup> The ruling constitutes a sharp contrast to the *Siemens* ruling where the German investor *Siemens* successfully convinced a different ICSID tribunal that the MFN clause in the same treaty provided an effective means of detouring around the requirement that claims be pursued in domestic courts for a minimum of 18 months. In contrast to *Wintershall*, *Siemens* was permitted to reach into other treaties signed by Argentina with third states and to make use of their "more favorable" dispute settlement provisions.

Of particular interest in this context is the fact that the *Wintershall* tribunal rejected an argument by the investor that Article 10(2) of the Argentina-Germany BIT imposed a "mere procedural waiting period".<sup>209</sup> It emphasized the fact that waiting periods for amicable settlement (negotiation) should be differentiated from requirements to invoke the jurisdiction of domestic courts for a given period of time, and considered the latter to be of a mandatory jurisdictional nature. The tribunal's reasoning raises interesting issues of treaty interpretation and is likely to be hotly debated in other pending Argentine cases which have yet to move to the jurisdictional phase.

##### 5. *Implicit Requirement to Exhaust Local Remedies?*

Another question is whether a local remedies rule can be read into BITs that do not include such a requirement even if the BIT does not provide for ICSID arbitration<sup>210</sup>. This question cannot be answered by reference to the generally accepted rule that in cases of diplomatic protection the rule is applied in the absence of any indication to the contrary. The rule as a part of the law of diplomatic protection is

<sup>206</sup> *Emilio Agustín Maffezini v Kingdom of Spain*, ICSID Case No ARB/97/7, Decision on Jurisdiction of 25 January 2000 (*Orrego Vicuña, Buergethal & Wolf*), ICSID Review: FILJ 16 (2001), 212; ICSID Reports 5 (2002) 387, paras 38 *et seq.*

<sup>207</sup> *Siemens A.G. v Argentine Republic*, ICSID Case No ARB/02/8, Decision on Jurisdiction of 3 August 2004 (*Rigo Sureda, Brower & Bello Janeiro*), paras 82 *et seq.*, available on the ICSID homepage.

<sup>208</sup> *Wintershall Aktiengesellschaft v Argentine Republic*, ICSID Case No ARB/04/14, Decision on Jurisdiction of 8 December 2008 (*Nariman, Bernárdez & Bernardini*), available on the ICSID homepage.

<sup>209</sup> *Ibid.*, at para 145.

<sup>210</sup> The same question arises in the context of human rights protection.

arguably distinguishable from the rule as a part of the law of investment protection. The former came into existence at a time when the state was considered to be in absolute control of matters taking place within its jurisdiction. The international community then adhered to a very rigid concept of sovereignty which does not apply any more today, especially not in the context of investment treaties. After all, it is the main objective of modern investment treaties to create alternative fora for dispute settlement and not to strengthen the exclusive jurisdiction of states. The ability of individuals to litigate or arbitrate directly under the modern system of investment treaty protection is also a departure from the practice of diplomatic protection. It de-emphasizes the role of states and gives the individual a direct way to protect his own interests.

On the other hand, since this ability derives from a treaty that has been concluded between the investor's home and host state, it might be argued that the procedure provided for is just a different form of the exercise of diplomatic protection by the investor's home state and therefore the local remedies rule should apply in the absence of an explicit waiver.<sup>211</sup> Such an implicit assumption would, however, run afoul of the object and purpose of BITs. BITs are concluded to provide an international forum for investment disputes and not to strengthen the power and authority of local courts. They always include detailed provisions on dispute settlement. If the parties thus intend to involve local courts, they must explicitly provide for such involvement.

It is furthermore questionable whether the insistence on the exhaustion of local remedies by a host state serves any useful practical purpose and facilitates dispute resolution. A necessity to resort to local remedies before the initiation of investment arbitration proceedings may be seen by the investor as a high burden in terms of resources and time. The public proceedings in the host state's courts may also exacerbate the dispute between the parties and thereby affect the host state's investment climate. Moreover, it is conceivable that an investment arbitration tribunal may "overturn" the decision of a local court which would further complicate the dispute.

#### *6. Partial Equivalents of the Local Remedies Rule in International Investment Law*

Although it is strongly argued here that the local remedies rule in general should not be read into international investment agreements unless they explicitly provide so, several specific constellations exist where some kind of local remedies exhaustion seems in order before an investment tribunal would issue an award. That is to say, the local remedies rule might not come into play as a formal requirement blocking arbitral proceedings as long as it is not fulfilled, but an investor-claimant will severely reduce his chances of immediate success if he refuses to turn to domestic administrative and/or judicial institutions first.

<sup>211</sup> If one followed this line of argumentation, one would also have to conclude that the rights granted under investment treaties are derivative rights instead of direct rights, belonging to the investor's home state and asserted on its behalf by the investor. See *Douglas*, BYIL 74 (2003), 151 (162) for a detailed discussion of whether investment treaties grant direct rights.



A major example of this approach even beyond the BIT-controlled area of international investment law is represented by Art. 17 of the Convention Establishing the Multilateral Investment Guarantee Agency (MIGA)<sup>212</sup>. This article provides that investors shall have recourse to administrative remedies in the host state before submitting a claim to MIGA and that MIGA shall not pay them out of the guarantee assumed as long as such remedies are still readily available under the host state's laws. It were again the Latin American states with their famous *Calvo* doctrine that pressed for this inclusion of a hybrid local remedies rule in the MIGA agreement<sup>213</sup>. And despite the ambiguous wording of the convention provision, already the first "Operational Regulations" established made clear that this rule was not only to apply to proceedings before administrative authorities, but to judicial remedies as well<sup>214</sup>. Moreover, MIGA is empowered to ask a claimant to pursue specific remedies at the agency's expense if those remedies – even in case of a successive subrogation under Art. 18 of the Convention – are not available to MIGA itself (like the typical ICSID proceeding)<sup>215</sup>. As a result, there is no formal barrier to a claim made by the holder of a guarantee under MIGA that local remedies be exhausted beforehand, but any such investor would be ill-advised if he did not even try out these remedies – unless, of course, the corresponding recourse to domestic institutions were apparently futile or would deprive the investor of other rights he could use on his own.

The most famous and contentious area where the applicability of some kind of local remedies rule even within ICSID proceedings is at stake, however, is the whole complex of "denial of justice" claims, *i.e.* claims based on some outrageously unfair treatment of a foreign investor by domestic courts<sup>216</sup>. In these cases, the local remedies problem arises whenever a lower court is accused of such a behavior, but ICSID proceedings are commenced without going all the way through the judicial system of the host state until a decision is rendered that cannot be appealed any more.

The case law is far from being unambiguous in that respect. To start with the most recent award that has become famous for different reasons, though, in the *Saipem* case the tribunal just reiterated that if an investor has undertaken serious efforts to litigate a matter before the domestic courts and a point is reached where further paths in this domestic litigation are not reasonably available or pursuing them seems obviously futile, exhaustion of local remedies may no longer be demanded<sup>217</sup>. In the *Loewen* case – the most striking example of denial of justice committed by a U.S. court – the tribunal defined the exhaustion of local remedies as a procedural requirement and therefore as a bar to jurisdiction when administrative failures are at issue. For judicial acts, by contrast, it introduced a requirement of finality as a peculiar

<sup>212</sup> *Cf.*, for instance, 24 ILM (1985) at 198.

<sup>213</sup> *Alsop*, Colum. J. Transnat'l L. 25 (1986), 101 (133).

<sup>214</sup> §§ 4.09, 2.14 (v) and (vi) of these Regulations, reprinted, for instance, in *Ebenroth/Karl*, Die Multilaterale Investitions-Garantie-Agentur, 364 (386, 403).

<sup>215</sup> *Seidl-Hohenveldern*, ICSID Review – FILJ 2 (1987), 111.

<sup>216</sup> *Paulsson*, Denial of Justice in International Law, 90.

<sup>217</sup> *Saipem S.p.A. v. The People's Republic of Bangladesh*, ICSID Case No ARB/05/7, Award of 30 June 2009 (*Kaufmann-Kohler, Schreuer & Otton*), para 183, available on the ITA website.

substantive barrier to issuing an award in favor of the investor-claimant<sup>218</sup>. But since the case was eventually decided on other grounds, the tribunal did not really explore the depths of this distinction.

The majority of legal practitioners writing on this issue also view the local remedies rule as a procedural requirement and sees no reason why judicial rulings should be treated differently from administrative decisions in that respect<sup>219</sup>. So, if under the respective BIT the road to arbitration is open without the need to challenge an administrative decision in the local courts, an investor would similarly not be required to appeal an unfavorable judgment from a lower court, but could instead directly switch to international arbitration. However, this leaves the question unanswered whether a failure to lodge an available and not obviously futile appeal with a higher judicial institution should play out to the detriment of an investor-claimant alleging denial of justice as the basis for his claim.

Especially *Jan Paulsson*, the author of the most comprehensive treatise on denial of justice in international law, suggests that such claims shall not succeed unless the claimant has exhausted available and effective domestic remedies against the court decision in question<sup>220</sup>. Acting as sole arbitrator in his most recent award, the *Pantehniki* case<sup>221</sup>, he consequently refused to find Albania guilty of denial of justice because the claimant had not pursued all local remedies that were reasonably available to him, despite the fact that there was *prima facie* evidence of “an extreme misapplication of law” by lower Albanian courts<sup>222</sup>.

There are two good reasons to support his view. First of all, the administrative and judicial hierarchies within a state, especially if it follows the separation of powers doctrine, may well be viewed as different systems. The classical local remedies rule – as a procedural requirement – would then only apply to the question whether it is necessary to cross the line between the executive and the judicial branch before going to international arbitration. For if administrative remedies, like turning to a higher authority which has the power to correct and alter decisions made by lower administrative officers, are readily available, the negative decision of a low-ranking government official alone should not suffice to trigger ICSID arbitration. A waiver of the local remedies requirement by the host state only means that once the executive has come to a final decision, the investor need not engage the local courts before embarking on ICSID proceedings. Likewise, if the wrong done to the investor first

<sup>218</sup> *The Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No ARB(AF)/98/3, Award of 26 June 2003 (*Mason, Mikva & Mustill*), ICSID Reports 7 (2005), 421, para 149.

<sup>219</sup> *Amerasinghe*, Local Remedies in International Law, 385 *et seq.* with further references, especially 416; *McLachlan/Shore/Weiniger*, International Investment Arbitration, 200.

<sup>220</sup> *Paulsson*, Denial of Justice in International Law, 106 *et seq.*; *Crawford*, Second Report on State Responsibility (17 March 1999), A/CN.4/498, para 97, also views denial of justice as the exception from the procedural approach to the local remedies rule.

<sup>221</sup> *Pantehniki S.A. Contractors & Engineers v. Republic of Albania*, ICSID Case No ARB/07/21, Award of 28 July 2009 (*Paulsson*), available on the ICSID homepage.

<sup>222</sup> For an extensive analysis of prior case law that all points into the same direction, namely, that a kind of substantive local remedies requirement must be read into any allegation of denial of justice, see *Kriebaum*, in: Binder/Kriebaum/Reinisch/Wittich (eds.), International Investment Law for the 21<sup>st</sup> Century, 417 (430 *et seq.*).

appears during judicial proceedings in the host state, it may be argued that these proceedings must be brought to an end before an international arbitral tribunal can examine them as a whole.

This distinction is buttressed by the very nature of denial of justice claims. Denial of justice cannot be assumed if a municipal court simply renders a wrong judgment, because otherwise ICSID tribunals would assume the role of second-guessing the national courts and playing courts of last instance themselves. On the contrary, it takes a systemic failure of a host state's judicial order to arrive at a finding of denial of justice. There must be some fundamental flaws in the system that under certain circumstances make it impossible for a foreign investor to achieve fair and equitable treatment in the domestic courts. But how can one assume this kind of fundamental flaws or systemic failures without first letting the system run its course? Deficits in fact-finding, misperception of the law and mistaken application of the pertinent rules to the facts happen everywhere in individual cases, due to the shortcomings of human nature. A denial of justice claim, however, is only warranted if there are either no or flatly insufficient mechanisms for review and correction of such failures within the system – and under normal circumstances it will be impossible to judge the effectivity of such mechanisms if they are not given a chance to work.

For these reasons, even in the absence of any formal jurisdictional or procedural requirement to exhaust local remedies, in the particular case of a denial of justice claim the claim should be considered substantively unfounded unless the claimant has tried out the correction mechanisms readily available to him and not apparently doomed to fail.

## 7. *Conclusions*

The fact that many BITs contain some kind of a local remedies rule demonstrates the origin of investment protection law as a part of public international law. Especially where the rule is employed in its customary form as a condition necessary to be fulfilled before an international forum can be approached, it can be seen as an attempt by the host state to safeguard its interests in the classical way, paving a way for the investor to international arbitration only after its own agencies and courts have had plenty of opportunity to look into the case. However, the host state's additional interest in attracting investors has already led to many deviations from this principle, making investment law an increasingly distinct legal body under this aspect as well. This is highlighted by the general decision of Art. 26 ICSID Convention to transform the introduction of the local remedies rule into a mere option of lesser relevance. The waiting periods prescribed for in a large number of BITs are precisely what the *Maffezini* and *Siemens* tribunals saw in them: half-hearted attempts to preserve a relic from past times when state sovereignty was the pivotal pillar of all areas of public international law. Even their transformation into mandatory jurisdictional requirements as envisaged by the *Wintershall* tribunal would not fundamentally alter this picture and just erect a superfluous, yet temporary roadblock to international investment arbitration. The story of the “fork in the road provisions” points into the same direction: as long as investors will consider international arbitration advantageous in comparison with the resort to local courts, such provisions will only

lead to the non-use of the host state's domestic legal system. If a "fork in the road" clause exists, a prior resort to local remedies as a prerequisite for international arbitration is ruled out from the beginning<sup>223</sup>. Only if the local remedies rule were to be seen as an overarching principle reaching into every BIT that does not explicitly address it, the general picture would change – but that would be a real nail in the coffin of international investment law as it has developed over the years and is therefore hardly conceivable as long as states remain interested in attracting investors from abroad.

In sum, contrary to its role in other areas of public international law, one may question whether the local remedies rule still serves any meaningful purpose in investment protection law other than calming the psyche of the host state's organs. If local courts seem so trustworthy to the foreign investor that their primary employment would be justified, the investor might use them anyway. If they do not, their involvement just delays and complicates the dispute settlement procedure. Any attempt by a host state to drag foreign investors which do not trust its court system into it, though, will only undermine its attractiveness for them. Thus, the issue for the host state boils down to the question of whether it is willing to pay this price for the illusion of having a wall erected between itself and international arbitration fora.

This pivotal conclusion – that the local remedies rule in its strict traditional sense, understood as a (temporary) formal barrier to an arbitral tribunal's exercise of jurisdiction, does not sit well with the proceedings in international investment arbitration – is shared by most experts active in the field. This does not come as a surprise, though, for the vast bulk of these experts are still recruited from capital-exporting countries, *i.e.* the Western world of states from which most of the multinational enterprises originate that invest all over the world and are therefore dependent on reliable mechanisms of protection for their investments. Insofar, the pleading advanced here to forego a local remedies requirement at first glance seems to be a typical Western point of view – a point of view from which the local remedies rule is potentially a bad thing because it may seriously delay or even prevent the initiation of international arbitral proceedings to the detriment of the investors concerned. It is in the interest of a typical investors' home state to allow its investors to bring claims to international fora as soon as possible – and it may be added that in the classical constellation of a developed country investing in a developing country the trust of the former in the domestic judicial system of the latter used to be relatively low. Getting back to the example used above, it is thus not astonishing that Germany, as has been determined, has over time switched to a uniform practice in formulating its BITs that includes an explicit waiver of the local remedies rule.

To be sure, this ancient Western dominance is subject to a constant process of erosion, but the new players now appearing on the capital-exporting side who get their lawyers trained at Western universities and in Western law firms follow in our footsteps for good reason. However, the world is constantly changing – and so are positions and attitudes of states. The classical constellation has largely faded away –

<sup>223</sup> Cf. Kriebaum, in: Binder/Kriebaum/Reinisch/Wittich (eds.), *International Investment Law for the 21<sup>st</sup> Century*, 417 (452).

today most BITs are actually concluded between developing countries themselves. And the “typical” investors’ home state probably does not exist any more either. In today’s globalized world, every state can easily find itself in the role of the defendant in an international investment arbitration. The U.S. has already experienced that quite extensively under NAFTA, with all potential backlashes springing from there, and Germany got at least a glimpse of the uncommon feeling to be a defendant in the readily settled *Vattenfall* case.

If these experiences persist, as it is presumed here, the local remedies rule might suddenly look appealing again in the eyes of these states. For no state – neither its executive nor its legislative branch, let alone the judicial one – really likes the idea of jurisdiction stripped away from its national courts when the result of the corresponding proceedings might be a major claim against the state’s budget. Additionally, the traditional capital-exporting states of the West usually hold their own judiciary in high esteem and expect any possible wrongs to be cured within their systems. This means they trust their systems and expect others – like foreign investors – to trust them as well. By contrast, international investment arbitration, when pursued directly under ICSID and a corresponding BIT, is precisely the expression of mistrust of domestic legal systems.

For the reasons argued above, though, it is to be hoped that states will not start turning their backs to the current established practice of waiving the local remedies rule. This is not to say that the availability of local remedies and their use by an investor would be totally meaningless in the context of international investment arbitration. As the partial equivalents pointed out above aptly demonstrate, this issue may at least come into play as a mitigating or balancing factor. For instance, in the case of MIGA guarantees it makes sense to empower MIGA even to withhold payments until the remedies “appropriate under the circumstances” have been taken, for otherwise there would be no incentive for the investor to undertake the corresponding efforts, since a payment from MIGA would be much easier to obtain. And in turn, the host state might not even get the chance to prevent a MIGA claim from being raised, entailing negative consequences for both the agency and the state itself. Likewise, in the specific constellation of denial of justice claims a finding that justice has been denied is hardly conceivable unless the court decision giving rise to this claim has been challenged unsuccessfully through the judicial process<sup>224</sup> as far as it is available to the foreign investor, for it must be determined whether the judicial system in its totality offers fair and efficient proceedings<sup>225</sup>. Of course, this statement leaves the general doctrine intact that obviously futile or ineffective review and appeal mechanisms need not be activated.

<sup>224</sup> See *The Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No ARB(AF)/98/3 (NAFTA), Award of 26 June 2003, ICSID Reports 7 (2005), 421, para. 159.

<sup>225</sup> *Crawford*, Second Report on State Responsibility (17 March 1999), A/CN.4/498, para. 75; *Paulsson*, Denial of Justice in International Law, 100.

### III. The Defence of Necessity – as Reflected in Recent Investment Arbitrations

*Christian J. Tams*

#### 1. Introduction

One of the more remarkable features of modern investment law is the extent to which it is shaped by, and is shaping, rules of general international law. This process is particularly visible in the interaction between specific rules of investment law and the general law of State responsibility, *i.e.* the rules governing the conditions for, and consequences of, States' responsibility for breaches of international obligations. Given the breadth of the concept of responsibility,<sup>226</sup> and the absence of specific regimes contracting completely out of the general international law framework, rules of State responsibility are regularly invoked in investment arbitration. Since the conclusion, by the UN's International Law Commission, of its decade-long work on the topic in 2001, the general law of State responsibility is set out in a set of 59 non-binding *Articles on State Responsibility*, which provide a convenient point of reference.<sup>227</sup> Even before the conclusion of the Commission's work, its various generations of *Draft Articles* had been frequently referred to; yet those references have increased markedly since 2001.<sup>228</sup> Awards and judgments citing the *Articles*, including many arbitral awards rendered in investment disputes, have typically confirmed or asserted their customary character and thus reinforced their status. Beyond that, subsequent jurisprudence, in some instances, has also clarified or obscured the meaning of some of the ILC's provisions.

The subsequent comment looks at one specific aspect of the law of State responsibility, namely the defence of necessity, and assesses how it has been applied in recent investment arbitrations. Although focused on necessity, it seeks to illustrate general features of the interaction between investment arbitration and general international law.

#### 2. Background

International law knows many rules on 'necessity'. Necessity *e.g.* is a limitation on the use of force (both under the *jus ad bellum* and the *jus in bello*)<sup>229</sup> just as it restricts the possibility of interference with individual rights under human rights law. More importantly, at least in this context, it is also a general defence permitting States to

<sup>226</sup> Compared to other legal systems, international law indeed adopts a broad approach, pursuant to which responsibility is entailed by *each and every* internationally wrongful act. Responsibility thus notably encompasses breaches of treaty and customary international law.

<sup>227</sup> The Articles and Commentaries are reproduced in, UN Doc. A/56/10 (2001), as well as in Crawford (ed.), *The International Law Commission's Articles on State Responsibility*.

<sup>228</sup> For a comprehensive account see *Olleson, The Impact of the ILC's Articles on State Responsibility of States for Internationally Wrongful Acts* (preliminary draft), BIICL Report (2007), available at: <[www.biicl.org](http://www.biicl.org)> (last visited on 20 December 2010).

<sup>229</sup> *Gardam, Proportionality, Necessity and the Use of Force by States*.

violate, under certain conditions, their obligations under international law. This latter version of necessity belongs to the province of the international law of State responsibility. The ILC's 2001 text addresses necessity in Article 25, which provides:

“Necessity

1. Necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State unless the act:

(a) is the only way for the State to safeguard an essential interest against a grave and imminent peril; and

(b) does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole.

2. In any case, necessity may not be invoked by a State as a ground for precluding wrongfulness if:

(a) the international obligation in question excludes the possibility of invoking necessity; or

(b) the State has contributed to the situation of necessity.”

Article 25 is noteworthy because it admits the defence of necessity, but seeks to restrict it by imposing a range of conditions.<sup>230</sup> These include:

- the restriction to “essential interests”;
- the requirement that these are at “a grave and imminent peril”; and that the measure in question was the “only means” available
- the exclusion of necessity where it impairs “essential interests” of others, and in cases of contribution
- the express (if redundant) statement that necessity can be excluded by special rules.

The provision had not been uncontroversial: whether or not international law should recognise some rule of necessity had been discussed for a while, especially in the light of the *Rainbow Warrior* arbitration.<sup>231</sup> The customary status of the concept, as well as its narrow construction, were affirmed by the International Court in the *Gabčíkovo Nagymaros case*<sup>232</sup> and more recently in the *Israeli Wall opinion*.<sup>233</sup> The most detailed treatment of necessity however can be found in recent investment arbitrations arising from the financial crisis in Argentina.

<sup>230</sup> This restrictive approach is clearly brought out in the ILC's explanatory commentary, see especially para. 2: “necessity will only rarely be available to excuse non-performance of an obligation and that it is subject to strict limitations to safeguard against possible abuse”.

<sup>231</sup> Case concerning the difference between New Zealand and France concerning the interpretation or application of two agreements concluded on 9 July 1986 between the two States and which related to the problems arising from the *Rainbow Warrior* affair, UNRIIAA, vol. XX (1990), 215 (254).

<sup>232</sup> ICJ, *Gabčíkovo-Nagymaros Project* (Hungary v. Slovakia), Judgment, I.C.J. Reports 1997, 7, especially 39-46, paras. 50-58.

<sup>233</sup> ICJ, *Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory*, Advisory Opinion, I.C.J. Reports 2004, 136, especially at 194-195, paras. 140-142.

### 3. *Investment Arbitrations Addressing Necessity*<sup>234</sup>

The various decisions mainly concern one particular issue: whether the economic crisis faced by the country in the late 1990s qualified as a state of necessity for the purposes of international law. Predictably, Argentina argued that it did, and that accordingly, the wrongfulness of measures adopted with a view to stabilising the situation (including the freezing of dollar-indexed tariffs in concession agreements and the devaluation of the peso) was precluded. To support its argument, Argentina relied on Article 25 ASR. In the various cases arising under the US-Argentina BIT,<sup>235</sup> it also invoked the special emergency provision contained in Article XI, which provided:

“This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or the Protection of its own essential security interests.”

The slew of awards and annulment decisions rendered so far all rely on some version of necessity, but reach divergent outcomes. The main findings are summarised in the following:

#### a) *CMS*

The *CMS* award<sup>236</sup> was the first major decision on the Argentine financial crisis, and exercised considerable influence on the subsequent case-law.<sup>237</sup> Crucially, the tribunal considered (just as the parties then seemed to have done) that Article XI BIT and Article 25 ASR raised “one fundamental issue”<sup>238</sup> which it examined under customary international law before doing so under the Article XI BIT. It held that Article 25 ASR “adequately reflects the state of customary international law on the question of necessity”.<sup>239</sup> As regards the various requirements, the tribunal expressed doubts (without properly distinguishing between the two aspects) whether the Argentinean financial crisis involved an “essential interest” and whether there was a “grave and imminent peril”; it did however seem to contemplate the possibility of economic states of necessity under more severe circumstances.<sup>240</sup> As regards the other criteria, the tribunal rejected Argentina’s reliance on necessity because it considered the stabilisation measures were not the only means by which the crisis could have been tackled – in its view this was “debatable”, and the tribunal referred summarily to the

<sup>234</sup> The subsequent discussion focuses on awards available in mid-2009; decisions made available after that time are considered in the footnotes.

<sup>235</sup> Available at: <[http://www.unctad.org/sections/dite/ia/docs/bits/argentina\\_us.pdf](http://www.unctad.org/sections/dite/ia/docs/bits/argentina_us.pdf)> (last visited on 20 December 2010).

<sup>236</sup> *CMS* Award, *supra* note 46, of 12 May 2005.

<sup>237</sup> Passages from *CMS* were to appear almost unchanged in the subsequent awards in *Enron* and *Sempra* (addressed below). There was a considerable personal continuity between the different tribunals; in particular all three arbitrations were chaired by the same arbitrator (*Professor Orrego Vicuna*).

<sup>238</sup> *Ibid.*, para. 308.

<sup>239</sup> *Ibid.*, para. 315.

<sup>240</sup> *Ibid.*, paras. 319-322.



“discussion of a variety of alternatives, including dollarization of the economy, granting of direct subsidies to the affected population or industries and many others.”<sup>241</sup> Without assessing alternatives at all, it then noted that there had been alternatives (and that therefore the measures adopted had not been the ‘only way’); furthermore, it held that Argentina’s own governmental policies had “significantly contributed to the crisis”.<sup>242</sup>

b) *LG&E*

The *LG&E* tribunal<sup>243</sup> was concerned a very similar set of facts, yet reached a different result.<sup>244</sup> The tribunal held that Argentina was ‘excused ... from liability for any breaches of the Treaty’ in the period between 1 December 2001 and 26 April 2003. It based this finding on Article XI BIT (also at issue in *CMS*), holding that there had been “a period of crisis during which it was necessary to enact measures to maintain public order and protect its essential security interests.”<sup>245</sup> Interestingly, for present purposes, the Tribunal did not stop there but claimed that its approach was in line with the general rules on necessity found in Article 25 ASR. Applying these, at least cursorily, to the case before it, the *LG&E* tribunal noted that Argentina faced “an extremely serious threat to its existence, its political and economic survival, to the possibility of maintaining its essential services in operation, and to the preservation of its internal peace”.<sup>246</sup> It also found there was “no serious evidence ... that Argentina contributed to the crisis”; and held that under the circumstances, “[a]lthough there may have been a number of ways to draft the economic recovery plan, ... an across-the-board response was necessary, and the tariffs on public utilities had to be addressed.”<sup>247</sup> The latter statement was sufficient for the tribunal to accept that the violations of international law had indeed been “the only way” to address the situation.

c) *Enron & Sempra*

The *Enron*<sup>248</sup> and *Sempra*<sup>249</sup> awards largely returned to the approach adopted by the *CMS* tribunal. The reasoning of both tribunals is similar in crucial respects:

<sup>241</sup> *Ibid.*, para. 322.

<sup>242</sup> *Ibid.*, paras. 324 and 329.

<sup>243</sup> *LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability of 3 October 2006.

<sup>244</sup> The *LG&E* decision was unanimous. This was particularly puzzling because one member of the *LG&E* tribunal (former ICJ judge *Francisco Rezek*) had previously participated in the (unanimous) decision in *CMS*, which had reached a diametrically opposite conclusion.

<sup>245</sup> *Ibid.*, para. 229.

<sup>246</sup> *Ibid.*, para. 256.

<sup>247</sup> *Ibid.*, paras. 256-257.

<sup>248</sup> *Enron Corporation and Ponderosa Assets L.P. v Argentine Republic*, ICSID Case No. ARB/01/3, Award of 22 May 2007.

1. Both awards place considerable emphasis on Article 25 ASR as a restatement of customary international law; both also consider that the general defence of necessity either applies alongside Article XI BIT and informs its interpretation: “[T]he Treaty itself did not deal with the legal elements necessary for the legitimate invocation of a state of necessity. The rule governing such questions will thus be found under customary law.”<sup>250</sup>
2. Both awards accept “that there was a severe crisis”, but refuse to accept that it involved an “essential interest” or “grave and imminent peril”, as “the very existence of the State and its independence” did not seem affected.<sup>251</sup>
3. Both awards agree with the *CMS* award that the stabilisation measures were not the “only means” by which Argentina could have addressed the situation. They however refuse to analyse alternatives and/or their viability; in fact, in an even more succinct way than the *CMS* tribunal, they restrict themselves to noting that “there are always many approaches to address and correct such critical events, and it is difficult to justify that none of them were available in the Argentine case”.<sup>252</sup>
4. Both awards, again without going into much detail, find Argentina to have contributed to the crisis, and on that count also reject the plea of necessity.<sup>253</sup>

d) *CMS Annulment Committee*

The *CMS* award did not end proceedings in the matter. Under the peculiar ‘control mechanism’ of the ICSID convention, Argentina sought to have it annulled.<sup>254</sup> The annulment committee largely upheld the initial award as to its result,<sup>255</sup> but expressed strong criticism of the reasoning, especially on issues of necessity. In fact, it adopted a very different line to that taken by the various tribunals discussed so far. Given the scope of annulment proceedings, the committee did not appreciate facts and law anew, yet it clearly adopted a new approach to the relationship between the state of necessity under customary international law and Article XI BIT.<sup>256</sup> In its view, reliance on Article 25 ASR by the *CMS* tribunal (and by the token, *Enron* and *Sempra*) had been exaggerated. If indeed, Article 25 ASR and the treaty-based clause of Article XI BIT had the same meaning, then tribunal(s)

<sup>249</sup> *Sempra Energy International v Argentine Republic*, ICSID Case No. ARB/02/16, Award of 28 September 2007.

<sup>250</sup> *Ibid.*, para. 378.

<sup>251</sup> See e.g. *Sempra*, *supra* note 249, para. 352.

<sup>252</sup> *Enron* award, *supra* note 248, para. 308. For severe criticism of this approach see the annulment decision of 30 July 2010 (*Enron Creditors Recovery Corp. and Ponderosa Assets, L.P. v. The Argentine Republic*, ICSID Case No. ARB/01/3), and briefly below, at note 275.

<sup>253</sup> A similar result was reached in the more recent decision in *National Grid PLC v. Argentine Republic*, UNCITRAL, Award of 3 November 2008, at para 261 (holding that the host State would have to establish that it had not contributed to the crisis).

<sup>254</sup> For details on the ICSID annulment mechanism see *Gaillard/Banifatemi* (eds.), *Annulment of ICSID Awards*.

<sup>255</sup> See *CMS Gas Transmission Company v Argentine Republic*, Decision of the ad hoc Committee on the Application for Annulment of the Argentine Republic issued on 25 September 2007.

<sup>256</sup> *Ibid.*, paras. 100 *et seq.*

“should have applied Article XI as the *lex specialis* governing the matter and not Article 25”.<sup>257</sup> In the committee’s view, however, there were clear differences between the two provisions, which meant that the “parallel” approach adopted by the *CMS* award (and most subsequent decisions) was untenable. In essence, this meant that Article 25 ASR was of less relevance than the previous tribunals had assumed.<sup>258</sup>

#### e) *Continental Casualty Company*

Finally, the award in *Continental Casualty Company*<sup>259</sup> is relevant in that it was rendered after the Annulment Committee’s decision in *CMS* had raised questions about the proper relationship between different defences available under treaty and general international law. As regards that issue, the *Continental Casualty Company* tribunal expressly “accept[ed] ... the *CMS Annulment Decision*”<sup>260</sup>. This meant that its decision would turn on Article XI BIT, and would rely on “the customary rule on State of Necessity (as enshrined in Art. 25 of the ILC test [!]) only insofar as the concept there used assist in the interpretation of Art. XI itself.”<sup>261</sup> The approach adopted thus differed from previous awards. It differed also in that the *Continental Casualty* tribunal examined Article XI BIT in detail.<sup>262</sup> Having assessed alternatives at length, it found Argentina’s stabilisation measures to be necessary for the protection of its own essential security interests (*i.e.* meeting the test of Article XI BIT). Admitting that Article XI BIT (just as Article 25 ASR) might require some sort of ‘clean hands’ element, it also held that Argentina had been entitled to rely on outside advice in the run-up to the crisis, and was not barred from invoking an emergency defence.<sup>263</sup>

#### 4. *An Assessment*

The awards just summarised illustrate the clear links between investment arbitration and general international law. They also show that arbitrators, whether commercial lawyers or public international lawyers ‘by trade’, have not shied away from applying and interpreting, and thereby pronouncing on, core rules of general international law. In fact, the discussion of Article 25 ASR in the awards, notably in *CMS*, is among the broadest engagements with the rules of necessity and exceeds the

<sup>257</sup> *Ibid.*, para. 133. More recently, this has in essence been followed by the Annulment Committee in the *Sempra* case (*Sempra Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16, Decision on the Argentine Republic’s Application for Annulment of the Award of 29 June 2010, at paras. 176 et seq.).

<sup>258</sup> Note that while this approach has largely been followed in the *Sempra* annulment decision (*supra* note 257), the *Enron* Annulment Committee (*supra* note 252) e.g. accepted the initial tribunal’s decision to conflate treaty-based and customary defences.

<sup>259</sup> *Continental Casualty Company v Argentine Republic*, ICSID Case No. ARB/03/9, Award of 5 September 2008.

<sup>260</sup> *Ibid.*, para. 73 (note 242).

<sup>261</sup> *Ibid.*, para. 168.

<sup>262</sup> *Ibid.*, paras. 189-230.

<sup>263</sup> *Ibid.*, para. 236.

treatment accorded to the provision in ICJ judgments by far. This does not mean that the tribunals' analyses were beyond criticism. In fact, the very fact that tribunals applying identical rules to largely the same sets of facts arrived at diametrically opposed results has been a cause for concern.<sup>264</sup> The subsequent sections do not attempt to evaluate which approach (whether *CMS* and followers or *LG&E/Continental Casualty*) was correct as a matter of law and fact. Instead, they briefly seek to identify four aspects of the recent decisions, which contribute to the debate on necessity, clarify or obscure the content of this general defence, or are noteworthy for their avoidance of issues.

#### a) Clarification

Notwithstanding their different results, the various awards clarify a number of issues. Three aspects stand out:

1. All awards support the view, already shared by a majority of courts and commentators, that necessity as addressed in Article 25 ASR indeed is a circumstance precluding the wrongfulness of State conduct under general international law. As noted above, recent ICJ jurisprudence seemed to have largely settled the matter.<sup>265</sup> Yet given the relative paucity of jurisprudence, the various investment awards remain relevant in that they provide further support. What is more, not only are they unanimous in affirming the customary status of the defence of necessity as such, but all accept Article 25 ASR as an appropriate restatement of the law on necessity – or, in the words of the *Enron* tribunal, “the learned and systematic expression of the development of the law on state of necessity by decisions of courts and tribunals and other sources along a long period of time.”<sup>266</sup> This is significant since Article 25 had gone beyond previous statements on necessity and was controversially discussed within the Commission.
2. The awards also clarify that emergency exceptions such as necessity are to be applied objectively, and that States invoking necessity are not the sole judge of their application. This is clear from the preceding summary of cases, but it deserves to be said that most of the tribunals expressly stated that Article XI BIT and Article 25 ASR were not self-judging.<sup>267</sup> As regards Article 25 ASR, this had probably been accepted before; yet tribunals have applied the same reasoning to Article XI BIT. This is relevant as the self-judging (or not self-judging) nature of emergency clauses had been a matter of controversy, whether with respect to Article XIX GATT or emergency clauses found in FCN treaties. Insofar as the tribunals' based themselves on features of Article XI of the applicable BIT, their reasoning should not be generalised. Yet it is revealing that in their reasoning, the

<sup>264</sup> On this point see e.g. *Reinisch*, JWIT 8 (2007), 191; *Gazzini*, Journal of Energy & Natural Resources Law 26 (2008), 450.

<sup>265</sup> See I.C.J. Reports 1997 (*Gabčíkovo*); I.C.J. Reports 2004, 161 (*Israeli Wall*).

<sup>266</sup> *Enron*, *supra* note 248, para. 303.

<sup>267</sup> See e.g. *Continental Casualty*, *supra* note 259, paras. 182 *et seq.*; *CMS*, *supra* note 46, para. 366 *et seq.*

tribunals referred to ICJ judgments on other emergency clauses.<sup>268</sup> On that basis, the series of cases suggest that arguments supporting the self-judging character of emergency clauses are increasingly difficult to support.

3. Finally, the awards are also relatively clear on the range of interests that can be protected by way of necessity. As noted above, the provision is deliberately phrased restrictively, allowing necessity only where “essential interests” are at stake. Understandably, commentators typically refrain from drawing up lists of “essential interests” that could be protected. It had always been agreed that a narrow range of interests affecting the “existence” of a State would qualify; but beyond that, there commentators had expressed divergent views.<sup>269</sup> The *Gabčíkovo Nagymaros* judgment marked a relatively broad approach; in it, the ICJ had accepted the State’s interest in preventing an environmental disaster as an “essential interest” for the purposes of necessity.

As noted above, the various investment arbitrations addressed in the preceding section evaluate the Argentine crisis rather differently and draw very different conclusions about the degree of risk faced by Argentina’s economy. As a matter of principle, they all however seemed to agree that an economic crisis *could* involve “essential interests” of a State.<sup>270</sup> Even the *CMS* tribunal *e.g.* noted that “there is nothing in the context of customary international law [on necessity] ... that could on its own exclude major economic crises” from the scope of defences or exceptions.<sup>271</sup> Differences seemed to follow from the tribunals’ different evaluations as to the gravity of the Argentine economic crisis; *i.e.* an evaluation of the facts. As regards the law, the various awards, despite their inconsistent results, may have brought about some clarification.

#### *b) Avoidance of Issues*

While clarifying some, the various awards have also avoided a number of issues. In particular, despite the breadth of discussion on necessity, there is very little on the requirement of a “grave and imminent peril”. As noted above, this separate requirement was often conflated with the problem of “essential interests”.<sup>272</sup> The *LG&E* tribunal (which accepted Article 25 ASR, if only to reinforce its conclusion on Article XI BIT) did address it, but did so in passing. In fact, its telegraphic treatment

<sup>268</sup> See *e.g.* *Continental Casualty*, *supra* note 259, paras. 187 (referring to the ICJ’s *Nicaragua and Oil Platforms* decisions).

<sup>269</sup> In its commentary, the ILC had *e.g.* noted that States had relied on necessity “to protect a wide variety of interests, including safeguarding the environment, preserving the very existence of the State and its people in time of public emergency, or ensuring the safety of a civilian population” (para. 14). However, this had to be read against the generally restrictive approach adopted by the Commission, and was not meant as an endorsement of State practice.

<sup>270</sup> See also *Bjorklund*, in: Muchlinski/Ortino/Schreuer (eds.), *The Oxford Handbook of International Investment Law*, 460 (481).

<sup>271</sup> *CMS Award*, *supra* note 46, para. 359. See also *LG&E Award*, *supra* note 243, para. 238; *Enron Award*, *supra* note 248, para. 332; *Continental Casualty Award*, *supra* note 259, para. 178.

<sup>272</sup> See *supra*, C.III.2.

does add little to the language found in Article 25 ASR: the tribunal noted that the danger had to be “extremely grave” (as opposed to “grave”), and understood “imminent” to mean that the risk “will soon occur”.<sup>273</sup> These statements are surely correct, but of little help in elucidating the meaning of an openly-phrased requirement. This suggests that the matter was really avoided, and not treated as a self-standing requirement. This may have been legitimate, since the risk in any event had already materialised. While the awards therefore do no harm, one might have hoped for a fuller treatment.<sup>274</sup>

c) *Obscuring the Analysis*

In other respects, the various awards seem to have fallen behind standards of analysis set up by the ILC, and in fact may risk obscuring the understanding of necessity. This in particular applies to the tribunals’ dissatisfactory treatment of the ‘only means’ requirement.<sup>275</sup> As noted above, a State relying on necessity must have no other means than to violate its international obligations. In its commentary, the ILC had explained: “The plea is excluded if there are other (otherwise lawful) means available, even if they may be more costly or less convenient.”<sup>276</sup> This by no means provides conclusive guidance, but it identifies relevant aspects of the requirement. In their analysis, the various awards have not added much to the ILC’s brief statement, and in fact may have even ignored its basic thrust. *LG&E* seemed to pay no more than lip service to the requirement, cursorily holding, in a very general way, that some “economic recovery package was the only means to respond to the crisis.”<sup>277</sup> This of course defied the question whether other forms of recovery packages might have been adopted that did not involve violations of international law. Perhaps worse, *CMS*, but particularly *Sempra* and *Enron*, almost seemed to suggest that necessity was precluded if the State could have adopted *any* other course of conduct.<sup>278</sup> This avoids the problem created by *LG&E* but completely undermines the defence<sup>279</sup> – States always have *some* other option: to take up examples from other areas of law where necessity comes into play, they can always decide not to use self-defence against an armed attack (but this is not meant by the “necessity of self-defence”) and they can always decide not to target a specific object (but this is not meant by “military necessity”). With respect to defences under the law of State responsibility, States facing an economic crisis can of course decide not to devalue their currency, or, alternatively, to expropriate foreign companies. Contrary to what the *Sempra* and *Enron* awards

<sup>273</sup> *LG&E*, *supra* note 243, para. 253.

<sup>274</sup> Cf. also *Bjorklund*, in: Muchlinski/Ortino/Schreuer (eds.), 460 (482-483). Contrast the more detailed assessment (drawing on *Gabčíkovo*) in the ILC’s commentary, at para. 15.

<sup>275</sup> The point made in the following has recently been explored by the *Enron* Annulment Committee, which expressed severe criticism of the initial tribunal’s failure to assess alternative ways properly: see *supra*, note 252, especially at paras. 370-372.

<sup>276</sup> ILC commentary on Article 25 ASR, at para. 15.

<sup>277</sup> *LG&E*, *supra* note 243, para. 256.

<sup>278</sup> *Enron*, *supra* note 248, para. 308; *Sempra*, *supra* note 249, para. 349.

<sup>279</sup> *Bjorklund*, in: Muchlinski/Ortino/Schreuer (eds.), 460 (483).

suggests, the ‘necessity’/‘only way’ requirement is not about the existence of *some* alternative, but requires an assessment and evaluation. The ILC in fact was clear that relevant alternatives were to be “lawful” and that the ‘only means’ requirement served to preclude States from invoking necessity to avoid inconvenient (or more costly) measures.<sup>280</sup> What is required to address these issues is an evaluation of alternatives, rather than the mere statements that alternative courses of conduct exist. In fact, one might have expected arbitral tribunals to consider, and assess, options open to Argentina – just as the ICJ, in *Gabčíkovo*, did consider alternatives to Hungary’s suspension or termination of its treaty obligations. What is more, one might have hoped that a series of awards dealing with one particular financial crisis might have provided an opportunity to clarify and concretise the ‘only way’ requirement – *e.g.* by reading into it some form of reasonableness test, or suggesting consideration of adequacy well-known from other variations of necessity rules.<sup>281</sup>

To sum up, the various tribunals have so far not managed to shed further light on the ‘only way’ criterion, and in fact seem to have obscured the analysis. One may draw some hope from the more recent *Continental Casualty* award which did assess alternatives and did evaluate them<sup>282</sup> – but did so under Article XI BIT, and without purporting to venture into the province of general international law.<sup>283</sup> This leads to the final, and conceptually most important point, namely the relationship between the two defences invoked in the various investment arbitrations.

*d) In particular: The Relationship between Article 25 ASR and Special Treaty Provisions*

Finally, the various investment arbitrations provide interesting perspectives on the relationship between Article 25 ASR (a defence under general international law) and Article XI of the BIT (a special, treaty-based emergency clause). The awards by the different tribunals’ on this point are highly problematic; however, the annulment committee in *CMS* may have set the record straight.

The tribunals that rendered their award prior to the *CMS* annulment decision based their findings to a large degree on Article 25 ASR, and did not hesitate to discuss the various exceptions found in it. As noted in the preceding sections, all of them to some extent “assimilate[e] the conditions necessary for the implementation of Article XI of the BIT to those concerning the existence of the state of necessity under customary international law.”<sup>284</sup> In this respect, two approaches can be distinguished:

<sup>280</sup> ILC commentary on Article 25 ASR, at para. 15.

<sup>281</sup> *Cf. Reinisch*, JWIT 8 (2007), 191 (201).

<sup>282</sup> See the detailed discussion at paras. 189-230, including comments on alternatives and their appropriateness, and the balance of interests required in applying the test.

<sup>283</sup> As noted above (note 275), the recent *Enron* annulment decision underlines the need for a different, more comprehensive. It is to be hoped that it paves the way for a more satisfactory handling of the ‘only means’ requirement.

<sup>284</sup> *Cf.* the statement by the Annulment Committee in *CMS*, *supra* note 255, at para. 128.

1. the very straightforward approach of the *CMS*, *Enron* and *Sempra* tribunals, which – as the *Sempra* tribunal noted – held Article XI to be “inseparable from the customary law standard insofar as the definition of necessity and the conditions for its operation are concerned, given that it is under customary law that such elements have been defined”;<sup>285</sup> and
2. the more cautious approach of the *LG&E* tribunal which applied Article XI BIT and then added that its understanding of that provision was supported by Article 25 ASR.<sup>286</sup>

The preceding discussion suggests that this approach may have entailed helpful side-effects in that it clarified some aspects of Article 25 ASR. Yet, at the same time, the focus (whether express or implicit) on general international law is curious. It seems that in their desire to assimilate Article XI BIT and Article 25 ASR, the tribunals overlooked three crucial differences between the two provisions:

- Article XI does not apply the treaty rather than precluding the wrongfulness of specific *prima facie* breaches.
- Article XI substantively differs from Article 25 ASR. In particular, it does not duplicate the various stringent conditions mentioned in Article 25 – *e.g.* there is no reference to the “essential interests” of others.
- It is by no means clear that the requirement that measures be “necessary” under Article XI is the same as the reference to “the only way” found in Article 25 ASR.

Irrespective of their methodological approach (and indeed of the result reached), the tribunals deciding prior to the annulment committee seem to have paid very little attention to the special rule applicable *in casu*. At least in the initial cases, this conflation may have been a response to the parties’ arguments on the matter, which equally preferred to argue with reference to Article 25 ASR.<sup>287</sup> Over time however, that approach was deliberately upheld in the face of mounting criticism.<sup>288</sup> At some level, the decision to focus on Article 25 ASR may be understandable, since tribunals called upon to apply obscure and vaguely-worded emergency provision may have felt on safer grounds when base their reasoning on the ILC’s approach.<sup>289</sup> Yet in retrospect one cannot help but be astonished at the lack of interest shown in a specific treaty clause, Article XI, that was plainly applicable, and at the lack of argument employed to justify the transition from the specific to the general. This in particular because the application of Article XI would have meant that there had been no breach of

<sup>285</sup> *Sempra*, *supra* note 249, para. 376.

<sup>286</sup> See *supra*, C.III.3.

<sup>287</sup> Cf. *CMS* Annulment Committee, *supra* note 255, para. 123.

<sup>288</sup> *Sempra*, *supra* note 249, para. 376; *Enron*, *supra* note 248, para. 334.

<sup>289</sup> See *e.g.* *Enron*, *supra* note 248, para. 334: “[It] is no doubt correct in terms that a treaty regime specifically dealing with a given matter will prevail over more general rules of customary law. Had this been the case here the Tribunal would have started out its considerations on the basis of the Treaty provision and would have resorted to the Articles on State Responsibility only as a supplementary means. But the problem is that the Treaty itself did not deal with these elements. The Treaty thus becomes inseparable from the customary law standard insofar as the conditions for the operation of state of necessity are concerned.”



international law in the first place, and Article 25 ASR (for lack of wrongfulness that could have been precluded) could not have been invoked in any event.

In its decision of September 2007, the Annulment Committee in *CMS* identified the flaws in the tribunals' approaches very clearly and did not hesitate to criticise the award's reasoning in very clear terms. It seems thereby to have contributed to a better understanding of the relationship between special and general rules. In fact, its decision (at least in terms of methodology) was largely followed by the subsequent *Continental Casualty Company* award, which – as noted above – reduced references to Article 25 ASR to a minimum. This suggests that over the course of 3 years of arbitrations, the tribunals may have come to correct an initial error.

## 5. Conclusion

The preceding sections illustrate the degree of interaction between international investment law and general international law. They show very clearly that arbitral tribunals routinely apply the law of State responsibility. In fact, they seem to be doing so even where there was no need to, and where the question at hand could have (and should have) been addressed on the basis of the applicable treaty rules. While therefore somewhat *malapropos*, the various pronouncements on necessity are not devoid of legal value. They are evidence of an emerging jurisprudence on a general defence that so far had been invoked and applied infrequently. They provide further evidence for the view that Article 25 ASR reflects customary international law. They also clarify aspects of its interpretation, notably by (i) suggesting that economic interests can qualify as “essential interests” and (ii) supporting a proactive approach to the reviewability of necessity and emergency clauses. As shown above, the analysis is less impressive in other respects, notably with respect to the ‘only way’ requirement. In this respect, one may hope that the much better-argued award in *Continental Casualty* will signal a new approach.

## D. Summary, General Conclusions and Outlook

### I. Summary on the Interdependence of General Public International Law and International Investment Law in Selected Areas

1. A comparative approach looking at domestic law provides considerable evidence on the relationship between investors and the state, and on the need to balance the protection of private property against competing public interests. While recourse to customary international law often does not provide sufficiently clear guidance, a comparative approach focusing on general principles of law promises to facilitate the application of international investment law. It is embedded in the broader understanding of international investment law as a genuinely public law discipline that concerns the restriction of the state's legislative, administrative and judicial discretion in treating foreign investors. At the same time, it situates international investment law firmly within the broader framework of general international law.

Endorsing a comparative methodology in order to develop general principles that may concretize substantive investment treaty obligations may also further buttress approaches in investment treaty-making, such as the one endorsed by Germany, that confidently draw up the principal investment treaty obligations as broadly stated principles and entrust arbitral tribunals with the elaboration of these principles, rather than attempt to increasingly concretize investor rights, an approach that can be problematic given the increasingly complex structure of foreign investment projects and the difficulties to predict the occasionally creative rent-seeking conduct of states that can negatively affect foreign investments. Arguably, with the proposed comparative methodology, a fair balance between investment protection and regulatory leeway for the furtherance of non-investment policies, which is acceptable to both host states and investors, can be established by arbitral tribunals.

2. In ‘hard cases’, public international law, one may argue, requires substantive criteria beyond the formal aspect of incorporation in order to determine the nationality of a corporation. This is in line with the judgment of the ICJ in *Barcelona Traction*. In this regard, international jurisprudence and relevant state practice indicate that there is regulatory autonomy for a state to determine criteria of nationality of corporations within its domestic law. Thus, the presumption in favor of domestic legal determination of nationality of corporations is, however, rebuttable by reference to international law in case that there is no factual relation between the respective state and the corporation. Whether this principle applies in the case of a given BIT which conclusively prescribes the criteria for the determination of nationality is subject to debate.

3. With all necessary caution one could basically suggest that the personality enjoyed by individuals in international investment law represents a marked increase in rights by comparison with those already provided for in human rights and consular law. In international human rights law protected status currently tends to exist (only) on a regional level.<sup>290</sup> The universal human right to the *protection of property* appears to be limited.<sup>291</sup> The individual should be able to derive direct rights from consular law,

<sup>290</sup> Art. 34 of the European Convention on Human Rights, Individual complaints according to 11<sup>th</sup> additional protocol; moreover, there are further restrictive exceptions from the principle of interstate mediation: Art. 24 of the Charter of the International Labor Organization, Art. 57 (b) of the Convention of the Multilateral Investment Guarantee Agency of the World Bank, Art. 187 (c) of the UN Convention of Law on the Sea, Art. 2.21 of the WTO-Agreement on Pre-shipment Inspection and Art. XX of the WTO-Agreement on Government Procurement.

<sup>291</sup> Property protection comparable to that in western industrialized countries or regional human rights systems does not exist in the general (universal) human rights regulations: Art. 17 of the General Declaration of Human Rights simply provides protection against arbitrary dispossession but not dispossession without compensation [10 December 1948, Res. 217 A (III), UN GAOR, III, Resolutions, 71]; Art. 15 of the International Covenant on Economic, Social and Cultural Rights 1966 limits its protection to intellectual property; see. *Griebel*, Internationales Investitionsrecht, 16; Bundesverfassungsgericht [German Constitutional Court] BVerfGE 112, 1 (34) [„[d]as universelle Völkerecht ... eine Gewährleistung des Eigentums ... als menschenrechtlichen Schutzstandard nicht [kennt]“]; *Van Banning*, The Right to Property, 34 *et seq.*; also of interest *Lithgow v UK* [EuGMR, *Lithgow et al. v. United Kingdom*, Judgment of 8 July 1986; Ser. vol. A 102, paras. 111 *et seq.*] und *James v UK* [EuGMR, *James et al. v. United Kingdom*, Judgment of 12 February 1986, Ser. vol. A 98, paras. 58 *et seq.*]; ECHR explains (paras. 116 and 120), that reference to the ‘Rules of International Law’ in Art 1 of the 1<sup>st</sup> Additional Protocol makes customary international

but there is no mechanism for the enforcement of rights for individuals at the level of international law, as the rights conferred under the Vienna Convention on Consular Relations (Art. 36(1)) can only be applied in connection with the relationship between states.<sup>292</sup>

In comparison, bilateral investment treaties give individuals a unique degree of material and procedural protection in international law and their proliferation in international investment law is developing into what amounts to a multilateral system of investment protection.<sup>293</sup> The process of increasing concentration of international investment law through the states' bilateral investment treaties and the awards of arbitral tribunals has at different times given rise to the question whether even a process of 'constitutionalization' of international investment law has not already commenced in this arena.<sup>294</sup>

4. By contrast, the local remedies rule is something international investment law has inherited from public international law. It is a piece of heritage, though, that modern BITs rather try to forego, at least in its classical understanding as a formal obstacle to jurisdiction. To be sure, the idea that a host state should get the chance to remedy possible violations of an investor's rights through its own judicial system before the matter is taken before an international tribunal has some appealing character of its own. However, save in special circumstances, such as the attempt to activate MIGA guarantees or a situation where denial of justice is at the core of the claim, clinging to this traditional concept of public international law does not prove very helpful in the investor-state context. The local remedies rule as such is therefore increasingly replaced by other arrangements which seem more appropriate for the specific needs of investment arbitration proceedings.

5. With regard to the law on state responsibility, the string of investment arbitrations on issues of necessity has become part of the 'interpretative discourse' helping to evaluate and concretize the meaning of general responsibility rules. In fact, when it comes to issues of State responsibility, investment tribunals are now among the most active participants in that discourse and regularly pronounce on questions as diverse as defenses, attribution of conduct, or the amount of compensation. This means that their approaches and reasoning will be subjected to scrutiny – not only by investment lawyers but by public international lawyers more generally, which leads to a stricter standard of scrutiny. Conversely, the preceding case-study illustrates the important role that investment tribunals have assumed in recent years – for better or worse, their voice is now clearly heard in discussions about the issues of general

law via the Convention on Human Rights competent for individuals especially for expropriations of foreign nationals.

<sup>292</sup> ICJ, *LaGrand Case* (Germany v. United States of America), Judgment, I.C.J. Reports 2001, 466, paras. 42, 77; *Tams*, JuS 2002, 287 *et seq.*; ICJ, *Avena and Other Mexican Nationals* (Mexico v. United States of America), Judgment, I.C.J. Reports 2004, 12.

<sup>293</sup> *Schill*, The Multilateralization of International Investment Law.

<sup>294</sup> *Behrens*, AVR 45 (2007), 153; *Behrens*, in: Engel/Möschel (eds.), FS Mestmäcker, 53; *Tams*, in: Tietje/Nowrot (eds.), Verfassungsrechtliche Dimensionen des Internationalen Wirtschaftsrechts, 229; *Hindelang*, in: Hanns Martin Schleyer-Stiftung (ed.), Globale Wirtschaft, 94; *Schneiderman*, Law & Social Inquiry 25 (2000), 757.

international law. The example of ‘necessity’ illustrates the chances and risks inherent in participating in the interpretative discourse.

## II. General Conclusions and Outlook

This paper has aimed at elucidating the relationship between public international law and international investment law. As public international law influences the analysis of specific investment law issues, developments in international investment law also affect public international law. Rather than maintaining a fragmented system of international law, it is in fact more useful to recognize the mutual relationship between the different sub-systems within international law.

International investment law is in need of comprehensive systemic concepts which cannot be developed in isolation. Rather, it is necessary to see international investment law as being part of the larger framework of public international law, while at the same time being aware of the fact that certain peculiarities of investment law have an influence on rules and principles of general public international law. As the relationship between international investment law and general international law is defined, it is necessary to be cognizant of the complementary relationship of and to pursue coherent approaches to issues in international investment law, respecting and profiting from the relationship. Moreover, as international investment law becomes more defined, a separate body of law within the international law system may need to be developed.

Finally, the question arises whether the comprehensive interdependence of general public international law and international investment law will add to the perspective of international law in the 21st century. International investment law can certainly be seen as a vanguard for the whole body of international law which recognizes the interests of all actors in international relations as well as of the international community altogether. To be sure, it displays some specific features that cannot be generalized or easily transferred to other areas of international law, but at least in part and to a considerable extent, it embodies the trend of international judicial globalization.

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**Beiträge zum Transnationalen Wirtschaftsrecht**  
(bis Heft 13 erschienen unter dem Titel: Arbeitspapiere aus dem  
Institut für Wirtschaftsrecht – ISSN 1619-5388)

ISSN 1612-1368 (print)  
ISSN 1868-1778 (elektr.)

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