



UNC
SCHOOL OF LAW

NORTH CAROLINA JOURNAL OF
INTERNATIONAL LAW AND
COMMERCIAL REGULATION

Volume 35 | Number 1

Article 4

Fall 2009

The Multilateralization of International Investment Law

Rafael Leal-Arcas

Follow this and additional works at: <http://scholarship.law.unc.edu/ncilj>

Recommended Citation

Rafael Leal-Arcas, *The Multilateralization of International Investment Law*, 35 N.C. J. INT'L L. & COM. REG. 33 (2009).
Available at: <http://scholarship.law.unc.edu/ncilj/vol35/iss1/4>

This Article is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Journal of International Law and Commercial Regulation by an authorized editor of Carolina Law Scholarship Repository. For more information, please contact law_repository@unc.edu.

The Multilateralization of International Investment Law

Cover Page Footnote

International Law; Commercial Law; Law

The Multilateralization of International Investment Law

Rafael Leal-Arcas[†]

I.	Introduction.....	35
II.	Preliminary Remarks on Foreign Direct Investment	37
	A. Definition of Foreign Direct Investment.....	37
	B. Strong Rise in Foreign Direct Investment.....	39
	C. Forms of Foreign Direct Investment.....	39
	1. Direct Investments.....	39
	2. Creation of a Company.....	39
	3. Mergers and Acquisitions	40
	4. Industrial Alliances.....	40
	D. Economic Analysis of Foreign Direct Investment.....	41
	1. Theories Explaining Foreign Direct Investment	41
	2. Analyzing the Effects of Foreign Direct Investment.....	46
	E. Political Economy of Foreign Direct Investment	48
	F. Foreign Direct Investment and Developing Countries	50
III.	History of Foreign Direct Investment Regulation	51
	A. Foreign Direct Investment as a Nationally Regulated Issue: Pre-Havana Charter	52

[†]Dr. Leal-Arcas is a Senior Lecturer in International Economic Law and European Union Law, and Deputy Director of Graduate Studies, Queen Mary University of London Centre for Commercial Law Studies, UK. He is also a 2008-2009 Tillar House Resident Fellow at the American Society of International Law; 2008-2009 Visiting Scholar at Georgetown University Law Center; Visiting Fellow at its Institute of International Economic Law and Member of the Madrid Bar. Dr. Leal-Arcas has a Ph.D. and M.Res. from European University Institute (Florence, Italy); J.S.M. (Stanford Law School); LL.M. (Columbia Law School); M.Phil. (London School of Economics and Political Science); B.A., J.D. (Granada University, Spain). He is the author of the books *INTERNATIONAL TRADE AND INVESTMENT LAW: MULTILEVEL GOVERNANCE* (forthcoming 2010) and *THEORY AND PRACTICE OF EC EXTERNAL TRADE LAW AND POLICY* (Cameron 2008). I wish to thank Elizabeth Andersen, John H. Jackson, Andrés Rigo, Borzu Sabahi, and Joshua Meltzer for their comments to a previous draft of this paper. Any error remains solely mine.

B.	First Attempt to Have a Structured Multilateral Framework: The Havana Charter	55
C.	Emergence of a Series of Common Standards: Codes of Conduct	57
D.	Bilateral Initiatives.....	59
E.	The Era of Multilateralization of Foreign Direct Investment Law	61
1.	Investment Under the GATT	62
2.	The TAFTA-South Project.....	63
3.	Multilateral Agreement on Investment (MAI)	66
a.	Background.....	66
b.	Analysis of the MAI	70
4.	WTO and Its Working Group on Trade and Investment.....	71
IV.	Current Regulatory Regimes	73
A.	Customary International Law	74
B.	Soft Law	76
C.	Bilateralism	77
1.	Overview of Bilateral Investment Treaties	77
2.	Admission of Investments.....	78
3.	Standard of Treatment of Investments.....	78
4.	Transfer	79
5.	Expropriation.....	79
6.	Settlement of Disputes	80
a.	ICSID.....	80
b.	UNCITRAL	82
c.	ICJ.....	84
i.	The ELSI Case.....	84
D.	Regionalism.....	90
1.	The European Union.....	91
a.	Freedom of Capital Movement	91
i.	Rules as Designed by the Treaty of Rome	92
ii.	Rules as Changed by the Treaty of Maastricht	93
b.	Freedom of Establishment	96
c.	Foreign Investment in International Agreements where the EC is a Party	96
d.	Are the EC Treaty Provisions the Only Rules Applicable?	100

2.	The North American Free Trade Agreement	102
a.	Main Characteristics of the Regime	102
b.	Overview of the Existing Rules	103
i.	Investment	103
	A. Investment liberalization measures - Articles 1102 to 1104 and 1106 of the NAFTA.....	104
	B. Investment protection measures— NAFTA Articles 1105 and 1110.....	104
ii.	Settlement of Disputes	105
E.	Multilateralism.....	108
1.	Some Background	109
2.	Investment under the WTO: The TRIMs Agreement.....	112
a.	EC—Bananas III (Ecuador).....	114
b.	Indonesia—Autos.....	115
c.	Canada—Autos	118
3.	The Energy Charter Treaty	119
V.	Why is There a Need for a Multilateral Investment Treaty?.....	120
A.	Practical and Structural Reasons for an MFI.....	121
B.	Need for Coherence	124
VI.	How to Design a Multilateral Framework for Investment	126
A.	Input from BITs into a Potential Multilateral Framework for Investment	128
B.	The WTO as a Potential International Organization to Create an MFI.....	128
C.	Policy Considerations	132
1.	Tendency: Broader Areas, but Lower Standards?.....	132
2.	Regulation v. Liberalization.....	132
3.	Overlapping Between Existing and New Rules—A Question of Coordination	133
4.	Dispute Settlement.....	133
VII.	Conclusions.....	134

I. Introduction

Since the time of Aristotle, foreign investment has been a source of concern. Then, as now, the concern was related to the

threat investment posed to sovereignty.¹ Aristotle tells the tale of Dionysius, the dictator of Syracuse, and a Sicilian investor. The Sicilian investor was expelled from the city when he threatened to corner Syracuse's iron market.² Similarly, in today's world economy there is concern about foreign direct investment (FDI) as a possible threat to national sovereignty.³ As markets become increasingly integrated, some critics assume that transnational firms will replace the fragile nation-state.

The aim of this Article is to analyze the field of FDI from economic, developmental, and political perspectives in order to examine whether there is a need for a multilateral framework for investment (MFI), the possible dimensions of such a framework, and its feasibility. To that end, this paper traces the history of FDI regulation; analyzes contemporary rules and practice; identifies the gaps and difficulties the current regime presents; and draws lessons from it for a possible multilateral solution. This article makes the case that an MFI is, in fact, necessary in order to have a coherent legal regime to regulate multilateral investment. The current fragmented and often uncoordinated international investment regime may encourage regulatory competition among

¹ Sovereignty is one of the most used and misused concepts of international affairs and international law. See Richard N. Haass, *Sovereignty: Existing Rights, Evolving Responsibilities*, The Information Warfare Site, ¶ 7 Jan. 15, 2003, <http://www.iwar.org.uk/news-archive/2003/01-15.htm> (discussing sovereignty as the role of states in international organizations); ERNST B. HAAS, *THE UNITING OF EUROPE: POLITICAL, SOCIAL AND ECONOMIC FORCES 1950-1957* 34 (George W. Keeton & Georg Schwarzenberger eds., Stanford University Press 1958) (discussing sovereignty as absolute power within a community); see also IVAN BERNIER, *INTERNATIONAL LEGAL ASPECTS OF FEDERALISM* (Longman Group Limited 1973); DUNCAN A. FRENCH, *A Reappraisal of Sovereignty in the Light of Global Environmental Concerns*, 21 *LEGAL STUD.* 376, 376-399 (2001); JOHN H. JACKSON, *SOVEREIGNTY, THE WTO AND CHANGING FUNDAMENTALS OF INTERNATIONAL LAW* 376-99 (Cambridge University Press 2006) (discussing sovereignty as it refers to allocation of power, i.e., government decision-making power).

² See Aristotle, *Politics* (Benjamin Jowett, trans.) reprinted in *THE HISTORY OF ECONOMIC THOUGHT: A READER* 5, 11-12 (Steven G. Medema & Warren J. Samuels eds., Routledge 2003).

³ See generally Vaughn Lowe, *Sovereignty and International Economic Law*, in *REDEFINING SOVEREIGNTY IN INTERNATIONAL ECONOMIC LAW* 77, 77-84 (Wenhua Shan, Penelope Simons & Dalvinder Singh eds., Hart Publishing 2008) (regarding sovereignty in the context of international economic law).

the various models of international investment agreements. This fragmentation of the international investment regime may also create an incentive for treaty shopping by those foreign investors who seek protection even in situations where their country has not concluded or ratified investment agreements that offer the same level of protection as those achieved in other countries. Finally, this Article offers recommendations for the way forward toward the development of such a multilateral regulatory regime.

After the introduction (Section I) and some preliminary remarks on FDI (Section II), Section III provides a chronological evolution of FDI regulation starting with the pre-Havana Charter period until the time of discussions about a possible inclusion of investment on the World Trade Organization (WTO) agenda. Section IV provides an overview of the existing rules and practice of FDI based on the following layers: Customary international law, soft law, bilateral investment treaties, regional approaches to investment regulation, and multilateral approaches to investment regulation. In Section V, this paper explores several reasons for having an MFI. Section VI formulates some policy concerns for a future MFI and examines the WTO as the international organization that may take the initiative of designing a multilateral framework for investment, before the Article concludes in Section VII.

II. Preliminary Remarks on Foreign Direct Investment

A. Definition of Foreign Direct Investment

“Foreign direct investment means transfer of foreign funds into a country to purchase a service or manufacturing business or to open a new factory or service company.”⁴ Direct investment is defined by the International Monetary Fund (IMF) as “investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor’s purpose being to have an effective voice in the management of the

⁴ Lori Wallach, Alexander Hamilton Inst. for Int’l Trade, Public Citizen Pocket Trade Lawyer: The Alphabet Soup of Globalization 5 (2005), <http://www.libertyparkusafd.org/lp/Hamilton/monographs/Pocket%20Trade%20Lawyer.pdf> (last visited Oct. 26, 2009).

enterprise.”⁵

The Organization for Economic Co-operation and Development (OECD)⁶ defines a foreign direct investor as

[a]n individual, an incorporated or unincorporated public or private enterprise, a government, a group of related individuals, or a group of related incorporated and/or unincorporated enterprises which has a direct investment enterprise – that is, a subsidiary, associate or branch – operating in a country other than the country or countries of residence of the direct investment investor or investors.⁷

According to the World Trade Organization (WTO), FDI occurs “when an investor based in one country (the home country) acquires an asset in another country (the host country) *with the intent to manage that asset . . .*”⁸ The management dimension is what distinguishes FDI from portfolio investment in foreign stocks, bonds, and other financial instruments.⁹ Another way to define FDI is to identify what it is not. In this sense, it should be noted that FDI does not include trade or portfolio investments, which are made through debt or equity instruments.¹⁰

On the whole, investment has helped reduce poverty and has increased the quality of life of people in countries where the investment has taken place.¹¹

⁵ INT'L MONETARY FUND, BALANCE OF PAYMENTS MANUAL 136 (Washington: The Fund 4th ed. 1977).

⁶ The OECD consists of thirty member countries sharing a commitment to democratic government and market economy in a unique forum to discuss, develop, and refine economic and social policies.

⁷ ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, OECD HANDBOOK ON ECONOMIC GLOBALISATION INDICATORS 50 (OECD 2005) [hereinafter OECD].

⁸ FOREIGN DIRECT INVESTMENT AND THE GLOBAL ECONOMY: CORPORATE AND INSTITUTIONAL DYNAMICS OF GLOBAL-LOCALISATION 33 (Nicholas A. Phelps & Jeremy Alden eds., The Stationary Office 1999) (emphasis added).

⁹ See *id.* at 33-7.

¹⁰ Debt instruments include bonds, commercial paper, and certificates of deposit, while equity instruments are composed of country funds (both closed and open ended). IBRAHIM SHIHATA, LEGAL TREATMENT OF FOREIGN INVESTMENT 2 (Martinus Nijhoff Publishers 1993).

¹¹ See, e.g., Michael Klein et al., *Foreign Direct Investment and Poverty Reduction* (World Bank, Policy Research Working Paper 2613, 2001), <http://www->

*B. Strong Rise in Foreign Direct Investment*¹²

FDI flows multiplied by fourteen (from U.S. \$25 billion to U.S. \$350 billion per year) between 1973 and 1996, outstripping growth in international trade.¹³ During the period from 1989 to 1995, average FDI per year totaled U.S. \$170 billion.¹⁴ This is almost double the average of the previous six years (U.S. \$91 billion for the period 1983-1988).¹⁵

Yet, despite the increasing internationalization of small and medium-sized enterprises, multinational corporations (MNCs) still contribute the most to international trade growth.¹⁶

C. Forms of Foreign Direct Investment

1. Direct Investments

Direct investments may take the form of either the creation or acquisition of a company, or participation in an existing company.

2. Creation of a Company

When a company is created, the investor retains possession of

wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2001/06/29/000094946_01061505074812/Rendered/PDF/multi0page.pdf.

¹² There are three main sources of statistics on FDI: 1) Statistics from the records of ministries and agencies, which administer the country's laws and regulations on FDI, i.e., the request for a license or the fulfillment of notification requirements allows these agencies to record data on FDI flows; 2) FDI data taken from government and other surveys which evaluate financial and operating data of companies; and 3) data taken from national balance-of-payments statistics, for which internationally agreed guidelines exist. See generally INT'L MONETARY FUND, *BALANCE OF PAYMENTS MANUAL 10* (The Fund 5th ed. 1993) (describing the international standard that controls the statistical framework of balance of payments).

¹³ *The Multilateral Agreement on Investment: Frequently Asked Questions and Answers* (OECD), <http://www.flora.org/flora/archive/mai-info/oced-faq.htm> (last visited Oct. 28, 2009).

¹⁴ See Economic and Social Committee of the European Communities, *Opinion on the Global Harmonisation of Direct Investment Regulation*, CES 260/96, (Feb. 28, 1996).

¹⁵ See *id.*

¹⁶ See generally U.N. Conference on Trade and Development, *World Investment Report 2009: Transnational Corporation, Agricultural Production and Development*, U.N. Doc WIR09 (2009), available at http://www.unctad.org/en/docs/wir2009overview_en.pdf (last visited Oct. 26, 2009).

the whole capital of the created enterprise and thus is able to maintain full power over his technology. Following Vernon's theory of the product cycle,¹⁷ direct investment allows a group to extend the life of its products by introducing them to a market that is less sensitive to the absolute level of technology than comparable preceding technologies.

Direct investment provides more autonomy for the investor and allows the possibility of a coherent relationship between the parent company and its branches, if any exist. This leads to delocalization of part of the openings and production, even though the established company does not have any preexisting base on the local market.

3. *Mergers and Acquisitions*

The acquisition of a company has become the dominant form of international investment. It is the consequence of the rapid growth of investments among developed countries. Acquisitions allow the buyer to benefit from the national company's experience and presence on the local market. This form of investment is very popular among companies that want to protect, consolidate, or increase their main or global activity, abandoning the fields that fall out of their main competencies and acquiring strategic assets related to their primary purpose, which allow them to become more competitive.¹⁸

4. *Industrial Alliances*

The creation of common branches, called joint-ventures,

¹⁷ Raymond Vernon's theory of the product cycle puts less emphasis on the factor-proportion theory of comparative advantage and more on the timing of innovation, the effects of scale economies, and the roles of ignorance and uncertainty in influencing trade patterns. Vernon contends that a large gap exists between the knowledge of scientific principles and the application of these principles in the generation of new, marketable products. Raymond Vernon, *International Investment and International Trade in the Product Cycle*, 80 Q.J. ECON. 190, 190-207 (1966).

¹⁸ See generally CES, Case No. COMP/M.2299-BP/SOLVAY/HDPE JV Merger Procedure Article 6(1)(b) Decision (2001), available at ec.europa.eu/competition/mergers/cases/decisions/m2299_en.pdf (last visited Oct. 26, 2009) (In this case, the company gave up a part of its pharmaceutical activity and acquired soda plants in the United States and in Europe in order to be able to re-center its activities on its primary activity (the soda) in these two regions.).

requires the resources of two independent companies that get together to create a new company and share its profits. These co-enterprises, which are contained within the definition of mergers and acquisitions, represent an important manner of market penetration.

D. Economic Analysis of Foreign Direct Investment

The financing and control of foreign establishments have become very important for companies with an international market. Large companies may have direct access to the national capital market and find their own funds. In the 1980s, the trend was to try to immobilize a minimum of company funds while still controlling the acquired company. The solution was the “leveraged buyout” or LBO, where the acquired company pays for its own acquisition. It is therefore important to look at the economic analysis of FDI, the political economy of FDI, and the relation between FDI and developing countries.

Generally, is there a link between FDI liberalization and economic growth? What are the economic advantages of using FDI as a financing source compared with other sources? What impact does market behavior have on FDI? These questions must be answered if one wants to make a case for multilateral rules on FDI.

The economic perspective of FDI is not sufficiently explored by legal and policy-oriented studies. It should be noted that FDI policy cannot be separated from the general economic policy of the moment. Moreover, historically, it has been demonstrated that interest in liberalizing the FDI field has increased only when its economic benefits have been widely accepted. The economic perspective allows us to explain the increasingly important place occupied by FDI in the world economy, and to elaborate upon its effects.

1. Theories Explaining Foreign Direct Investment

There are many reasons why multinational enterprises (MNEs) decide to operate abroad and it is not always easy to distinguish their motivation. MNEs may be motivated by both supply factors and demand factors that reflect the attractiveness of the host-

country. The supply factors include improvement of the company's efficiency with more competitive factors of production (e.g., a cheaper labor force); getting past existing natural or artificial barriers to market access; protection against exchange rate fluctuations; guarantee of free access to certain products of raw materials; opportunity to create economies of scale; and acquisition of new or complementary technologies. Demand factors include the growth rate, the size of the foreign market, and the need to better respond to specific local conditions.

Buigues and Jacquemin distinguish between two main categories of considerations motivating FDI.¹⁹ The first category considers research relating high efficiency to production costs. Examples include research that looks at low labor costs and low social charges; exploitation of the differences of capital costs between the host country and the country of origin; availability of efficient infrastructures; and the existence of local suppliers able to offer competitive inputs.²⁰ In this sense, FDI is an alternative to the mobility factors. Investment is encouraged by various immobile factors located in the foreign markets.

The second category considers the strategic behavior related to market power and price control. It refers to the various aspects of imperfect competition, including the increased exploitation of monopolistic advantages in new markets and of the "first mover" position. It also examines how to overcome the imperfections of the market, such as the existence or anticipation natural or artificial entry barriers.²¹

Theories on the multinationalization of companies are recent, only dating from the late 1950s. Early analyses focused on the structures of imperfect competition and oligopolies. Progressive theorists then developed determinants related to the organization of companies. Also, some elements of comparative advantage theory were reintroduced.²² Each one of these early approaches

¹⁹ See generally Pierre Buigues & Alexis Jacquemin, *Foreign Direct Investment and Exports to the European Community*, in DOES OWNERSHIP MATTER? JAPANESE MULTINATIONALS IN EUROPE 164, 164-199 (Mark Mason & Dennis Encarnation eds., Oxford University Press 1994).

²⁰ *Id.* at 165.

²¹ *Id.* at 168.

²² See generally John S. Chipman, THE THEORY OF INTERNATIONAL TRADE:

centered on a unique determinant. Some contemporaneous theories integrated three levels of analysis: Company, industry, and country.²³

Following David Ricardo's theory, complemented by the Heckscher-Ohlin-Samuelson theorem, international trade in goods and services is considered to be the result of differences among national economies.²⁴ However, the internationalization of firms is contrary to this hypothesis, since it proves that capital is mobile and thus national economies are much more fluid and integrated than previously thought. Due to the diversity of the MNEs' strategies and their growing importance in the world economy, scholars began to consider them to be aiming for a global position. This view is further supported by the MNEs' permanent presence in various markets that would ultimately merge into a single, global market.

The proliferation of American companies in Europe started in the 1950s and gave birth to a theory that underlines the importance of technological advantage in competition among companies. In the 1960s, Stephen H. Hymer announced the theory of foreign investment as an alternative to the international transfer of know-how for licensing revenue.²⁵ Following Hymer, if MNEs have an advantage in exploiting their technique, it is because the technological advantage they provide is much more profitable than the profits they could obtain from third party licensing. This advantage puts the MNE in a dominant position, and the degree of domination is a function of the diffusion of technology among competitors. Being directly on the market, national or international, the company is able to correctly assess its advantage and keep an eye on its competitors. It is therefore by an imperfection of the market (dominant position) that investment

VOLUME 1 (Edward Elgar ed., 2008) (regarding the various theories of international trade).

²³ See *MULTINATIONALS AND EUROPE* 1992, at xvii (Beat Bürgenmeier & Jean-Louis Mucchielli, eds., Routledge 1991).

²⁴ See *DAVID RICARDO, PRINCIPLES OF POLITICAL ECONOMY AND TAXATION* 1817 (Prometheus Books 1996) (laying out Ricardo's theory of international trade and comparative advantage).

²⁵ *STEPHEN HYMER, THE INTERNATIONAL OPERATIONS OF NATIONAL FIRMS: A STUDY OF DIRECT INVESTMENT* (MIT Press 1976).

between two industrialized countries is conducted.

Charles Kindleberger, who extended Hymer's works, was the first to consider market imperfections and the possibility of an economy of scale.²⁶ FDIs cannot develop unless there is a market failure, including a technological evolution or any governmental policy that tends to check the competition among markets. These imperfections, however, are not sufficient. The company must also have its own advantages, such as a superior technology, which allows compensation for the inherent disadvantages and the higher costs of producing in a foreign market.

This analysis of the oligopolistic behavior of MNEs was reconsidered some years later by Raymond Vernon, who advanced the idea of a market logic contrary to the optimization of the industrial instrument.²⁷ Inspired by works on marketing, he built the theory of the product cycle (naissance-maturation-standardization): When an MNE settles abroad, it is in order to extend the life of a product that has attained its maturity on the national market.²⁸ Therefore, when the market of a product is in its growth phase, the company sees its initial investment becoming more profitable due to research, development, and industrialization, because it enlarges the market through exports. The economies of scale realized in this way allow the MNE to offer competitive prices in other markets. Still, after a certain period, when the product is popularized, competition becomes more intense, and the company has to innovate. Vernon notes that, at this particular stage, FDI allows the company to extend the life of the product, and the production in a local market creates a commercial advantage that compensates for the loss of the technological advantage.²⁹ This theory only addresses investments for new products; it cannot explain those investments for products that have been on the market for a long time. It is limited to a description of the American companies' situation in Europe in the

²⁶ See CHARLES P. KINDLEBERGER, *MULTINATIONAL EXCURSIONS* (MIT Press 1984); *THE MULTINATIONAL CORPORATION IN THE 1980s* (Charles P. Kindleberger & David B. Audretsch eds., MIT Press 1983).

²⁷ Raymond Vernon, *The Product Cycle Hypothesis in a New International Environment*, 41 *OXFORD BULL. OF ECON. STAT.* 255, 255-67 (1979).

²⁸ Vernon, *supra* note 17, at 190-207.

²⁹ *Id.*

twenty years following World War II.

The works of Vernon and Hymer, although reaching contradictory conclusions, have essential similarities: 1) FDI is first of all the result of a strategy that favors the industrial and/or commercial aspects over those related to immediate financial rentability; 2) FDI is only one type of internationalization of a company and, even though Vernon and Hymer did not agree, it may be combined with other types of internationalization; and 3) FDI aims at benefiting the company and cannot therefore be identified with the interests of the host-country or of the country of origin.

John H. Dunning formulated a paradigm known as the “eclectic paradigm.”³⁰ This paradigm is also called the “OLI” paradigm because it identifies conditions related to ownership, location, and internalization as necessary for a company to invest abroad.³¹ The company must have its own advantages, which allow it to successfully compete with foreign companies in their own markets. These can be, among other things, its products, the characteristics of the production process, knowledge, or management competencies. The company will prefer to internalize its own advantages through an extension of its own activities rather than externalize them through market transactions with independent firms. These advantages from internalization result from the imperfections of some markets and from the importance of transaction costs. The company must have a location advantage that encourages it to produce a good or to offer a service in the foreign market, instead of producing it domestically and exporting it. The existence of natural or artificial trade barriers, low production cost, and better access to consumers comprise the main advantages of location.

Dunning gives an exhaustive classification of these advantages and stresses that they may vary depending on the country’s specific characteristics, as well as the specific characteristics of the

³⁰ Dunning’s work was influenced by Hymer, who was the first to address the issue of FDI with a non-classical approach. See HYMER, *supra* note 25.

³¹ See JOHN H. DUNNING, EXPLAINING INTERNATIONAL PRODUCTION 135 (Unwin Hyman Ltd. 1988).

industry and the company.³² The presence or absence of these OLI advantages then determines whether it is possible for the company to engage in international production.

Dunning Theory³³

<i>Options/advantages</i>	<i>Ownership</i>	<i>Internalization</i>	<i>Location</i>
FDI	Yes	Yes	Yes
Exports	Yes	Yes	No
Transfers of resources in capital	Yes	No	No

The OLI theory has been heavily criticized for being too descriptive and not providing answers to questions related to the FDI trends of the last few years.

Jean-Louis Mucchielli was inspired by an approach comparable to that of Dunning and underlined the dynamics between the company's characteristics ("competitive advantages") and those of the host-country ("comparative advantages").³⁴ Mucchielli shows that a company invests in a country whose comparative advantages are compatible with the competitive advantages the company wants to preserve or establish.³⁵ It is because the MNE no longer finds optimal conditions to develop in its country of origin that it decides to invest in another country where it can have an advantageous position.³⁶

2. Analyzing the Effects of Foreign Direct Investment

Scholars have been preoccupied with the costs and benefits of

³² *See id.*

³³ *See id.* at 49.

³⁴ *See* Jean-Louis Mucchielli, *Multinational Enterprises, International Investments and Transfers of Technology: the Elements of an Integrated Approach*, in *MULTINATIONALS, GOVERNMENTS AND INTERNATIONAL TECHNOLOGY TRANSFER* 11, 11-33 (A.E. Safarian & Gilles Y. Bertin eds., 1987).

³⁵ *See id.* at 20.

³⁶ *See id.* at 22-7.

FDI for a long time. Even though this is a very important issue, its scope is quite limited, because many essential issues have been excluded. Still, when analyzing the main reasons why countries should make efforts to attract FDI, it appears that these reasons are not absolute, as they depend on the characteristics of national economies. Thus, there is a multitude of policies available for countries that want to have a positive attitude towards FDI.

FDI does have an impact on the economic balance of a country. Typically, if a country has substantial FDI investment, it will see a general increase in its national production. The country will therefore export more, which will also provide the country with the opportunity of importing more as its commercial balance reestablishes equilibrium. This will also mean a larger presence in the international market and a more active role in the world economy.³⁷

It is interesting to note how FDI has become part of an international production process in the world economy.³⁸ There is a general consensus among scholars that the relationship between international trade and FDI is of major importance.³⁹ As we have analyzed earlier, the WTO opened a series of negotiations and discussions regarding this issue, focusing on whether the two are complementary, whether one eliminates the other, or whether one influences the other.⁴⁰ Whereas international trade creates a periodic commercial relationship focusing on goods and services, direct investment implements long-term and continuous relations among the economic actors of the countries concerned. Therefore, the answer to the previous question of the relationship between

³⁷ See generally Eduardo Borensztein, Jose De Gregorio & Jong-Wha Lee, *How Does Foreign Direct Investment Affect Economic Growth?*, 45 J. INT'L ECON. 115, 115-35 (1998); Luiz R. de Mello Jr., *Foreign Direct Investment in Developing Countries and Growth: A Selective Survey*, 34 J. DEV. STUD. 1, 1-34 (1997).

³⁸ See generally ECONOMIC DEVELOPMENT, FOREIGN INVESTMENT AND THE LAW: ISSUES OF PRIVATE SECTOR INVOLVEMENT, FOREIGN INVESTMENT AND THE RULE OF LAW IN A NEW ERA (R. Pritchard ed., Kluwer Law International 1996).

³⁹ See Mary Amity & Katharine Wakelin, *Investment Liberalization and International Trade*, 61 J. INT'L ECON. 101, 101-26 (2003). See also Xiaming Liu, Chengang Wang & Yingqi Wei, *Causal Links Between Foreign Direct Investment and Trade in China*, 12 CHINA ECON. REV. 190, 190-202 (2001).

⁴⁰ See World Trade Organization, Ministerial Declaration of 9-13 December 1996, WT/MIN(96)/DEC (1996).

international trade and FDI is that both FDI and trade will continue to be instruments of the world economy, available to all economic actors.

This brings us to the most important and interesting observation concerning trade and investment:⁴¹The analysis of how companies reach resources and where they find them. The analysis consists of the same process that an enterprise has to carry out before deciding to invest in a certain part of the world. There are two inquiries: 1) where to invest; and 2) where to export.

Another observation is that FDI has become an integral part of an international system of production. Companies are structured in an integrated manner. Until recently, foreign branches were almost completely independent; today they are part of a very well structured division of labor and an integrated system of production. The level of intra-company trade amounts to a third of total international trade. This argues in favor of a simultaneous use of both FDI and trade by transnational companies in organizing production. The number of small and medium-sized companies that have become transnational is very high and proves that there is a real tendency to go beyond national boundaries when it comes to the organization of production. In the past, this international strategy was left to large multinational firms. The internationalization of companies not only provides the possibility of greater market access but also the comparative advantages of using individualized national resources.

E. Political Economy of Foreign Direct Investment

Foreign investment is a fundamental aspect of the international political economy. Projections suggest that foreign investment inflows will be close to U.S. \$1.4 trillion by 2010.⁴² There are two

⁴¹ See generally Friedl Weiss, *Trade and Investment*, in THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 182, 182-223 (Peter Muchlinski, Frederico Ortino, & Christoph Schreuer, eds., Oxford University Press 2008) (analyzing the ongoing parallel evolution of bilateral and plurilateral approaches to investment and trade).

⁴² See ECONOMIST INTELLIGENCE UNIT, WORLD INVESTMENT PROSPECTS TO 2010: BOOM OR BACKLASH? 29, tbl. 8 (2006), http://www.cpii.columbia.edu/pubs/documents/WIP_to_2010_SPECIAL_EDITION.pdf (last visited Oct. 26, 2009); see also U.N. Conference on Trade and Development, *World Investment Report 2007: Transnational Corporations, Extractive Industries and Development*, xv (Overview), U.N. Doc WIR07

main theories on the political economy of FDI: One that involves FDI with concepts such as human rights, the environment, development, and technology transfer; and another that considers FDI from its economic perspective. In both theories, one can argue that there is a need for multilateral rules. One should make it clear from the start whether investment is anything more than just an alternative source of finance, and whether there is a need to underline its knowledge, qualification, and its development virtues. Sornarajah believes that understanding investment without considering development, the environment, or human rights issues is a traditional and already old-fashioned approach.⁴³

According to the European Commission, “[FDI] has become an essential element in today’s complex corporate investment and production strategies. The development of global instantaneous communications and data transfer has resulted in the creation of a near global market place.”⁴⁴ Statistical data on the volume of FDI and also on its geographical spread support this thesis.

It is also useful to apply FDI and look at its consequences regarding multinational corporations (MNCs), national governments, and consumers in both the host and the home countries. FDI is a politically sensitive issue because the taking of control is sometimes perceived as an attempt to weaken national sovereignty and national interest.⁴⁵ In our view, well-designed regulations should help overcome this possible perverse effect of FDI and reassure those countries that have such fears. Therefore,

(2007), available at http://www.unctad.org/en/docs/wir2007_en.pdf (last visited Oct. 26, 2009) (data from 2006 suggests that foreign investment inflows were approximately U.S. \$857 billion to the developed world, approximately U.S. \$379 billion to developing countries, and approximately U.S. \$69 billion to transition economies).

⁴³ MUTHUCUMARASWAMY SORNARAJAH, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* (Cambridge Univ. Press 1994).

⁴⁴ Commission of the European Communities, *Communication from the Commission: A Level Playing Field for Direct Investment Worldwide*, at 2, COM (1995) 42 final (March 1, 1995), available at http://aei.pitt.edu/6195/01/003345_1.pdf (last visited Oct. 26, 2009).

⁴⁵ See generally Tim Büthe & Helen V. Milner, *Bilateral Investment Treaties and Foreign Direct Investment: A Political Analysis*, in *THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL INVESTMENT TREATIES, DOUBLE TAXATION TREATIES, AND INVESTMENT FLOWS* 171, 171-224 (Karl P. Sauvant & Lisa E. Sachs eds., Oxford Univ. Press 2009) (analyzing FDI from a political perspective).

knowing full well the difficulty of such a task, we advocate the gradual elimination of the political side of FDI as it only brings uncertainty and maintains unfounded fears.

F. Foreign Direct Investment and Developing Countries

It is noteworthy to look at the effect of FDI on developing countries, since gathering the support of these countries was the main obstacle in the negotiations on a multilateral framework for investment in the GATT/WTO context.⁴⁶ Developing countries have a number of fears that prevent them from accepting any kind of negotiations on FDI in a multilateral organization. Among these fears is the possible reduction of their room to maneuver in domestic policies. At least in the beginning, any agreement discussed multilaterally will be designed on a voluntary basis, and a State may commit only if it considers it appropriate. Therefore, the fears of developing countries should not be an obstacle to further discussions on the scope of such an agreement. That said, there is also the risk that developing countries will feel politically pressured to commit to the agreement. Another fear of developing countries is the possible infringement on their national sovereignty. Whether due to the influence of the positive effects of FDI or to the consolidation of the internal situation of these countries, this fear has become marginal today.

The main arguments in favor of FDI in developing countries are immediate capital formation, creation of new employment,⁴⁷ upgrading of infrastructure facilities, and transfer of skills in technology and management. However, the main argument against FDI in developing countries is the fact that investors develop a very specialized labor force, meaning that in the long run, it is not such a gain. Because of this specialization, these labor forces have limited benefit for use in other industries. Some critics say that there is no proof of a link between liberalization

⁴⁶ Non-governmental organizations (NGOs) have been a major obstacle to intergovernmental negotiations for the creation of a multilateral framework on investment. NGOs have declared a real war on negotiations concerning FDI.

⁴⁷ See Markus Leibrecht & Johann Scharlerr, *How Important is Employment Protection Legislation for Foreign Direct Investment Flows in Central and Eastern European Countries?*, 17 *ECON. TRANSITION* 275, 275-95 (2009) (discussing the correlation between employment and FDI).

and development that has resulted in an economic progress of less-developed countries.⁴⁸

However, what concept of development are we using? There are two possibilities: the neo-liberal approach to development (driven by programs and codes of conduct of the World Bank and the International Monetary Fund (IMF)) and the approach that recognizes that there should be liability in actors other than States for the deprivation of rights associated with development, including human rights. So the question arises: Should only investments that are respectful of development, the environment, and human rights, be granted the higher levels of protection? Or should they all be treated the same? In other words, should there be a minimum requirement for investment?⁴⁹

III. History of Foreign Direct Investment Regulation

Contrary to the tight regime governing international trade, there is no international regime in place for FDI.⁵⁰ FDI relies

⁴⁸ See generally THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL INVESTMENT TREATIES, DOUBLE TAXATION TREATIES, AND INVESTMENT FLOWS, *supra* note STATISTICAL DATA ON THE VOLUME OF FDI and also on its geographical spread support this thesis.

It is also useful to apply FDI and look at its consequences regarding multinational corporations (MNCs), national governments, and consumers in both the host and the home countries. FDI is a politically sensitive issue because the taking of control is sometimes perceived as an attempt to weaken national sovereignty and national interest. (compiling studies showing positive, negative, and no relationships between foreign direct investment and economic growth in developing countries).

⁴⁹ See RUDOLPH DOLZER & CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 119-91 (Oxford Univ. Press 2008); Todd J. Grierson-Weiler & Ian A. Laird, *Standards of Treatment*, in THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 261-304 (Peter Muchlinski, Federico Ortino & Christoph Schreuer eds., Oxford University Press 2008); ANDREAS F. LOWENFELD, INTERNATIONAL ECONOMIC LAW 535-91 (John H. Jackson ed., 2nd ed. 2008); CAMPBELL MCLACHLAN ET AL., INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES 199-263 (Loukas Mistelis, ed., Oxford University Press 2008); ANDREW NEWCOMBE & LLUÍS PARADELL, LAW AND PRACTICE OF INVESTMENT TREATIES; STANDARDS OF TREATMENT 233-319 (Kluwer Law Int'l 2009) (discussing the different standards of treatment for international investments).

⁵⁰ See Pierre Sauvé, *Multilateral Rules on Investment: Is Forward Movement Possible?*, 9 J. INT'L ECON. 325, 325-55 (2006) (exploring the reasons why there are no

instead on a patchwork of bilateral investment treaties (BITs),⁵¹ regional provisions (such as those of the European Union or the North Atlantic Free Trade Agreement (NAFTA)) and multilateral instruments (signed in the framework of the WTO, OECD, World Bank, or the United Nations Conference on Trade and Development (UNCTAD)⁵²). One should add to this list the unilateral liberalization measures taken by both developed and developing countries during the 1980s and 1990s once the political suspicion toward FDI was converted into a growing competition for FDI.⁵³ As will be analyzed later, one of the characteristics of FDI regulation is the coexistence of voluntary, non-binding and binding rules that impose on the State an obligation and the responsibility to implement.⁵⁴

*A. Foreign Direct Investment as a Nationally Regulated Issue: Pre-Havana Charter*⁵⁵

For a long time, foreign direct investment (FDI) remained a matter of national law. Only in exceptional cases was international law concerned with issues related to investment. One of the main reasons for this exclusion of FDI from the international scene lies in the very nature of classical international law since it crystallized in the nineteenth century.⁵⁶ The rules

multilateral rules on investment to date).

⁵¹ As of 2007, over 2,600 BITs had been concluded. The number of BITs and countries involved seems to be growing, reaching more than 2,700 BITs involving 179 countries by 2009. UN Conference on Trade and Development, [UNCTAD], IIA Monitor No. 2: *Recent Developments in International Investment Agreements* (2007-June 2008), ¶¶ 2-6, UNCTAD/WEB/DIAE/IA/2008/1 (2008).

⁵² UNCTAD was established in 1964 as the principal organ of the United Nations General Assembly dealing with trade, investment, and development issues. See U.N. Dept. of Pub. Info., 3rd United Nations Conference on the Least Developed Countries, Brussels, May 14-20, 2001, *UNCTAD at a Glance*, ¶ 1 DPI/2190/J (Apr. 2001).

⁵³ See generally Sylvia Ostry, A NEW REGIME FOR FOREIGN DIRECT INVESTMENT (Group of Thirty 1998) (exploring the favorable shift in the national policies).

⁵⁴ *Infra* section IV.

⁵⁵ See Arghyrios A. Fatouros., *Towards an International Agreement on Foreign Direct Investment*, in OECD DOCUMENTS: TOWARDS MULTILATERAL INVESTMENT RULES, 47 (OECD 1996) (detailing the historical evolution of international and national law and policy).

⁵⁶ For a rationalist analysis of the structure of international law, see generally JOEL

were primarily concerned with allocating jurisdiction among States, as the only subjects of international law. In this context, the relations between foreign investors and host States were solved by national law.

Cases concerning international law generally revolve around three issues: (1) The treatment of foreigners' property by the host State; (2) the international responsibility of States for acts in violation of international law; and (3) the exercise of diplomatic protection by the investor's national State.

The liberal era of the nineteenth century was not concerned with controlling or restricting international private capital transactions. At that time, indirect foreign investment was far more important than direct investment, both from an economic and political point of view.⁵⁷ The existing FDI at the time mainly concerned the exploitation of natural resources (plantation or mines) and, occasionally, the operation of public utilities. Colonies constituted a special case even though they were not treated as "foreign" entities in relation to the metropolitan country. As a result, they were the center of a series of legal debates.⁵⁸

As the nineteenth century was coming to an end, FDI became increasingly important and assumed its present form. The first attempt to coordinate rules on an international level materialized in the Drago-Porter Convention of 1907,⁵⁹ which imposed limitations on the use of armed force for the recovery of public debts. In the same period, national measures started having a more general than individual character. Nevertheless, FDI largely remained a national concern.⁶⁰

P. TRACHTMAN, *THE ECONOMIC STRUCTURE OF INTERNATIONAL LAW* (Harvard University Press 2008).

⁵⁷ See Ragnar Nurkse, *Period Analysis and Inventory Cycles* 203 (Oxford Economic Papers 1954).

⁵⁸ Few cases concerned the expropriation of the property of individual aliens to serve specific public purposes (road building or other less widely acceptable grounds). Most of the property problems arose once the change of sovereignty (creation of a new State or cession of territory) over the territory took place.

⁵⁹ See George W. Scott, *Hague Convention Restricting the Use of Force to Recover on Contract Claims*, 2 AM. J. INT'L L. 78, 89 (1908).

⁶⁰ See generally NEWCOMBE & PARADELL, *supra* note 49, 3-18 (describing the historical development of investment treaty law and interpretation).

In the rare cases where international law was at stake, two principles were concerned: The principle of territorial sovereignty asserting each State's full and exclusive jurisdiction over persons and events in its territory; and the principle of nationality involving each State's interest in the proper treatment of its nationals abroad.⁶¹ Even though the cases were related to investment matters, they referred mainly to States' issues and only indirectly to the investors themselves. The place of private persons in international law was and is still far from being accomplished.

Initially, there was a clear distinction between the attitude of the capital-exporting countries and that of the capital-importing countries. While the latter insisted on the exclusive character of territorial sovereignty and on the fact that foreign investors would not be entitled to more than equal treatment with the host State nationals,⁶² the capital-exporting States reinforced the principle of nationality and the respect for a minimum standard of treatment. Also, a distinction was made between the taking of property and the measures affecting state contracts with aliens.

During the first half of the twentieth century, the issues concerning FDI became increasingly complex and difficult to solve on the basis of classical international law. This evolution is partially due to changes in the very nature of government measures, a large number of which affected foreign property. These measures were all taken as a consequence of historical events like the Mexican Revolution.⁶³

⁶¹ See generally INTERNATIONAL LAW OF STATE RESPONSIBILITY FOR INJURIES TO ALIENS (Richard B. Lillich, ed., Univ. Press of Virginia 1983); SORNARAJAH, *supra* note (describing the principles of territorial sovereignty and nationality which are generally accepted as customary international law).

⁶² See Donald R. Shea, THE CALVO CLAUSE: A PROBLEM OF INTER-AMERICAN AND INTERNATIONAL LAW AND DIPLOMACY 16-21 (Univ. of Minnesota Press 1955) (analyzing a doctrine formulated by Carlos Calvo, a nineteenth-century Argentine, who argued that under international law, aliens have no rights greater than citizens of the host country).

⁶³ Mexico insisted on the State's sovereign right to control its natural resources and on the lack of internationally established rules requiring the payment of full compensation in case of generalized measures: The United States, although recognizing the right to nationalize, relied on the payment of "prompt, adequate and effective" compensation in all cases of takings of alien property.

*B. First Attempt to Have a Structured Multilateral Framework: The Havana Charter*⁶⁴

The end of World War II brought with it a series of initiatives aimed at reshaping the post-war economy. In this context, the Havana Charter of 1948 constituted an attempt to formulate international principles concerning FDI.⁶⁵ Originally intended to establish an international trade organization, the Havana Charter dealt mainly with international trade issues.⁶⁶ It also addressed other issues such as investment and competition. During the negotiations, a clear clash appeared between U.S. proposals (protection of investors) and those of developing countries.⁶⁷ The final draft received strong opposition from investors of developed countries, which partially explains the failure of the Charter to enter into force.

The period following the end of the war was marked by three trends: (1) Massive nationalization of key industries in socialist bloc countries as well as Western countries such as France and the United Kingdom;⁶⁸ (2) Decolonization, which opened the way to a group of new States that, in the process of regaining their independence, multiplied the takings of foreign-owned property;⁶⁹ and (3) Regaining of national control over natural wealth and

⁶⁴ The Havana Charter was the charter of the defunct International Trade Organization (ITO). It was signed by fifty-four countries on March 24, 1948. It allowed for international cooperation and rules against anti-competitive business practices. The charter ultimately failed because the Congress of the United States rejected it. Elements of it would later become part of GATT. *See generally* NEWCOMBE & PARADELL, *supra* note 49.

⁶⁵ *See* SURYA P. SUBEDI, *INTERNATIONAL INVESTMENT LAW: RECONCILING POLICY AND PRINCIPLE* (Hart Publishing 2008) (explaining the principles of international investment law).

⁶⁶ Havana Charter for an International Trade Organization, 24 March 1948, U.N. Doc. E/CONF.2/78.

⁶⁷ Developing countries wanted to introduce a series of important qualifications in the original text. They asked for the inclusion of provisions allowing them to expropriate foreign investment. They feared that pro-investment rules would lead to foreign control over natural resources and strategic industries, affecting their newly acquired sovereignty.

⁶⁸ NEWCOMBE & PARADELL, *supra* note , at 24-25.

⁶⁹ *Id.* at 26.

economy for newly independent States.⁷⁰ There was a general fear that a foreign presence within the economy would compromise the newly achieved independence.

In order to better deal with this situation, a new distinction was made between old investments (those during the colonial period) and new ones (post independence). In this context, all the interests of both host countries and of investors and their countries were focused on FDI in natural resources and other key industries. The general attitude was to admit both the need for FDI and the need for national controls and limitations over FDI. However, a clash between developed and developing countries emerged concerning the payment of indemnification in case of nationalization or expropriation. Developing countries refuted the rules of general international law in this respect. The investment exporting countries found themselves on the defensive on an increasing number of occasions.⁷¹

The United Nations (UN) confirmed the need for FDI in the context of development, specifically in various resolutions by its General Assembly focusing on the new economic order and in the Charter of Economic Rights and Duties of States, adopted on December 12, 1974.⁷² The protection of investment was such an important issue that both the entry of foreign firms and their treatment after establishment were left entirely to the local law of the host countries. Until the 1970s, "laws and policies directed at ensuring national control over FDI were predominant, even in mixed economy countries favouring foreign investment."⁷³ The number of nationalizations and expropriations continued to increase until the next decade.⁷⁴ The creation of a "New International Economic Order"⁷⁵ reinforced the focus of

⁷⁰ *Id.*

⁷¹ *Id.* at 26-27.

⁷² See G.A. Res. 3281 (XXIX), 29 U.N. GAOR, Supp. No. 31, U.N. Doc. A/9631 (Dec. 12, 1974).

⁷³ See Fatouros, *supra* note 55, at 48.

⁷⁴ *Id.* at 49.

⁷⁵ The New International Economic Order was a campaign launched in the early 1970s by developing countries to bring about radical changes in the international economic order. It was based on a perception that economic and technological progress since the end of World War II had not enriched the lives of people in developing

developing countries on controlling MNCs.

C. Emergence of a Series of Common Standards: Codes of Conduct

During the end of the 1960s and the beginning of the 1970s, multilateral initiatives started to materialize. In 1962, the OECD released the Draft Convention on the Protection of Foreign Property, which was further developed and approved by the OECD in 1967.⁷⁶ The OECD Draft Convention sets out the minimum standards of treatment as follows:

Each Party shall at all times ensure fair and equitable treatment to the property of the nationals of the other Parties. It shall accord within its territory the most constant protection and security to such property and shall not in any way impair the management, maintenance, use, enjoyment or disposal thereof by unreasonable or discriminatory measures. The fact that certain nationals of any State are accorded treatment more favourable than that provided for in this Convention shall not be regarded as discriminatory against nationals of a Party by reason only of the fact that such treatment is not accorded to the latter.⁷⁷

With respect to compensation for expropriation, the OECD Draft Convention reflects the Hull formula's requirement for prompt, adequate, and effective compensation.⁷⁸ Taking of property is to be "accompanied by provision for the payment of just compensation. Such compensation shall represent the genuine value of the property affected, shall be paid without undue delay, and shall be transferable to the extent necessary to make it effective for the national entitled thereto."⁷⁹

countries in any meaningful way. See WALTER GOODE, *DICTIONARY OF TRADE POLICY TERMS* 301-03 (Cambridge Univ. Press 2007) (1997).

⁷⁶ See OECD Draft Convention on the Protection of Foreign Property art. 1(a), 7 I.L.M. 117 (1968) [hereinafter OECD Draft Convention].

⁷⁷ See *id.*

⁷⁸ The Hull formula refers to the view expressed in 1938 by Cordell Hull, then U.S. Secretary of State, in response to Mexican agrarian nationalization measures that there should be "prompt, adequate and effective" compensation in cases of expropriation. See GOODE, *supra* note 75, at 218. For further reading on the Hull formula, see LOWENFELD, *supra* note 49, at 475-81.

⁷⁹ See OECD Draft Convention art. 3, 7 I.L.M. 117, 124 (1968).

Although the OECD Draft Convention failed to gain sufficient support among OECD countries for adoption as a multilateral convention, its substantive provisions have served as an important model for bilateral investment treaties.⁸⁰ It is interesting to note that the OECD Draft Convention, although setting out a mechanism for investor-state arbitration, stipulates arbitration on a separate declaration of consent to arbitral jurisdiction by the State.⁸¹

A series of other codes have been adopted, like those aimed at establishing standards for the conduct of transnational corporations (TNCs).⁸² In 1974, the United Nations Economic and Social Council established the Commission on Transnational Corporations, the primary purpose of which was to draft a Code of Conduct on Transnational Corporations (Code).⁸³ From the earliest discussions, disagreement emerged between capital exporting and importing states as to whether the Code would only apply to the conduct of transnational corporations or whether it would extend to the treatment of TNCs by host States. In 1980, the U.N. Economic and Social Council decided that the Code would address both issues.⁸⁴ For the next ten years, the drafting of the Code's substantive provisions was characterized by continued disagreements over its content, inclusion of references to the minimum standard of treatment and compensation for expropriation, and its legal status.⁸⁵ Negotiations were suspended in 1992.⁸⁶

⁸⁰ See Rudolf Dolzer & Margrete Stevens, *BILATERAL INVESTMENT TREATIES* 2 (Martinus Nijhoff Publishers 1995).

⁸¹ See OECD Draft Convention art. 7, 7 I.L.M. 117, 132 (1968).

⁸² See generally LEGAL PROBLEMS OF CODES OF CONDUCT FOR MULTINATIONAL ENTERPRISE (Norbert Horn, ed., Kluwer Law International 1980); SPYRO A. METAXAS, *ENTERPRISES TRANSNATIONALES ET CODES DE CONDUITE: CADRE JURIDIQUE ET QUESTIONS D'EFFECTIVITE* (Schulthess 1988) (discussing successes and problems with codes of conduct that govern transnational and multinational corporations).

⁸³ See Peter T. Muchlinski, *MULTINATIONAL ENTERPRISES AND THE LAW* 660-62 (Oxford Univ. Press, 2d ed., 2007).

⁸⁴ See *id.*

⁸⁵ See The Draft U.N. Code of Conduct on Transnational Corporations, 23 I.L.M. 626 (1984).

⁸⁶ See Muchlinski, *supra* note 83, at 473-506, 661.

D. Bilateral Initiatives

In the post-World War II era, various States entered into bilateral treaties on commerce and navigation. These treaties were often called Friendship, Commerce and Navigation Treaties (FCNs).⁸⁷ Initially, international investment treaties were primarily signed between developed States (for example, FCNs) or between developed and developing States (for example, bilateral investment treaties (BITs)). The number of investment treaties signed exclusively between developing States remained very low. BITs have become a common feature of the FDI panorama in the last two decades,⁸⁸ with FCNs and BITs now being the two main types of international investment treaties.

The FCNs were initially designed as bilateral commercial treaties aimed at facilitating trade and creating a stable diplomatic and economic relationship between parties.⁸⁹ They were primarily concerned with trade and shipping rights of individuals that were covered through national and most-favored-nation (MFN) treatment clauses.⁹⁰ Property protection was only an auxiliary concern of those documents. Corporations, major actors of today's international economic integration, were completely excluded from early FCNs.⁹¹ The Treaty of Amity and Commerce signed between the United States and Japan in 1911 contained a

⁸⁷ From 1946 to 1966, the United States entered into twenty-one FCN treaties. Two of the treaties were subject to proceedings before the International Court of Justice: *Military and Paramilitary Activities (Nicar. v. U.S.)*, 1986 I.C.J. 14 (June 27), and *Case Concerning Elettronica Sicula S.p.A. (ELSI) (U.S. v. Italy)*, 1989 I.C.J. 15.

⁸⁸ 1986 is considered to be the beginning of the BITs era. From this year on, the number of BITs increased exponentially.

⁸⁹ The first FCN treaty signed between the United States and France in 1778 included an MFN clause for commerce and navigation. *See* Treaty of Amity and Commerce, Feb. 6, 1778, US-FR, 8 Stat. 12. Article II (MFN Clause) of the Treaty of Amity and Commerce provides in relevant part that "[t]he Most Christian King and the United States engage mutually not to grant any particular favor to other nations, in respect of commerce and navigation, which shall not immediately become common to the other party, who shall enjoy the same favor"

⁹⁰ *See* KENNETH J. VANDELVELE, *UNITED STATES INVESTMENT TREATIES: POLICY AND PRACTICE* 19 (Kluwer Law and Taxation 1992).

⁹¹ *See* Herman Walker, Jr., *Provisions on Companies in United States Commercial Treaties*, 50 AM. J. INT'L L. 373, 375 (1956) (discussing the history of corporate protection in FCNs and why corporations were excluded from early commercial treaties).

significant change, granting foreign corporations legal status and domestic court access in a contracting party's territory. It was only in 1946, with the United States—Taiwan FCN, that U.S. corporations gained the right to conduct business in other countries on a non-discriminatory, national treatment basis.⁹² With the creation of the General Agreement on Tariffs and Trade (GATT),⁹³ the main aim of FCNs—trade relations—was changed and the new aim became the sovereign protection of FDI.⁹⁴ Also, through a compromissory clause, foreign investment dispute resolution was expanded to include adjudication by the International Court of Justice (ICJ) on an exclusively sovereign level.⁹⁵

The U.S. BIT program was launched in 1977, emulating similar treaty programs conducted by European nations earlier in the decade, and was based on three goals: Establishing international precedent regarding compensation for expropriation; protecting existing stocks of U.S. FDI; and providing a means to depoliticize international investment disputes.⁹⁶ The U.S. program emerged as a successor to the long-running practice of protecting trade interests through bilateral treaties or FCNs, which most U.S. allies had signed since the 1780s.⁹⁷ While FCN treaties did not explicitly protect foreign investment, they did provide for the protection of individual aliens residing overseas for the purpose of establishing trading ventures.⁹⁸ A BIT is an agreement, typically between a rich and a poor country, which establishes rights and protections for investors and a system to enforce those rights. Some of these BITs contain NAFTA-style investment provisions such as the right for corporations to sue a government directly if they feel that their profits are being undermined. For instance,

⁹² *Id.* at 380.

⁹³ For an understanding of how GATT came into being, see DOUGLAS A. IRWIN ET AL., *THE GENESIS OF THE GATT* (Cambridge Univ. Press 2008).

⁹⁴ See VANDEVELDE, *supra* note 90, at 19.

⁹⁵ See Walker, *supra* note 91, at 229.

⁹⁶ See Kenneth J. Vandeveld, *U.S. Bilateral Investment Treaties: The Second Wave*, 14 MICH. J. INT'L L. 621, 625-26 (1993).

⁹⁷ The first FCN treaty was signed with France in 1778. See VANDEVELDE, *supra* note 90, at 14.

⁹⁸ See SORNARAJAH, *supra* note , at 229-30.

Bechtel Corporation, a U.S.-based company (which is incorporated in the Netherlands) is currently using a BIT between the Netherlands and Bolivia to demand \$25 million in compensation from Bolivia over alleged future lost profits.⁹⁹ The company claims that Bolivia violated Bechtel's investor rights under the Bolivia-Netherlands BIT when residents of a Bolivian city demanded that their water system be returned to public control (after Bechtel's privatization of the Cochabamba water system resulted in a price increase of approximately 300%).¹⁰⁰

E. The Era of Multilateralization of Foreign Direct Investment Law

This section examines the multilateralization of FDI regulation beyond bilateral initiatives. The concept of multilateralization refers to the process of transferring an issue from the unilateral action of the host State to the multilateral field, and also implies an international responsibility of the State.¹⁰¹ A great deal of literature exists on the link between trade and FDI, most comprehensively in a report completed by the WTO Secretariat, entitled "Trade and Foreign Direct Investment."¹⁰² The report states that, to date, linkage analyses focus not on causation, but rather the correlation between FDI and trade.¹⁰³ In failing to find a negative correlation,¹⁰⁴ the report suggests that FDI and trade are more like complements than substitutes.¹⁰⁵ While the correlation

⁹⁹ Wallach, *supra* note 4, at 4.

¹⁰⁰ *Id.*

¹⁰¹ See Charles Leben, *L'évolution du Droit International des Investissements*, 7 J. CENTRE ENERGY PETROLEUM & MIN. L. & POL'Y 12, ¶ 16 (2000), available at <http://www.dundee.ac.uk/cepmlp/journal/html/vol7/article7-12.html> (last visited Oct. 26, 2009) (discussing the formative purpose of multilateral trade treaties in a historical context).

¹⁰² *Trade and Foreign Direct Investment*, World Trade Organization (1996) available at http://www.wto.org/english/news_e/pres96_e/pr057_e.htm.

¹⁰³ *Id.* at ¶ 23 (stating that "empirical work . . . has not tried to establish causation—that is, to determine, for example, whether inflows of FDI cause exports to be greater than they would otherwise be or if, instead, expanding exports attract increased FDI").

¹⁰⁴ *Id.* at ¶ 57 (stating that "there is no serious empirical support for the view that FDI has an important negative effect on the overall level of exports from the home country").

¹⁰⁵ *Id.* at ¶ 63.

can vary depending on a country's specific trade policy (for instance, regarding tariffs), overall, liberal trade and investment policies increases FDI.¹⁰⁶ The report also concludes that FDI adds to the overall economic development of States by producing intangibles, particularly the transfer of technology, and by stimulating growth and competitiveness.¹⁰⁷

Irrespective of whether trade and FDI are substitutes or complements, there also exists a causal link between the two. While trade reflects a finished commodity, investment causes the chain of production to continue. Investment frameworks should therefore cover not only capital mobility but also capital production. At another level, investment may also be treated as a subject of trade.

This section first analyzes investment regulation under the 1947 GATT. Then, it analyzes investment in the framework of the Transatlantic Free Trade Area (TAFTA)-South project, followed by an analysis of the Multilateral Agreement on Investment. Finally, this section examines investment under the WTO framework.

1. *Investment Under the GATT*

It is important to make clear that the 1947 GATT was not created for competence over investment-related issues.¹⁰⁸ However, as evidenced in the Foreign International Review Act (FIRA) case (USA v. Canada) of 1984, this did not prevent investment issues from being raised in the GATT context.¹⁰⁹ The importance of the FIRA case is that it shows the need, since the 1980s, for an international structure for investment. Despite the fact that GATT did not deal with investment issues, the United States characterized the issues discussed as trade-related, not investment-related, in order to bring the complaint before the

¹⁰⁶ *Id.* at ¶ 174

¹⁰⁷ *Id.* at ¶ 5. See also C. O'Neal Taylor, *Linkage and Rule-Making: Observations on Trade and Investment and Trade and Labor*, 19 U. PA. J. INT'L ECON. L. 639, 657 (1998).

¹⁰⁸ See generally IRWIN ET AL., *supra* note 93 (discussing the creation of the GATT to regulate trade).

¹⁰⁹ Panel Report, *Canada – Administration of the Foreign Investment Review Act*, ¶ 1.4, L/5504-30S/140 (Jul. 25, 1983) (adopted Feb. 7, 1984).

Panel.¹¹⁰

FIRA required that foreign investors respect two conditions: 1) Local content undertakings; and 2) export performance undertakings.¹¹¹ The United States did not take issue with the FIRA itself, but rather the fact that by keeping the FIRA with the initial provisions, Canada was violating its obligations under GATT.¹¹²

The Panel found that 1) the investment issue was consistent with GATT-specific trade related measures; 2) the local content requirements were inconsistent with GATT Article III(4) on national treatment;¹¹³ and 3) there was no inconsistency in export performance requirements.¹¹⁴

2. *The TAFTA-South Project*

Unlike earlier free trade ventures in the postwar period, many recent trade agreements involve countries outside the regional neighborhoods and seek reciprocal, rather than preferential, treatment. The best example of this practice is the series of trade initiatives taken by the European Union (EU) concerning Latin American and Caribbean States.

The Transatlantic Free Trade Area (TAFTA)-South is a trade initiative that aims at an inter-regional nexus between the EU and its trading partners from the Latin American and Caribbean basins.¹¹⁵ While sharing some similarities with the U.S. agreement with the region (the Free Trade Area of the Americas (FTAA)), the TAFTA-South project involves a different approach by the EU.¹¹⁶ Both the United States and the EU began by working with

¹¹⁰ *Id.* ¶¶ 1.4.

¹¹¹ *Id.* ¶¶ 2.4-2.7.

¹¹² *Id.* ¶ 3.1.

¹¹³ In GATT/WTO law, the national treatment principle is the principle of giving others the same treatment as one's own nationals. In other words, WTO members must treat domestic and foreign goods, services and/or investors in the same manner for regulatory, tax and other purposes. See GATT art. III, XVII; TRIPS art. 3.

¹¹⁴ Panel Report, *Canada – Administration of the Foreign Investment Review Act*, *supra* note , ¶ 6.

¹¹⁵ Jeffrey J. Schott & Barbara Oegg, *Europe and the Americas: Toward a TAFTA-South?*, 24 *WORLD ECONOMY* 745, 746 (2001).

¹¹⁶ *See id.*

individual countries in the region.¹¹⁷ Under a series of Acts, the United States first granted unilateral trade preferences to the smaller countries, and then negotiated framework agreements in order to set the stage for subsequent trade talks.¹¹⁸ The EU followed the same steps, building on the Lomé Conventions¹¹⁹ and framework agreements with individual countries or regional groups. However, the EU did not “integrate these initiatives into a single negotiation project aimed at creating, over time, a single regional free-trade zone” like the FTAA.¹²⁰

The EU’s strategy was more diversified than that of the United States and varied in speed among the different regions.¹²¹ It signed a free-trade agreement (FTA) with Mexico in 1997, the culmination of a decade of negotiations by Mexican authorities to bring European capital into Mexico and to dilute its strong dependence on the U.S. market.¹²² Another agreement was signed with Chile in June 1996.¹²³ Negotiations for an FTA have been ongoing with the Mercado Commun del Sur (Mercosur) since 2000.¹²⁴ As for reciprocal trade agreements with Caribbean countries,¹²⁵ on October 15, 2008, the European Community (EC)

¹¹⁷ *See id.*

¹¹⁸ *See id.* at 747.

¹¹⁹ *See id.* *See also* RAPHAEL LEAL-ARCAS, THEORY AND PRACTICE OF EC EXTERNAL TRADE LAW AND POLICY, 284 (Cameron 2008) [hereinafter THEORY AND PRACTICE] (discussing the growth of the Lomé Conventions out of special regimes designed to aid the development of former colonies to EU countries).

¹²⁰ Schott & Oegg, *supra* note 115, at 746.

¹²¹ *See id.* at 747.

¹²² *See* Economic Partnership, Political Coordination and Cooperation Agreement, EC-Mex., Aug. 12, 1997, 2000 O.J. (L276) 45.

¹²³ Schott & Oegg, *supra* note 115, at 750.

¹²⁴ *See* Council Decision (EC) 96/205, 1996 O.J. (L 69) 1; Council Decision (EC), 1996 O.J. (C 14) 3 (concerning the provisional application of certain provisions of the Interregional Framework Cooperation Agreement between the EC Member countries and the Southern Common Market Party States); Schott & Oegg, *supra* note 115 (discussing similar agreements with Mercosur and Chile in the 1990s which resulted in more formal bilateral trade negotiations).

¹²⁵ On February 3, 2000, a new Partnership Agreement was concluded between the Caribbean States and the EC. It encompasses political relations between these two groups, development cooperation strategies, financial cooperation, as well as trade relations. The new pact seems to be more reciprocal, and it is designed to culminate in a free-trade agreement. New trade arrangements aimed at progressive and fully reciprocal

signed an Economic Partnership Agreement with 13 Caribbean Forum of African, Caribbean and Pacific States (CARIFORUM) countries: Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, the Dominican Republic, Grenada, Jamaica, Saint Lucia, Saint Vincent and the Grenadines, Saint Christopher and Nevis, Suriname, and Trinidad and Tobago.¹²⁶ Guyana signed on October 20, 2008.¹²⁷ The Agreement is provisionally applied as of December 29, 2008, while such initiatives with the Andean Community¹²⁸ and the Central American countries are only in the planning stages.

There are three main reasons for having these reciprocal trade agreements. First, the two regions have traditional political, cultural, and commercial ties that they want to develop.¹²⁹ In this sense, trade relations often serve political goals. Second, there is an interest in increasing exports to the European market. Third, new accords would help EU partners attract more foreign direct investment into their economies.¹³⁰ Attempts to encourage this will be effective only as part of a broader set of policy reforms, and economic and political measures. These kinds of secondary reforms are taken unilaterally by the majority of States. A free-trade area would only guarantee against the reversal of these policies and would constitute a measure of legal security for investors.¹³¹

removal of trade barriers entered into force on January 1, 2008. This was established by the Cotonou Agreement of June 23, 2000.

¹²⁶ The CARIFORUM (Caribbean Forum of African, Caribbean and Pacific States) is a regional grouping of 15 Caribbean countries including those listed above and Guyana and Haiti.

¹²⁷ Council Decision 2008/805, 2008 O.J. (L289) 1 (EC). The CARIFORUM-EC Economic Partnership Agreement is a pioneering agreement in the international trading system. It is the first genuinely comprehensive North-South trade agreement that promotes sustainable development, builds a regional market among developing countries, and helps eliminate poverty.

¹²⁸ See Schott & Oegg, *supra* note 115, at 755. The Andean Community is a trade bloc comprising four South American countries: Colombia, Peru, Ecuador and Bolivia. The trade bloc (formerly known as the Andean Pact) was founded with the signing of the Cartagena Agreement in 1969.

¹²⁹ *Id.*

¹³⁰ *Id.*

¹³¹ *Id.*

Agreements between the EC and the TAFTA-South countries would help attract FDI. This is especially true as many of the TAFTA-South countries have undergone a decade of reform, restructuring their financial sectors and telecommunications, and transportation networks. Within this broader set of policy reform, FTAs with the EC as well as other agreements with the United States can only provide more incentives for domestic and foreign investors.¹³² EU direct investment in the TAFTA-South region has indeed increased over the past few years. By the end of 1998, EU FDI in the region totaled almost US \$130 billion.¹³³ Between 1994 and 1999, EU FDI in the region more than doubled to 44%.¹³⁴ In contrast, investments by U.S. firms were fairly constant over this period, resulting in a decrease in U.S. FDI in the region from nearly 60% in 1994 to 21.5% in 1999.¹³⁵

3. *Multilateral Agreement on Investment (MAI)*¹³⁶

a. *Background*

When the Uruguay Round began in 1986, the United States brought up the need for “stricter disciplines on trade-distort[ed] investment measures.”¹³⁷ The American proposal concerned the fact that GATT Contracting Parties should consider the application of the national treatment principle¹³⁸ and the most-favored-treatment principle to foreign investment.¹³⁹ While other

¹³² *Id.* at 756.

¹³³ *Id.*

¹³⁴ Schott & Oegg, *supra* note 113, at 756.

¹³⁵ *Id.*

¹³⁶ See generally Rainer Geiger, *Towards a Multilateral Agreement on Investment*, 31 CORNELL INT'L L.J. 467, 467-75 (1998) for literature on the MAI negotiations; Glen Kelley, Note, *Multilateral Investment Treaties: A Balanced Approach to Multinational Corporations*, 39 COLUM. J. TRANSNAT'L L. 483 (2001) (discussing the MAI's virtues and faults); Jeswald Salacuse, *Towards a Global Treaty on Foreign Investment: the Search for a Grand Bargain*, in ARBITRATING FOREIGN INVESTMENT DISPUTES 51-88 (Horn & Kroll, eds., 2004) (discussing the history and failure of the MAI).

¹³⁷ Stefan Amarasinha & Juliane Kokott, *Multilateral Investment Rules Revisited*, in THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 125.

¹³⁸ See *supra* note 113 and accompanying text.

¹³⁹ See Amarasinha & Kokott, *supra* note 137, at 125. In GATT/WTO law, the most-favored-nation (MFN) treatment is the principle of not discriminating between

developed countries supported the U.S. proposal, developing countries were concerned with the legality of investment negotiations under GATT. These discussions resulted in negotiations with a narrower scope, limited to only trade-related investment measures.¹⁴⁰

Since the beginning of the 1990s, business actors and governments have stressed the need for a liberal, stable, transparent, and coherent international investment regime. Following the failure to have investment protection in the Uruguay Round agreements, the United States promoted negotiations for a MAI¹⁴¹ in the OECD framework.¹⁴² In 1995, ministers of OECD decided that the “time [was] ripe to negotiate a multilateral agreement in investment.”¹⁴³ The rationale behind the MAI was that if developing countries would not negotiate under GATT/WTO, some countries could group together within the OECD framework and negotiate a separate investment agreement, which they could later open to non-OECD countries.¹⁴⁴

The MAI—which was negotiated in secret among members of the OECD between 1995 and 1998—aimed to develop multilateral rules that would ensure that international investment would be governed in a more systematic and uniform way among States.¹⁴⁵ That said, even if there is no complete uniformity yet, there is enough convergence to be able to speak of international investment law as an existing international law discipline made up of uniform investment law principles. By doing so, the MAI

one’s trading partners. It is the core principle of WTO Agreements. In general, MFN means that every time a WTO country lowers a trade barrier or opens up a market, it has to do so for the same goods or services from all its trading partners—whether rich or poor, weak or strong. See GATT art. I, art. II; TRIPS art. 4.

¹⁴⁰ See Amarasinha & Kokott, *supra* note 137, at 125.

¹⁴¹ OECD, *The Multilateral Agreement on Investment Draft Consolidated Text*, OECD Doc. DAFFE/MAI(98)7/REV (April 22, 1998), available at <http://www1.oecd.org/daf/mai/pdf/ng/ng987r1e.pdf> (last visited Oct. 26, 2009).

¹⁴² See Salacuse, *supra* note 136 for a general review of the subject. See also Peter Muchlinski, *The Rise and Fall of the Multilateral Agreement on Investment: Where Now?*, 34 INT’L LAWYER 1033, 1037 (2000).

¹⁴³ OECD, *supra* note 7, at 9.

¹⁴⁴ Amarasinha & Kokott, *supra* note 137, at 126

¹⁴⁵ Wallach, *supra* note 4, at 8.

sought to set strict global rules limiting governments' rights and abilities to regulate currency speculation and set public interest policies regarding investment in land, factories, service sectors and stocks.¹⁴⁶ This proposal would have expanded worldwide key NAFTA investment provisions, including investor rights not included in the WTO. These included the right to establish an investment in another country, the ability for corporations to sue governments for cash damages over any regulatory action affecting profits, and an expansive definition of investment beyond what the WTO recognizes.¹⁴⁷

Transnational corporations and major business lobbies worldwide pushed for the MAI. MAI negotiations started at the same time as several NAFTA investment claims that attained a high public profile.¹⁴⁸ When the first draft was leaked to the public in 1997, it drew widespread criticism from civil society groups and developing countries, particularly over the possibility that the agreement would make it difficult to regulate foreign investors. Non-governmental organization (NGO) opposition to the MAI, which started largely in Canada after the Ethyl Corporation dispute under NAFTA,¹⁴⁹ ranged from those worried about the potential implications for the environment and labor standards to organized laborers who feared that jobs would be sent abroad.¹⁵⁰

After an intense global campaign against the MAI by the treaty's critics, the host nation, France, announced in October 1998, that it would not support the agreement, thereby killing it because of the OECD's consensus procedures.¹⁵¹ "Ultimately, the

¹⁴⁶ For an interesting analysis of what globalization can teach us about law in the Western tradition, see DAVID B. GOLDMAN, *GLOBALISATION AND THE WESTERN LEGAL TRADITION: RECURRING PATTERNS OF LAW AND AUTHORITY* (2007).

¹⁴⁷ See SERGEY RIPINSKY & KEVIN WILLIAMS, *DAMAGES IN INTERNATIONAL INVESTMENT LAW* (2008).

¹⁴⁸ NEWCOMBE & PARADELL, *supra* note 47, at 55.

¹⁴⁹ See TONY CLARKE & MAUDE BARLOW, *MAI: THE MULTILATERAL AGREEMENT ON INVESTMENT AND THE THREAT TO CANADIAN SOVEREIGNTY* (1997) (discussing Canadian opposition).

¹⁵⁰ For an account of the MAI negotiations, see EDWARD M. GRAHAM, *FIGHTING THE WRONG ENEMY—ANTIGLOBAL ACTIVISTS AND MULTINATIONAL ENTERPRISES* (2000).

¹⁵¹ See generally Sol Picciotto, *Linkages in International Investment Regulation:*

MAI did not come into existence after public exposure via an international NGO campaign.”¹⁵² While the MAI was stopped, its agenda has been renewed in a variety of fora such as the General Agreement on Trade in Services (GATS) and the Free Trade Area of the Americas (FTAA).¹⁵³ The failed MAI was expected to provide a strong and comprehensive framework for international investment and strengthen the multilateral trading regime.¹⁵⁴

Stefan Amarasinha and Juliane Kokott, however, have a different theory as to why the MAI failed. According to their theory, there are six main reasons why the MAI did not see the light: 1) The MAI was an overly ambitious attempt to cover both pre-investment and post-investment at the same time; 2) the pre-investment led to the submission of provisional exclusions and exemptions documents which were very bulky for some countries; 3) lack of support from the business community, which found the text unclear and argued that existing BITs provided a better protection; 4) the inability of negotiators to compromise on environmental issues and labor standards; 5) the lack of clarity in regarding the relationship among the MAI, BITs, the GATS, and the Agreement on Trade-Related Investment Measures (TRIMs Agreement); and 6) some OECD countries were opposed to according national treatment with regard to the privatization of state-owned enterprises.¹⁵⁵

The Antinomies of the Draft Multilateral Agreement on Investment, 19 U. PENN. J. INT’L ECON. L. 731, 740-64 (1998) (discussing problems arising in the MAI framework); Geiger, *supra* note 136 (offering a differing perspective on the MAI); Catherine Schittecatte, *The Politics of the MAI – On the Social Opposition of the MAI and its Role in the Demise of the Negotiations*, 1 J. WORLD INVESTMENT 329 (2000) (exploring the failings of the MAI); Jürgen Kurtz, *A General Investment Agreement in the WTO? Lessons from Chapter 11 of NAFTA and the OECD Multilateral Agreement on Investment*, 23 U. PENN. J. INT’L ECON. L. 713 (2002) (drawing lessons from the mistakes of the MAI); Sauvé, *supra* note 48 (discussing the MAI with a new perspective).

¹⁵² Wallach, *supra* note 137, at 6. *But see* Amarasinha and Kokott, *supra* note , at 127 (offering six alternative reasons for why they believe the MAI failed).

¹⁵³ Wallach, *supra* note 4, at 6. The Free Trade Area of the Americas (FTAA) was launched at the Miami Summit in 1995 with a purpose to extend NAFTA to all countries in the western hemisphere (except for Cuba). Negotiations have not yet been completed despite recent efforts to revive FTAA talks. *Id.*

¹⁵⁴ Since the failure of the Multilateral Agreement on Investment has been deeply studied by scholars, this Article will not deal with it in detail.

¹⁵⁵ Amarasinha & Kokott, *supra* note 137, at 127.

b. Analysis of the MAI

The MAI sought to combine traditional investment protection with more novel mechanisms for pre-investment. The MAI envisioned a top-down approach for pre-investment so that “all sectors of the economy would be covered by the national treatment and MFN disciplines *unless* explicitly exempted or excluded.”¹⁵⁶ The pre- and post-investment would then be bolstered by a dispute settlement system allowing for state-state as well as investor-state arbitration. While the MAI was associated with the OECD Guidelines for Multinational Enterprises, it did not create any new duties for foreign investors.¹⁵⁷

According to Peter Muchlinski, the MAI was nothing more than a pure investor and investment protection instrument that failed to address crucial questions regarding the environment and labor standards.¹⁵⁸ In Graham’s view, the MAI draft “was becoming little more than a codification of existing law, policy and practice among the negotiating countries.”¹⁵⁹ Amarasinha and Kokott have argued that environmental and labor standards are increasingly seen as inseparable from foreign investment and therefore it is key to ensure that they are incorporated into investment issues without being impractical at the same time.¹⁶⁰ Other commentators have argued that the lack of transparency in the negotiating process made the public and interested NGOs feel ostracized.¹⁶¹

¹⁵⁶ *Id.*

¹⁵⁷ *See id.* at 129.

¹⁵⁸ Muchlinski, *supra* note 142, at 1049.

¹⁵⁹ GRAHAM, *supra* note 150, at 7.

¹⁶⁰ Amarasinha & Kokott, *supra* note 137, at 128.

¹⁶¹ *See* Alan Rugman, *New Rules for International Investment: The Case for a Multilateral Agreement on Investment (MAI) at the WTO*, in TRADE LIBERALIZATION, COMPETITION AND THE WTO 176 (Milner & Read eds., 2002); Jürgen Kurtz, *NGO's, the Internet and International Economic Policy Making: The Failure of the OECD Multilateral Agreement on Investment*, 3 MELBOURNE J. INT'L L. 213, 231 (2002).

4. *WTO and Its Working Group on Trade and Investment*¹⁶²

During the Uruguay Round (1986-1994), the United States pushed for greater discipline on trade-related investment measures and sought a code that would further liberalize market access for investment.¹⁶³ The majority of the GATT contracting parties rejected this proposal, preferring to clarify the types of measures that breached the existing GATT obligations.¹⁶⁴ The resulting accord was the Agreement on Trade-Related Investment Measures (TRIMs Agreement).¹⁶⁵ The TRIMs Agreement reaffirmed that WTO Members may not apply investment measures that are inconsistent with GATT national-treatment obligations or that otherwise violate the general prohibition on quantitative restrictions on imports and exports of goods.

In addition to the TRIMs Agreement, the Uruguay Round gave birth to GATS,¹⁶⁶ which is often called a back-door MAI because it creates rights for foreign investors to set up service businesses inside other WTO Member States. GATS essentially creates rights for foreign investors to invest in service sectors covered by

¹⁶² See also Kurtz, *supra* note 151 (questioning the investment capabilities of the WTO); Esther Kentin, *Prospects for Rules on Investment in the new WTO Round*, 29 LEGAL ISSUES ECON. INTEGRATION 61 (2002) (elucidating the potential of investment rules in a WTO regime); Philippe Gugler & Julien Chaisse, *Foreign Investment Issues and WTO Law - Dealing with Fragmentation while waiting for a Multilateral Framework*, in 1 ESSAYS ON THE FUTURE OF THE WORLD TRADE ORGANIZATION - POLICIES AND LEGAL ISSUES 135 (Julien Chaisse & Tiziano Balmelli eds., 2008) (investigating the problem of fragmentation in WTO regulation). See generally Correa & Kumar, PROTECTING FOREIGN INVESTMENT: IMPLICATIONS OF A WTO REGIME AND POLICY OPTIONS 1-3 (providing an overview of the book which discusses efforts by the WTO to create an investment discipline).

¹⁶³ See TERENCE P. STEWART, *Trade Related Investment Measures*, in THE GATT URUGUAY ROUND: A NEGOTIATING HISTORY 2348 (Kluwer Law International, 1994).

¹⁶⁴ Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 107 (1999).

¹⁶⁵ Agreement on Trade-Related Investment Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, in LEGAL TEXTS: RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 143 (WTO, Cambridge Univ. Press, 1999) [hereinafter TRIMs Agreement].

¹⁶⁶ General Agreement on Trade in Services, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, 33 I.L.M. 1167 (1994).

GATS commitments. For this reason, the GATS can be considered the first multilateral investment liberalization treaty.

In the framework of the 1996 WTO Ministerial Conference,¹⁶⁷ and as a result of the 1996 WTO Singapore Declaration,¹⁶⁸ WTO Members established a working group on the relationship between trade and investment. The idea was to study the link between trade and investment. Since the MAI was abandoned in 1998, some WTO members looked toward the WTO as the appropriate forum for creating the multilateral investment rules.

Indeed, in the Doha Declaration (2001), WTO members recognized the need for “a multilateral framework to secure transparent, stable and predictable conditions for long-term cross-border investment.”¹⁶⁹ The working group focused on various investment issues, the idea being that a text would be produced to be taken to the next WTO Ministerial Conference in Cancún in 2003.¹⁷⁰ However, leading up to the 2003 WTO Ministerial Conference, developing WTO members opposed the negotiation of the “Singapore issues.”¹⁷¹ At the Cancún WTO Ministerial Conference, the EU trade commissioner agreed to drop investment from the Doha Round agenda, indicating flexibility on the Singapore issues.¹⁷² This decision was later supported by the U.S.

¹⁶⁷ See generally LEAL-ARCAS, THEORY AND PRACTICE, *supra* note 119, at 494 (discussing the role that WTO Ministerial conferences play in decision making and the origin of the Singapore, Doha and Cancun references, because each was a host conference site).

¹⁶⁸ World Trade Organization, Ministerial Declaration of 14 November 2001, WT/MIN(01)/DEC/1, 41 I.L.M. 746, 749 (2002) [hereinafter Doha Declaration] (spelling out the mandate of the trade and investment working group).

¹⁶⁹ *Id.*

¹⁷⁰ See *id.* (listing the issues as scope and definition; transparency; non-discrimination; modalities for pre-establishment commitments based on a GATS-type, positive list approach; development provisions; exceptions and balance-of-payments safeguards; consultation and the settlement of disputes between members).

¹⁷¹ The WTO Ministerial Conference of 1996 in Singapore established working groups on four issues: Investment protection, competition policy, transparency in government procurement, and trade facilitation. See http://www.wto.org/english/thewto_e/whatis_e/tif_e/bey3_e.htm.

¹⁷² See Press Notice, European Commission, EU- WTO: European Commission Proposes to put Doha Round of Trade Talks Back on Track (Nov. 26, 2003), *available for download at* <http://www.europa.eu/rapid> (expressing desires to return to Doha material); see also Simon Evenett, *Five Hypotheses Concerning the Fate of the*

government in a letter circulated on January 11, 2004 by the then U.S. Trade Representative Robert Zoellick in which he stated that he would prefer to drop investment in the WTO negotiations and referred to the Singapore issues as “distractions.”¹⁷³ It seems, therefore, unlikely to provide for investment in the WTO framework in the foreseeable future.¹⁷⁴

IV. Current Regulatory Regimes¹⁷⁵

Clearly, the FDI regulation panorama is very diverse and multilayered. Yet, the existing investment treaties—whether bilateral, regional, or multilateral—can be understood as part of an overarching treaty framework within the developing global market economy. The failed attempts to establish multilateral rules for investment, such as the MAI in 1998 and the Cancún WTO Ministerial Conference of 2003,¹⁷⁶ seem to have triggered the new trend of bilateral and regional promotion and protection of FDI. The proliferation of investor-state arbitrations is evidence that, for the time being, bilateral and regional governance of investment via BITs and investment chapters of FTAs will be the prevailing means of governing FDI.¹⁷⁷ The amount of investor-state arbitration causing issues of conflicting arbitral awards and forum

Singapore Issues in the Doha Round, 23 OXFORD REV. ECON. POL. 392 (2007) (discussing the Singapore issues).

¹⁷³ Zoellick Letter to Trade Ministers, Inside U.S. Trade, Jan. 16, 2004 at 15.

¹⁷⁴ MICHAEL TREBILCOCK & ROBERT HOWSE, THE REGULATION OF INTERNATIONAL TRADE 461 (2005).

¹⁷⁵ For an overview, see LOWENFELD, *supra* note 47, at 371-417 (illustrating the rules and organizations overseeing international trade); see generally DOLZER & SCHREUER, *supra* note 47 (describing interpretation and application of investment treaties and contracts).

¹⁷⁶ See Kenneth J. Vandeveld, *A Brief History of International Investment Agreements*, 12 U.C. DAVIS L. REV. 157, 157-94 (2005) (describing the history of international investment agreements since the colonial era); Riyaz Dattu, *A Journey From Havana to Paris: The Fifty-Year Quest for the Elusive Multilateral Agreement on Investment*, 24 FORDHAM INT'L L.J. 275, 275-316 (2001) (analyzing recent attempts to negotiate a comprehensive agreement on multilateral investment).

¹⁷⁷ See generally AUGUST REINISCH & CHRISTINA KNAHR, INTERNATIONAL INVESTMENT LAW IN CONTEXT (Eleven Int'l Publishing 2008); CHRISTOPHER F. DUGAN, ET AL., INVESTOR-STATE ARBITRATION (Oxford Univ. Press 2008) (discussing current trends in international investment law).

shopping shows the importance of coordination at the multilateral level toward the creation of a multilateral investment treaty.¹⁷⁸

This section provides an overview of the regulatory systems related to investment. The scope of this overview is to lay down the existing rules in order to prepare the field for further comments on the issue. The following layers of FDI regulation will be presented: 1) Customary international law; 2) soft law; 3) bilateral investment treaties; 4) regional approaches to investment regulation; and 5) multilateral approaches to investment regulation.

A. Customary International Law

The principles of customary international law that are relevant for our topic were crystallized at the end of the nineteenth and the beginning of the twentieth century. Classical international law approaches FDI issues in terms of two fundamental international law principles:

1. The principle of territorial sovereignty asserts that each State exercises full and exclusive jurisdiction over persons and events in its territory. On the basis of this principle, the State has the power to admit or to exclude aliens from its territory, to regulate the operations of all the economic actors, and to take the property of private persons in pursuit of public purposes.

2. The principle of nationality recognizes that each State has an interest in the proper treatment of its nationals and their property abroad, and may, through the exercise of diplomatic protection, invoke the rules concerning the responsibility of States for injuries to aliens and their property in violation of international law.¹⁷⁹

These two principles are generally accepted as customary

¹⁷⁸ See generally THE FORDHAM PAPERS, CONTEMPORARY ISSUES IN INTERNATIONAL ARBITRATION AND MEDIATION (Arthur W. Rovine, ed., Martinus Nijhoff Publishers 2009) (analyzing the current situation and ongoing issues in international arbitration).

¹⁷⁹ See generally INTERNATIONAL LAW OF STATE RESPONSIBILITY FOR INJURIES TO ALIENS (Richard B. Lillich, ed., Univ. Press of Virginia 1983) (discussing further the principle of nationality within the context of customary international law).

international law. In our view, recent developments¹⁸⁰ in the international treatment of investments lead to the emergence of new principles that could qualify as generally accepted,¹⁸¹ and therefore would become a part of customary law. That is the case with compensation. Even though the amount and conditions of payment of compensation in cases of expropriation are still controversial issues, it is generally accepted that such compensation is due whenever the investor or its investment suffers from a measure taken unilaterally by the host State. However, only the two above mentioned principles are, without any controversy, accepted as customary international law.

A note should be made on the concept of property in a multilateral framework for investment. There is an absolute concept of property as a fundamental basis for society's organization, to be contrasted with the social function of property, where individual rights are subject to a prior right of the society to secure common goals. There is a clear question of harmonization of this concept: First, because it is one of the pillars of a multilateral framework for investment; and second, because of the important number of different interpretations and conceptions that may be found in the various national constitutions or laws.¹⁸² These national systems may be in a difficult situation if the Treaty provisions appear to be contrary to their own provisions.

Is it then legitimate to believe that the great number of bilateral treaties lead to a sort of standardization of some concepts, namely the property concept? Is there any reason to believe that the fact that the United States signed various BITs means that all those treaties provide the same concept and definition of property just because one of the two parties is always the same? If this is the case, then we could reasonably say that the signature of BITs is a first step to a multilateral framework for investment in the sense

¹⁸⁰ These developments are primarily the increasing number of bilateral treaties and the regional agreements that will be studied later in this work.

¹⁸¹ This acceptance is manifested through bilateral treaties that are signed with an increasing number of countries, and especially with an increasing number of developing countries.

¹⁸² See generally BRIAN K. LANDSBERG & LESLIE G. JACOBS, GLOBAL ISSUES IN CONSTITUTIONAL LAW (Thomson/West 2007) (analyzing the different concepts of property in constitutions).

that it helps to create a more unified framework.

B. Soft Law

Soft law is a special category of legal prescriptions whose normative intensity is variable and generally applicable. They are known under the concept of “standards.” They are not always legal in the traditional sense because they are not formally binding on States or individuals. However, they may still possess considerable legal and political authority to the extent that they often represent widely held expectations that affect the actual behavior of economic and political actors in a variety of ways.

There are two major types of soft law standards. The first type comprises standards based on international instruments that have been adopted by States in a non-legally binding form, such as resolutions of the General Assembly of the United Nations or formal declarations of States.¹⁸³ A second type are those proscriptions found in formally binding legal documents, such as international agreements, in provisions couched in language that precludes an implication of strict obligation or right. Typical illustrations of such language are references to “best efforts” or to “endeavoring” to act in a certain manner.

The main role of soft law is to regroup these shared expectations and, through repeated invocation and appropriate use, to move to the status of binding and enforceable rules. It is in this sense that soft law has sometimes been called “green law.” It may also play an educational role by suggesting to governments possible approaches that are generally accepted.¹⁸⁴

¹⁸³ Illustrations of such standards are those found in the General Assembly resolutions relating to the New International Order or to the international codes of conduct negotiated in the 1970s and 1980s.

¹⁸⁴ Such effects are enhanced when there is an institutional implementation mechanism. This is the role for the OECD Committee on International Investment and Multinational Enterprises (CIME) in the implementation of the Guidelines for Multinational Enterprises.

C. *Bilateralism*¹⁸⁵

The year 2001 was a milestone in the evolution of bilateral investment treaties. Ninety-seven countries—the largest number ever—were signatories to at least one treaty. With 158 BITs signed in 2001, the total number of treaties rose to 2,099 from 1,941 the previous year. Most importantly, the number of BITs signed among developing countries increased from thirty-six in 2000 to sixty-six in 2001 (42% of all BITs).¹⁸⁶

These figures are encouraging because BITs provide evidence of signatories' interest in the elaboration of FDI rules, i.e., in the creation of a body of rules outside the national territory.¹⁸⁷ Although BITs differ depending on the States that sign them, they forge a number of common denominators that will be very useful in the design of a multilateral framework for investment. From the existing BITs, we can already point out several similarities or trends that are the first steps towards the internationalization of the topic.

1. *Overview of Bilateral Investment Treaties*

Bilateral treaties especially designed for investment aim at

¹⁸⁵ See generally Nicholas DiMascio & Joost Pauwelyn, *Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?*, 102 AM. J. INT'L L. 48, 48-89 (2008) (discussing the differences between bilateral investment treaties and multilateral trade agreements).

¹⁸⁶ See UNCTAD, Geneva, Switz., June 12, 2003, *World Investment Report 2002: Transnational Corporations and Export Competitiveness* UNCTAD/WIR/2002 (illustrating the regions of the world that have been the most active in signing bilateral investment treaties).

¹⁸⁷ For an analysis of BITs on FDI, see MARY HALLWARD-DRIEMEIR, *DO BILATERAL INVESTMENT TREATIES AFFECT FDI? ONLY A BIT...AND THEY COULD BITE* 395-424 (World Bank Development Research Group Investment Climate 2003); Emma Aisbett, *Bilateral Investment Treaties and Foreign Direct Investment: Correlation versus Causation* (Dep't of Agric. & Res. Econ., UCB, Working Paper 1032, 2007); Bütthe & Milner, *supra* note 44. Statistical data on the volume of FDI and also on its geographical spread support this thesis.

It is also useful to apply FDI and look at its consequences regarding multinational corporations (MNCs), national governments, and consumers in both the host and the home countries. FDI is a politically sensitive issue because the taking of control is sometimes perceived as an attempt to weaken national sovereignty and national interest., at 171-217.

both the protection and the promotion of investment. In spite of differences in emphasis and drafting style, the majority of BITs subscribe to a common structure. They provide four types of dispositions: (1) The establishment of investment; (2) its treatment following the establishment; (3) its protection and guarantee; and (4) the settlement of disputes between States as well as between the host State and investors. To this end, there is a series of issues that BITs generally consider: Admission of investments, standards of treatment of investments, transfer of the proceeds, expropriation, and settlement of disputes.

2. *Admission of Investments*¹⁸⁸

An investment is not permitted in the territory of the host State if it is not in conformity with the domestic laws of that State. For this reason, the drafters of the majority of bilateral investment treaties consider it important to set out an express provision within the treaty conforming to the law to those of the host State. The various formulas emphasize different elements, producing a slightly different effect. For example, in the majority of BITs, the contracting parties seek to encourage, promote, and create favorable conditions for foreign investments, subject to their national legislation.¹⁸⁹ Other BITs add regulations and/or administrative practices to existing legislation. In other BITs, the obligation to admit foreign investment is subject to the Parties' rights to exercise powers conferred on them by their own legislation. Finally, a small number of BITs provide for admission of foreign investments only if the host country's authorities maintain discretionary power over its economic policy.

3. *Standard of Treatment of Investments*¹⁹⁰

How an investment is treated depends on the obligations of

¹⁸⁸ On admission of investment, see Ignacio Gómez-Palacio & Peter Muchlinski, *Admission and Establishment*, in THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 227, 227-58 (Oxford Univ. Press 2008).

¹⁸⁹ See United Nations Conference on Trade and Development, Feb. 2001, Geneva, Switz., *G-24 Discussion Paper Series: Should Countries Promote Foreign Direct Investment?* (Prepared by Gordon H. Hanson).

¹⁹⁰ On standards of treatment, see Grierson-Weiler & Laird, *supra* note 47, at 259-304.

admission, the ease with which proceeds are transferred, and agreement on a reasonable mode of dispute settlement. The majority of BITs contain the general formula of “fair and equitable treatment.” In approximately half of existing BITs, this general formula is replaced by a provision mandating that treatment should be no less favorable than that accorded to national investors or investors of any other State, whichever is more favorable.¹⁹¹

4. *Transfer*

Since ease of transfer of proceeds is crucial for a foreign investor, the majority of BITs provide for transfers without delay. Nevertheless, some BITs recognize that the balance of payments of many developing countries may make it difficult for them to allow the immediate transfer of large sums of money. In such cases, they provide for the transfer of such sums in installments. A lesser number of BITs provide for payments of interest for delay. The exchange rate is another important element; provisions concerning it are to be found in most treaties, generally with reference to the official and/or the market rate of exchange or to IMF exchange regulations.

5. *Expropriation*

There are three issues to take into account in a discussion involving an expropriation: Conditions; measures of compensation; and transfer of compensation.¹⁹²

The public interest is a consideration when embarking on any measure of expropriation in almost all BITs. Many also require the measure to be “non-discriminatory” and some even require a specific commitment not to expropriate.

The measure of compensation, and especially its amount, is expressed in a variety of ways. It would be a long and detailed study to look at these differences and understand whether they are fundamental or merely verbal. Our ambition here is just to give an

¹⁹¹ Denise Manning-Cabrol, *The Imminent Death of the Calvo Clause and the Rebirth of the Calvo Principle: Equality of Foreign and National Investors Law and Policy in International Business*, 26 LAW & POL’Y INT’L BUS. 1169, 1169-99 (1995).

¹⁹² See August Reinisch, *Expropriation*, in THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 407, 407-58 (Oxford Univ. Press 2008).

overview of the various provisions.

Approximately half of the BITs contain the Hull formula: “[P]rompt, adequate, and effective.”¹⁹³ However, the formula has not been applied literally: “Prompt” has not excluded payments over time, and “adequate” has often not been the equivalent of full value. Other BITs provide for “just,” “full,” “reasonable,” or “fair and equitable” compensation.¹⁹⁴ Another approach is to look at the value of the investment either at the date of expropriation or at the real or market value.

Finally, the transfer of compensation is to be realized without delay or without undue delay in most BITs. However, a large number of BITs envisaged the possibility of delay. In such an event, the interest should be paid at the normal commercial rate or a rate agreed upon between the Parties. All other matters relating to the transfer of compensation are governed by the main provision dealing with the transfer of the proceeds of the investment.

6. *Settlement of Disputes*

Almost all BITs contain an arbitration clause. This section will examine the two major institutions dedicated to arbitration, namely the International Centre for Settlement of Investment Disputes (ICSID) and the United Nations Commission on International Trade Law (UNCITRAL). This section will also analyze one of the three cases involving claims of expropriation of foreign investment before the International Court of Justice (ICJ). Forum shopping and inconsistency of arbitral awards in dispute resolution are the primary reasons why the creation of a multilateral framework for investment is necessary. Through these institutions, private parties have been given more opportunities to arbitrate disputes in front of international tribunals.

¹⁹³ See generally LOWENFELD, *supra* note 49, at 475-81 (discussing the Hull formula).

¹⁹⁴ See RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 (1987).

a. ICSID

The ICSID, or International Centre for Settlement of Investment Disputes, is an institution of the World Bank. The organization was founded in 1966 pursuant to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (commonly known as the ICSID Convention or Washington Convention).¹⁹⁵ As of 2009, 156 countries have signed the ICSID Convention.¹⁹⁶ The ICSID arbitrates investment disputes between member states and individual investors, providing “a forum for conflict resolution in a framework which carefully balances the interests and requirements of all the parties involved, and attempts in particular to ‘depoliticize’ the settlement of investment disputes.”¹⁹⁷

Although not a permanent arbitral tribunal, the ICSID provides a legal and organizational framework for the arbitration of disputes between contracting states and investors who qualify as nationals of other contracting states. The ICSID Convention requires that all investment disputes be arbitrated before the ICSID tribunal. The ICSID allows investment disputes to be arbitrated without interference from domestic political or judicial organs.

Arbitration under the ICSID is subject to four conditions: (1) The parties must have agreed to submit their dispute for settlement under the ICSID; (2) the dispute must be between a contracting state to the ICSID (or a subdivision or agency of that state) and the national of another contracting state; (3) the dispute must be a legal dispute; and (4) the dispute must arise directly out of an investment made in the host contracting state.¹⁹⁸ The ICSID Convention provides that, where the parties have consented to ICSID arbitration, the consent excludes any other forum or

¹⁹⁵ See generally CHRISTOPHER H. SCHREUER, *THE ICSID CONVENTION: A COMMENTARY: A COMMENTARY ON THE CONVENTION ON THE SETTLEMENT OF INVESTMENT DISPUTES BETWEEN STATES AND NATIONALS OF OTHER STATES* (Univ. Press 2001) (providing legal commentary on the Convention).

¹⁹⁶ See <http://icsid.worldbank.org>.

¹⁹⁷ Ibrahim Shihata, *Towards a Greater Depoliticization of Investment Disputes: The Roles of ICSID and MIGA*, 1 ICSID REV.: FOREIGN INV. L.J. 1, 5 (1986).

¹⁹⁸ Int'l Centre for Settlement of Inv. Disputes [ICSID], *ICSID Convention, Regulations & Rules*, art. 25(1), ICSID/15 (Apr. 2006).

remedy.¹⁹⁹ In particular, States may not exercise diplomatic protection once a claim has been submitted to the ICSID, except where there is a failure to comply with an award.²⁰⁰ In addition, where a State has consented to arbitration, it can neither withdraw consent unilaterally, nor can it require that there be an exhaustion of local remedies unless this has been made an express condition of its consent to arbitration.²⁰¹

b. UNCITRAL

The United Nations Commission on International Trade Law (UNCITRAL) is a body of member and observer states under the guidance of the United Nations.²⁰² In June 1985, the UNCITRAL drafted and later adopted the UNCITRAL Model Law on International Commercial Arbitration.²⁰³ Agreements citing the UNCITRAL Arbitration Rules may be bound to this form of dispute resolution.²⁰⁴

Many national arbitration laws are based on the UNCITRAL Model Law. The Model Law sets out the provisions to be adopted by a State for its national law and directs courts to provide assistance to the tribunal in question. Although some national laws are not based on the UNCITRAL Model Law, they nevertheless provide access to the arbitration process. This is the case of the English Arbitration Act of 1996, which provides for the enforcement of preemptory orders of the tribunal, securing the attendance of the witnesses and may order the production or preservation of evidence.²⁰⁵

The UNCITRAL Arbitration Rules were adopted by the UN Commission on International Trade Law in 1976 as a comprehensive set of procedural rules to govern international

¹⁹⁹ *See id.* §§ 26.

²⁰⁰ *See id.* §§ 27.

²⁰¹ *See id.* § 25(1), § 26.

²⁰² UNCITRAL: United Nations Commission on International Trade Law, <http://www.uncitral.org> (last visited November 12, 2009).

²⁰³ *Id.*

²⁰⁴ *Id.*

²⁰⁵ English Arbitration Act of 1996 ¶¶ 42-4, 35 I.L.M. 155 (1996).

commercial arbitrations.²⁰⁶ Despite their widespread use, there is concern that the more than thirty year-old UNCITRAL Rules need to be updated to reflect developments and changes in international arbitral practice.²⁰⁷ UNCITRAL is considering revisions to the rules.²⁰⁸

Arbitration under UNCITRAL Rules may be an option under a regional regime for investment (for example, NAFTA)²⁰⁹ or under a BIT. Alternatively, provisions may be made for a dispute to be referred to an *ad hoc* tribunal operating under UNCITRAL Rules.²¹⁰ Under BITs, arbitrations following *CME/Lauder v. the Czech Republic* are supposed to be the “first publicly known investment dispute involving bilateral investment treaties”²¹¹ to be decided under UNCITRAL Rules instead of ICSID. In that case, the dispute resolution provision in the relevant BIT (1991 BIT between Czechoslovakia and the Netherlands) provided for a dispute to be submitted to an *ad hoc* arbitral tribunal, which would determine its own procedure and would apply the UNCITRAL

²⁰⁶ For commentary on the rules in the context of foreign investment, see DAVID D. CARON, LEE M. CAPLAN, MATTI PELLONPAA, *THE UNCITRAL ARBITRATION RULES: A COMMENTARY* (Oxford Univ. Press 2006); see also STEWART ABERCROMBIE BAKER, & MARK DAVID DAVIS, *THE UNCITRAL ARBITRATION RULES IN PRACTICE: THE EXPERIENCE OF THE IRAN-UNITED STATES CLAIMS TRIBUNAL* (Kluwer Law and Taxation Publishers 1992).

²⁰⁷ See generally GEORGIOS PETROCHILOS, *PROCEDURAL LAW IN INTERNATIONAL ARBITRATION* (Oxford Univ. Press 2004) (looking at procedural law in international arbitration).

²⁰⁸ See UNCITRAL, Secretariat Note, “Settlement of commercial disputes: Revisions of the UNCITRAL Arbitration Rules,” 20 July 2006, A/CN.9/WG.II/WP.143; Jan Paulsson & Georgios Petrochilos, “Revisions of the UNCITRAL Rules” (2006), available at www.uncitral.org.

²⁰⁹ See *GAMI Inv., Inc v. United Mexican States*, Tribunal Rep. Final Award, ICSID W. BANK (2004); *Int'l Thunderbird Gaming Corp. v. United Mexican States*, Tribunal Rep. Final Award, ICSID W. BANK (2006); *Ethyl Corp. v. Canada*, Tribunal Rep. Final Award, ICSID W. BANK (1998); *Methanex Corp. v. United States of America*, Tribunal Rep. Final Award, ICSID W. BANK (2005) (NAFTA cases decided under UNCITRAL Rules).

²¹⁰ See Antonia Parra, *Provisions on the Settlement of Investment Disputes in Modern Investment Law*, 12 ICSID REV.: FOREIGN INV. L.J. 287, 287-96 (1997).

²¹¹ Giorgio Sacerdoti, *Investment Arbitration under ICSID and UNCITRAL Rules: Prerequisites, Applicable Law, Review of Awards*, 19 ICSID REV.: FOREIGN INV. L.J. 1 (2004).

Rules.²¹² Another example of a BIT requiring that the arbitral tribunal apply the UNCITRAL Rules is *Saluka Investments BV (The Netherlands) v. The Czech Republic*.²¹³

c. ICJ

The role of the International Court of Justice (ICJ) in the field of investment disputes has been quite limited. Although there have only been three cases involving claims of expropriation of foreign investment before the ICJ, i.e., the Anglo-Iranian case,²¹⁴ the Barcelona Traction case,²¹⁵ and the ELSI case,²¹⁶ we will focus our attention mainly on the ELSI case. In all three cases, the claim was dismissed, but the ICJ avoided a pronouncement on the underlying question of the responsibility of the host State to foreign investors.

i. The ELSI Case

The ICJ judgment of July 20, 1989 concerning the case *Eletronica Sicula S.p.A (ELSI)*, was developed on the grounds of the FCN between Italy and the United States,²¹⁷ signed in Rome on February 2, 1948, and completed by the Agreement Supplementing the Treaty, signed in Washington, D.C. on September 26, 1951.

In relation to the facts of the case, it is worth noting that in 1955, Raytheon, a well-known public company in the United States, invested in ELSI, which became a wholly owned subsidiary and carried on business in Palermo, Italy. The company employed fewer than one hundred people and was

²¹² Legal Opinion, UNCITRAL Arbitration Proceedings: Quantum Proceedings, *CME Czech Republic B.V. (The Netherlands) v. The Czech Republic*, 42-43 ¶¶ 143-48 (June 20, 2002) (prepared by Christoph Schreuer & August Reinisch).

²¹³ UNCITRAL Rules, Partial Award, 17 March 2006, available at <http://ita.law.uvic.ca/documents/Saluka-PartialawardFinal.pdf> (last visited Oct. 26, 2009).

²¹⁴ *Anglo-Iranian Oil Co. (U.K. v. Iran)*, 1952 I.C.J. 28 (Jan. 28).

²¹⁵ *Barcelona Traction, Light and Power Co. Ltd. (Belg. v. Spain)*, 1970 I.C.J. 3 (Feb. 5) [hereinafter *Barcelona Traction*].

²¹⁶ *Eletronica Sicula (U.S. v. Italy)*, 1989 I.C.J. 15 (July 20) [hereinafter *Eletronica*].

²¹⁷ *Infra* note .

unsuccessful in its operations.²¹⁸ Between February 1967 and March 1968, there were intensive negotiations between the Italian Government and state-owned enterprises in order to achieve a takeover of ELSI. However, these negotiations failed.²¹⁹ In March 1968, the company decided to proceed with an orderly liquidation and laid off its employees.²²⁰ On April 1, 1968, the Mayor of Palermo issued a requisition of the plant and its assets for six months, promising compensation later on.²²¹ On April 19, 1968, the company appealed against the Mayor's order to the Prefect of Palermo.²²² On August 22, 1969, the Prefect of Palermo allowed the appeal (long after the requisition came to an end and one month after the sale had been announced).²²³ On April 26, 1968, the company filed a petition for bankruptcy. On May 16, 1968, a decree for bankruptcy was published. On July 12, 1969, a fourth auction was held, resulting in the acquisition of ELSI by ELTEL (Industria Elettronica Telecomunicazioni S.p.A.), a subsidiary of the Istituto per la Ricostruzione Industriale (IRI) set up in December 1968.²²⁴

As for the procedure, on June 16, 1970, the trustee in bankruptcy brought an action against the Republic of Italy, claiming damages for the requisition. The Court of First Instance dismissed the action on February 2, 1973. On January 24, 1974, the Court of Appeal declared the acquisition unlawful and awarded a "rental" payment.²²⁵ On April 26, 1975, the *Corte di Cassazione* (Italian Supreme Court) confirmed the decision of the Court of Appeal. Meanwhile, on February 7, 1974, the United States submitted its claim on behalf of Raytheon.²²⁶ Italy rejected the claim on June 13, 1978, and provided no formal answer to the United States for over four years.

²¹⁸ *Id.* ¶ 13.

²¹⁹ *Id.* ¶ 15.

²²⁰ *Id.* ¶ 20.

²²¹ *Id.* ¶ 30.

²²² Elettronica ¶ 34.

²²³ *Id.* ¶ 41.

²²⁴ *Id.*

²²⁵ *Id.* ¶ 43.

²²⁶ *Id.* ¶ 46.

Following these developments, several problems arose. First, Italy claimed the non-exhaustion of local remedies. Second, the United States claimed the requisition of the ELSI plant by the Mayor of Palermo. As a consequence, shareholders of the company lost their right to “control and manage.”²²⁷ An issue then arose regarding the protection and security of nationals and their property, as well as the lawfulness of the requisition. Third, the United States claimed that the requisition was a discriminatory act.

As for the first problem, the Court rejected the U.S. complaint, finding that Italy was not guilty of any international illegality, tort or wrong, stating: “Italy has not been able to satisfy the Chambers that there clearly remained some remedy which Raytheon and Machlett, independently of ELSI, and of ELSI’s trustee in bankruptcy, ought to have pursued and exhausted.”²²⁸ The Chamber rejected the objection to non-exhaustion of local remedies.

The Court addressed three issues regarding the requisition. The first issue was the phrase “right to control and manage.”²²⁹ The Court considered the financial situation of ELSI at the time of the requisition and affirmed that “it cannot be said that it was the requisition that deprived it of this faculty of control and management.”²³⁰ Second, the Court continued its analysis by arguing that “[t]he essential question is whether the local law, either in its terms or in its application, has treated United States nationals less well than the Italian nationals. This, in the opinion of the Chamber, has not been shown.”²³¹ The Mayor’s decision did not cause the loss of property; therefore no compensation was justified. Third, the requisition could be regarded as unlawful only if it caused or triggered the bankruptcy. In this case, the requisition did not cause the bankruptcy and loss in value of the plant’s assets.

When affirming that “compliance with municipal law and compliance with the provisions of a treaty are different

²²⁷ *Id.* ¶ 120.

²²⁸ *Id.* ¶ 63.

²²⁹ *Id.* ¶ 70.

²³⁰ *Id.* ¶ 101.

²³¹ *Elettronica* ¶ 108.

questions,”²³² the Court considered the developments before the Italian Courts. Both the Court of Appeal and the *Corte di Cassazione* found that the requisition was unlawful. There is no doubt that Italian law considers that kind of act unlawful. The striking issue is that, in terms of international law, the requisition was said to be lawful. Generally, the standards of international law, especially those of treaties designed to protect foreign investors, are not lower than those of municipal legal systems. The Court was in a difficult position, since declaring the requisition unlawful on the grounds of the U.S. complaint (as the cause of ELSI’s financial situation) would not have been correct. The plant was already in bankruptcy before the requisition was operated. Yet, the Court did not reason this way; it denied the international illegality itself.

The United States alleged the illegality on grounds of three provisions of the Friendship, Commerce and Navigation Treaty (including the Protocol and Supplementary Agreement).²³³ The Court entered into a detailed analysis of the company’s financial situation. Instead of declaring that Italy violated the Articles of the Treaty, the Court claimed that Raytheon suffered no damage due to the precarious financial situation of ELSI, ultimately leading to bankruptcy.²³⁴ The United States complained about the loss of the “right to manage and control”²³⁵ the company, not about its financial situation, which had actually been precarious since March 1968, when the company decided to liquidate. When one loses the right to manage and control a company, somebody else must acquire it. In reality, it is only by means of the requisition that a change was made. This right was transferred to the Mayor of Palermo.

Last in this trilogy of problems, the Court also ruled that prohibition of arbitrary government conduct need not be tied to a specific financial loss. It focused on the nature of the action, whether arbitrary or discriminatory, rather than its effects. If such

²³² *Id.*

²³³ Treaty of Friendship, Commerce and Navigation, U.S.-Italy, Feb. 2, 1948, 63 Stat. 2255, art. III, V, VII.

²³⁴ *Electronica* ¶ 135.

²³⁵ *Id.* ¶ 15.

action is discriminatory or arbitrary, then there is a breach of the Treaty. Insufficient evidence existed to support the idea that ELSI was discriminated against because of its foreign ownership. Moreover, the interpretation of the Mayor's decision following the Court's definition of an arbitrary conduct²³⁶ gives reasons to criticize it. It shows that there is no real test of arbitrariness within the Court. The Court's failure to establish an objective and explicit standard means that in practice, its decision is unpredictable, and that the Court does not necessarily have to justify its decisions. An objective standard would have reinforced the Court's decisions and the parties' ability to bring the best arguments.²³⁷

The *ELSI* case is an unexpected development in the ICJ case law on the issue of shareholders' rights. It is difficult to interpret the decision because it is either a very important change in the Court's view or the reinforcement of its previous case law.

In previous decisions, particularly in the *Barcelona Traction* case,²³⁸ the Court quite firmly rejected the possibility of according shareholders with diplomatic protection as a general rule.²³⁹ Customary international law allows a State to bring a complaint on behalf of the damaged company and against the State responsible for the injury (generally the State where the company is established). In *Barcelona Traction*, the Court did not address the question of the shareholders (foreign investors): They cannot enjoy diplomatic protection either from their national State or from the national State of the company, since this is the State against which the claim should be directed.²⁴⁰ This leaves shareholders without any protection under international law. They

²³⁶ “[Arbitrary conduct is] a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety.” *Id.* §128.

²³⁷ See Kurt J. Hamrock, *The ELSI Case: Toward an International Definition of Arbitrary Conduct*, 27 TEX. INT'L L.J. 837 (1992) (proposing a test defining “arbitrary conduct” more explicitly than the standard applied in the *ELSI* case).

²³⁸ *Barcelona Traction*, *supra* note 215.

²³⁹ See Roberto Bruno & Joseph H. H. Weiler, *Access of Private Parties to International Dispute Settlement: A Comparative Analysis* (The Jean Monnet Center for Int'l and Regional Econ. Law and Justice, Working Paper No. 13/97, 1997), available at <http://www.jeanmonnetprogram.org/papers/97/97-13.html>.

²⁴⁰ *Barcelona Traction*, *supra* note 215.

are forced to rely exclusively on the laws and procedures of the host State, with all the risks and uncertainties that follow.²⁴¹

It is surprising that the *ELSI* Court did not make any reference to *Barcelona Traction*.²⁴² This silence makes interpretation of the *ELSI* case on this particular issue even more difficult.

It is also interesting to discuss the legal standing of the claimant State. The United States acted on behalf of its two national companies, which were the controlling shareholders of *ELSI*. The issue was whether the United States was allowed to exercise diplomatic protection on behalf of its nationals, shareholders of an Italian company against which violations of the 1948 Treaty of Friendship, Commerce and Navigation (FCN) between Italy and the U.S. were committed. Following *Barcelona Traction*, such an action would not be allowed. This was not the conclusion of the Court.²⁴³

The Court's reasoning was based on the FCN Treaty. It held that, concerning the acts committed against a corporation, the Treaty conferred rights on shareholders as well.²⁴⁴ The traditional distinction between shareholder and corporation interests was only implicit. The important outcome of the case was that it lessened the importance of this distinction; the prevailing matter was the adequate protection of the investments. This matter has yet to be supported and encouraged by adequate provisions.

What lessons can be learned for future investment treaties? The *ELSI* case was brought on the grounds of an existing FCN Treaty between the U.S. and Italy. Four lessons can be learned from this case:

- Treaties should be drafted so as to entitle foreign investors to make claims with respect to acts suffered by a domestic company substantially owned by the investors.
- The standards concerning expropriation should be viewed broadly. When a treaty states that investments "shall not be nationalized, expropriated or subject to measures having

²⁴¹ *Id.*

²⁴² *Id.*

²⁴³ *Id.*

²⁴⁴ *Id.*

effect equivalent to nationalization or expropriation,”²⁴⁵ it uncertain whether these provisions cover the requisition. In any case, the ICJ does not seem to be ready to take such a broad view.

- States must consider the translation of agreements, and the meaning of words in the different languages concerned. The fact that the U.S. allowed “taking” to be translated as “expropriation,” and “interests” as “rights” is not easily comprehensible.
- Finally, Judge Schwebel’s mention of the Vienna Convention on the Law of Treaties between States and International Organizations or between International Organizations (VCLTIO),²⁴⁶ and in particular Article 31 shows the importance of specificity.²⁴⁷ The interpretation of treaties is a very broad and widely commented issue.²⁴⁸ The *ELSI* case shows that general words do not seem to be good enough; they must be, therefore, supplemented by more specific ones, making it impossible to deny investment protection where it was indeed intended.

The overview of the BITs content was aimed at giving a general idea of the kind of issues discussed in these treaties and also at arguing that, even though there is a high number of BITs signed, there are not as many varieties of provisions. The differences are more often verbal than substantial.

²⁴⁵ See, e.g., UK-Costa Rica BIT art. 5(1) (1982).

²⁴⁶ The 1986 Vienna Convention on the Law of Treaties articulates the basic rules applied to the interpretation of treaties.

²⁴⁷ See Vienna Convention on the Law of Treaties Between States and International Organizations or Between International Organizations, art. 31, Mar. 21, 1986 (outlining the “good faith” interpretation of treaties as well as other factors that will be taken into account).

²⁴⁸ See RICHARD K. GARDINER, *TREATY INTERPRETATION* (Oxford University Press 2008); see also MARK E. VILLIGER, *COMMENTARY ON THE 1969 VIENNA CONVENTION ON THE LAW OF TREATIES* (Martinus Nijhoff 2009).

*D. Regionalism*²⁴⁹

Regionalism may be an alternative to bilateralism and yet is short of multilateralism. There are attempts at the regional level to build a more institutionalized framework for investment. We shall analyze the kind of framework obtained through a BIT or through a regional agreement, and the multilateral framework. Could it be that multilateralism does not suit investment? To answer this question, we will focus on two regional blocs: the European Union (EU) and the North American Free Trade Agreement (NAFTA). We will also look at the enforcement of Article XXIV of GATT.

*1. The European Union*²⁵⁰

The most widely used European rules applicable to investment are the combination of two different series of provisions: Article 56 of the EC Treaty, regarding the freedom of capital movement,²⁵¹ and Article 43 of the EC Treaty, regarding the freedom of establishment.²⁵² The European Commission issued a communication on intra-EU investment aimed at interpreting the two above-mentioned Articles.²⁵³

a. Freedom of Capital Movement

Freedom of capital movement is one of the four fundamental

²⁴⁹ Bilateralism/regionalism is the normal consequence of failed multilateralism. See Rafael Leal-Arcas, *The Resumption of the Doha Round and the Future of Services Trade*, 29 LOY. L.A INT'L & COMP. L. REV. 339, 409-15 (2007).

²⁵⁰ The European Union (EU) is an intergovernmental and supranational union of twenty-seven European countries, known as EU Member States. See LEAL-ARCAS, THEORY AND PRACTICE, *supra* note 119, at 86-89 (stating that the European Union was established under that name in 1992 by the Treaty on European Union (the Maastricht Treaty). The European Union's activities cover all areas of public policy, from health and economic policy to foreign policy and defense).

²⁵¹ Treaty Establishing the European Community art. 56, 1997 O.J. (C 340) 3 [hereinafter EC Treaty] (prohibiting "all restrictions on the movement of capital between Member State and between Member States and third countries").

²⁵² *Id.* art. 43 (prohibiting "restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State," including "restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State").

²⁵³ See Communication of the Commission on Certain Legal Aspects Concerning Intra-EU Investment No. C 220/15 of 7 July 1997, 1997 O.J. (C 220) 06.

freedoms introduced in the EU by the Treaty of Rome.²⁵⁴ Restrictions on capital movements are called exchange and investment controls. These restrictions limit capital outflows, import and export of certain goods or services and some types of foreign investment.²⁵⁵ Exchange controls restrict transactions such as the inward or outward flow of investment capital and repatriation of the proceeds of investment, depending on the policy goal.²⁵⁶ States that use exchange and investment controls apply monetary policies more or less broadly, thereby totally preventing types of capital movements or restricting them in part.²⁵⁷

The free movement of capital in Europe was significantly transformed by the Maastricht Treaty. This section will consider the evolution from the Treaty of Rome to the Treaty of Maastricht as it portrays the development of this freedom through the years.

*i. Rules as Designed by the Treaty of Rome*²⁵⁸

In the Treaty of Rome, Articles 67 to 73 of the Treaty Establishing the European Economic Community (EEC) deal with the freedom of capital movement. We will focus only on those characteristics that were changed by the Maastricht Treaty in order to underline the evolution that took place.

While the freedom of capital movement was one of the four fundamental freedoms, its treatment in the EEC Treaty suggested it was less peremptory than the other three. Article 67 (1) of the EEC limits the progressive abolishment of restrictions on capital movements, as well as discrimination based on nationality and place of residence, to the extent necessary to ensure proper functioning of the common market.²⁵⁹ The liberalization of capital movements is seen, therefore, from a purely European perspective, as a tool to accomplish the idea of a common market, not as an

²⁵⁴ *Infra* note

²⁵⁵ GEORGE A. BERMAN ET AL., CASES AND MATERIALS ON EUROPEAN UNION LAW 1173 (West Group 2d ed. 2002).

²⁵⁶ *Id.*

²⁵⁷ *Id.*

²⁵⁸ Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11 [hereinafter EEC Treaty].

²⁵⁹ *Id.* art. 67(1).

issue *per se*.

The only two provisions that regard the liberalization of capital movements independently from the other auxiliary aims are Article 68 (1) of the EEC Treaty, which requires the States to grant exchange authorizations,²⁶⁰ “in the most liberal manner possible,” and Article 71 of the EEC Treaty, which requires EU Member States to endeavor to avoid the introduction of new exchange restrictions on capital movements.²⁶¹ The provisions on the free movement of goods of the EEC Treaty establish a “prohibition between Member States of custom duties on imports. . . .”²⁶² The focus is extremely different from one freedom to the other, as there is a considerable difference between the “most liberal manner possible” requirement and a general prohibition.

“The wording of these Treaty Articles necessarily had an impact on the way in which the European Court of Justice (ECJ) approached this area.”²⁶³ In *Casati*, the Court retained the idea of less peremptory measures while interpreting them.²⁶⁴

ii. Rules as Changed by the Treaty of Maastricht

The Treaty of Maastricht completely revised the provisions on free movement of capital.²⁶⁵ The freedom of capital movements entered a new era in 1990 and became fully liberalized within the EC.²⁶⁶ In 1993, with the entry into force of the Maastricht Treaty, this fundamental freedom gained the same status as the other single market freedoms, and its governing principles were inserted

²⁶⁰ *Id.* art. 68(1).

²⁶¹ *Id.* art. 71.

²⁶² *Id.* art. 9(1).

²⁶³ PAUL CRAIG & GRAINNE DE BURCA, *EU LAW: TEXT, CASES AND MATERIALS* 645-46 (Oxford Univ. Press 4th ed. 2008).

²⁶⁴ Case 203/80, *Casati*, 1981 E.C.R. 2595 (1981).

²⁶⁵ See Leo Flynn, *Coming of Age: The Free Movement of Capital Case-Law 1993-2002*, 39 COMMON MKT L. REV. 773 (2002).

²⁶⁶ The European Community (EC) was created by the Treaty of Rome of 1957, whereas the EU was created by the Maastricht Treaty on European Union in 1992. Currently, the entities co-exist. See LEAL-ARCAS, *THEORY AND PRACTICE*, *supra* note 119, chap. 2.

in the EC Treaty.²⁶⁷ The current provisions included in the EC Treaty are Articles 56 to 60.

These new provisions consider the freedom of capital movement as an independent issue, abolishing the limited perspective of the Treaty of Rome.²⁶⁸ The other innovation is that EU Member States and third countries seem to receive equal treatment. This is, however, false; the Articles following Article 56 of the EC Treaty—which establishes full freedom as a rule—qualify the application of that provision, introducing a series of specific exceptions.²⁶⁹ They give the right to the EC or its Member States to maintain or introduce restrictive measures, in particular with respect to foreign ownership of EU assets. Article 57 (1) allows the lawful restrictions on such capital movements existent on December 31, 1993, to remain.²⁷⁰ Article 57 (2) requires the Council to endeavor to achieve free movement of capital with third countries “to the greatest extent possible.”²⁷¹ This formula leaves a great deal of interpretation to the EU Council.

The EU Council is also empowered to take safeguarding measures in exceptional circumstances when capital movements to and from non-member states may threaten to cause serious difficulties for the operations of the economic and monetary union.²⁷² The power left to the Council may seem too great, but there are three limitations. First, the measures taken under Article 59 of the EC Treaty are temporary, lasting only for a maximum of six months.²⁷³ Second, they may be taken only when “*strictly necessary*.”²⁷⁴ Finally, “unanimity shall be required for measures . . . which constitute a step back in Community law as regards the

²⁶⁷ See Council Directive 88/361, 1988 O.J. (L 178) 5 (establishing the basic principle of free movement of capital as a matter of EC law, with effect from July 1, 1990).

²⁶⁸ EEC Treaty, *supra* note 231, art. 67(1).

²⁶⁹ See EC Treaty, *supra* note 251.

²⁷⁰ See *id.* art. 57(1).

²⁷¹ See *id.* art. 57(2).

²⁷² See *id.* art. 59.

²⁷³ See *id.*

²⁷⁴ *Id.* (emphasis added).

liberalization of the movement of capital to or from third countries.”²⁷⁵ These three limitations act as a sort of guardians of the law.

Other exceptions are found, as was stated previously, in the Articles following Article 56. The main exception is Article 58 (1), which recognizes the right of EU Member States “to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested”²⁷⁶ and “to take all requisite measures to prevent infringements of national law and regulations.”²⁷⁷ These two exceptions are subject to Article 58 (3), which provides that the measures taken “shall not constitute a means of arbitrary discrimination or a disguised restriction” to free movement of capital or payments.²⁷⁸ In other words, the measures have to be objectively justified. It also means that the Member States will have to bring proof of the necessity of different treatment in order to protect the tax system and also of equivalent measures taken in relation to any equivalent domestic product.²⁷⁹ This last remark is supported by the decisions of the ECJ in the *Conegate*²⁸⁰ and *Adoui and Cornuaille*²⁸¹ cases.

Finally, in order to have a complete overview of the rules on free movement of capital, one should mention Articles 119²⁸² and 120 of the EC Treaty.²⁸³ These provisions give a qualification of a

²⁷⁵ EC Treaty art. 57(2).

²⁷⁶ *Id.* art. 58(1)a.

²⁷⁷ *Id.* art. 58(1)b.

²⁷⁸ *Id.* art. 58(1)c.

²⁷⁹ CRAIG & DE BURCA, *supra* note 263, at 724.

²⁸⁰ Case 121/85, *Conegate v. H.M. Customs and Excise Commissioners* E.C.R 1007 (1986).

²⁸¹ Cases 115 and 116/81, *Adoui and Cornuaille v. Belgium*, E.C.R 1665 (1982).

²⁸² See EC Treaty, *supra* note 251, art. 119 (stating that “[w]here a Member State is in difficulties or is seriously threatened with difficulties as regards its balance of payments . . . the Commission shall immediately investigate the position of the State in question and the action which . . . that State has taken or may take . . .”).

²⁸³ See *id.* art. 120 (stating that during a balance of payments crisis, “the Member State concerned may, as a precaution, take the necessary protective measures”).

different nature with respect to Article 56. These two Articles envisaged a balance-of-payment²⁸⁴ crisis prior to the entry into force on January 1, 1999, of the third step of the European Monetary Union. It is pertinent to mention these Articles as they constitute one of the numerous emergency provisions designed by the EC Treaty. It is a two-step strategy. First, a Community-sponsored situation is sought (Article 119); if not found, a unilateral action by the EU Member State is allowed (Article 120).

b. Freedom of Establishment

The EC Treaty provisions that concern the freedom of establishment are contained in Articles 43 to 48. Two kinds of situations are regulated throughout these Articles: Natural persons (workers, students, retired persons) and legal persons (companies, branches, subsidiaries, agencies). We will focus on the second category.

Article 43 prohibits any kinds of "restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State." In regard to companies, this provision also applies to the various forms of secondary establishment—subsidiary, branch or agency.

Article 48 provides that the "companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States."²⁸⁵ This would be difficult to carry out as there are many differences between natural and legal persons.²⁸⁶ The alternative would be to distinguish between primary and secondary establishment in the case of a registered office of a company opposed to one of its subsidiaries or branches. In practice, despite the many company law directives adopted,²⁸⁷

²⁸⁴ The balance of payments (BOP) measures the payments that flow between any individual country and all other countries. See INT'L MONETARY FUND, BALANCE OF PAYMENTS MANUAL, *supra* note 5.

²⁸⁵ EC Treaty, *supra* note 225, art. 48.

²⁸⁶ CRAIG & DE BURCA, *supra* note 251, at 756.

²⁸⁷ Under Article 46 (2) EC, "[t]he Council shall, acting in accordance with the procedure referred to in Article 251, issue directives for the coordination of the

there are still considerable differences in how various EU Member States regulate companies and their activities.

*c. Foreign Investment in International Agreements
where the EC is a Party*

Acknowledging the importance of foreign investment regulation, the EC has incorporated foreign investment in association agreements with third countries. The EC Treaty does not offer a specific legal basis enabling the EC to take external action in the field of foreign investment. Unlike issues of trade, EC competence on foreign investment has always been limited²⁸⁸ and still remains vague.²⁸⁹ The lack of an explicit legal basis on foreign investment has been the result of the reluctance of Member States to hand over to the EC any competence over foreign investment matters.²⁹⁰ This is especially true since the EC has taken initiatives and concluded BITs with third party countries, thus formulating the basic regulatory framework for the treatment and protection of their investors abroad.²⁹¹ Nevertheless, the EC Treaty includes a number of provisions that enable the EC to take action and conclude international agreements with third countries in the field of foreign investment.

abovementioned provisions.”

²⁸⁸ Wenhua Shan, *Towards a Common European Community Policy on Investment Issues*, 2 J. WORLD INV. & TRADE 603, 603 (2001).

²⁸⁹ *Id.* See Jan Ceyskens, *Towards a Common Foreign Investment Policy? Foreign Investment in the European Constitution*, 32 LEGAL ISSUES OF ECON. INTEGRATION 259 (2005); Joachim Karl, *The Competence for Foreign Direct Investment*, 4 J. WORLD INV. AND TRADE 414 (2003) (analyzing EC competence over foreign investment under the Constitutional Treaty and the Lisbon Treaty).

²⁹⁰ The supranational efforts in the EU toward providing the EU with exclusive competence in FDI with the Lisbon Treaty articulate the need to have a harmonized system of investment regulation. Article 207 of the Treaty on the Functioning of the EU extends the scope of the EU’s common commercial policy, including thereby FDI as part of it. See Rafael Leal-Arcas, *50 Years of Trade Policy: Good Enough or as Good as it Gets?*, 15 IRISH J. EUROPEAN LAW, 157 (2008); see also Rafael Leal-Arcas, *Is Lisbon the Answer or the Anathema to EC Trade Law and Policy?*, 2 INT’L J. LIAB. & SCIENTIFIC ENQUIRY 125 (2009).

²⁹¹ Due to the emphasis placed on investment protection against expropriation, which can be associated with the pursuance of national interests, EU Member States have consistently considered that international foreign regulation lies under their own exclusive competence.

As mentioned above, the EC Treaty makes an explicit reference to foreign investment in Article 56 on capital movements, while a number of provisions touch upon specific aspects of foreign investment regulation. For example, the provisions on freedom of establishment and the EC's common commercial policy arguably grant some competence to the EC with regard to the entry and operation of foreign investment. Furthermore the open-ended scope of provisions on harmonization in the internal market could arguably enable the EC to regulate protection of foreign investment from expropriation, and the chapter on development cooperation adds another legal basis that could be used for inserting investment promotion provisions in international agreements concluded by the EC with an investment component.²⁹²

In order to avoid the opposition of EU Member States, the EC has considered its foreign investment policy complementary to that of its Member States, inserting provisions on issues such as capital movements and investment promotion as a field of development cooperation.²⁹³ The EC has gradually expanded its foreign investment policy in other areas of foreign investment regulation, in particular concerning entry and operation of foreign investment. Given that EC competence in these fields is shared, the exercise of its competence also preempts EU Member States from taking any further action, thus rendering these aspects of foreign investment regulation under exclusive EC competence.²⁹⁴ This internal power struggle between the EC and its Member

²⁹² See generally LEAL-ARCAS, *THEORY AND PRACTICE*, *supra* note 119, chap. 4 (analyzing competences and distribution of powers in the EU).

²⁹³ Olufemi Babarinde & Gerrit Faber, *From Lomé to Cotonou: Business as Usual?*, 9 *EUROPEAN FOREIGN AFFAIRS REV.* 27, 33-35 (2004).

²⁹⁴ EC competence in the field of the internal market, as well as in the field of the common commercial policy with regard to some services within trade in services, is shared with the EU Member States. For literature in this respect, see Marise Cremona, *A Policy of Bits and Pieces? The Common Commercial Policy After Nice*, 4 *CAMBRIDGE YEARBOOK OF EUROPEAN LEGAL STUDIES* 61, 84 (2001). The competence is rendered exclusive once the EC has adopted common rules in the field and exclusivity is necessary to avoid any effect on the common rules which may result from autonomous action taken by the EU Member States (ERTA-type exclusivity). For an analysis of ERTA-type exclusivity, see PANOS KOUTRAKOS, *EU INTERNATIONAL RELATIONS LAW* 84-88 (Hart Publishing 2006).

States has been made explicit in practice, as the EC has insisted on the re-negotiation of the BITs between the recently acceded Central and Eastern European Member States and the United States. The EC has also brought infringement proceedings against individual EU Member States for having concluded BITs that are incompatible with the EC Treaty.²⁹⁵

Foreign investment provisions are incorporated in agreements that have divergent objectives and aim at different levels of political, economic, and social integration. As the EC has opted for broader association agreements dealing with a variety of external policy issues, regulation of foreign investment is only part of the broader framework, being influenced by the general objectives pursued. Considering the orientation of EC external policy with regard to developing countries and its emphasis on their development and integration in the world economy,²⁹⁶ it is understandable that the Economic and Partnership Agreement between the EC and thirteen CARIFORUM countries places emphasis on the development aspects of foreign investment regulation. Moreover, the promotion of a broad and innovative system of rules on foreign investment in, for example, association agreements is linked with the EC external policy objective of establishing itself as an important actor in international economic relations.

The breadth and innovative scope of foreign investment provisions illustrates the attempt of the EC to exert its own model of international economic regulation to its partners. The EU takes advantage of its size and economic power in order to somehow impose on its partners international rules on foreign investment

²⁹⁵ On the re-negotiation of the BITs between EU Member States and the U.S., see KOUTRAKOS, *supra* note 294, at 321-25. Furthermore, the European Commission has initiated action against Sweden and Finland requiring that these countries change their BITs in order to conform to EC law. See Case C 249/06, *Comm'rs of the European Community v. Kingdom of Sweden*, 2009 E.C.R. 000; [Finland case – C-118.07 (not available in English)].

²⁹⁶ On EU external development policy, see Joint Statement by the Council and the Representatives of the Governments of the Member States meeting within the Council, the European Parliament and the Commission on European Union Development Policy, 'The European Consensus', 2006 O.J. (C46) 1; see also Karin Arts, *ACP-EU Relations in a New Era: The Cotonou Agreement*, 40 COMMON MKT L. REV. 95 (2003).

and gradually improve its international position, affecting future bilateral and multilateral agreements on foreign investment.²⁹⁷ Considering the reluctance of states, and in particular developing countries, to assume further international obligations on foreign investment, the EU promotes a development-friendly legal framework, which arguably takes into account both the economic interests of capital exporting countries and the needs for development of capital importing countries. Consequently, the EU meets less resistance in promoting its own model of international foreign investment regulation and enhances its presence as a key actor in the international field.

d. Are the EC Treaty Provisions the Only Rules Applicable?

Except for the free movement of capital and the freedom of establishment contained in the EC Treaty, there are various sources that produce, if not rules, at least measures that affect the treatment of investors and their investments in EU Member States. In this non-classified category,²⁹⁸ one should place the unilateral measures taken by EU Member States,²⁹⁹ the measures taken by Member States within the exercise of power received under the EC Treaty, as well as those measures that are directly based on customary law. In a way, these different sources cover the issues that the EC Treaty does not, but in a much more chaotic manner as there is no unification on these topics. It is generally accepted, for example, that in the case of the nationalization of private party property, compensation must be paid in exchange. This general consensus does not apply when calculating compensation³⁰⁰ and when the State claims to have acted within its regulatory powers.

The preliminary observation at this point is that the few rules

²⁹⁷ TREBILCOCK & HOWSE, *supra* note 174, at 385-87.

²⁹⁸ By "non-classified" category we understand all the measures that are not part of a commonly agreed document, as the EC Treaty, but that, nevertheless, have an impact on investment.

²⁹⁹ Since the 1980s, various developed countries, and recently developing countries as well, have chosen to take measures that liberalize investment in a unilateral manner.

³⁰⁰ Extensive case law has been developed on the compensation issue. It is generally admitted that it has to be prompt, equitable, and effective, but both its calculation and its effective payment are subject to complicated arguments.

clearly stated by the EC Treaty cover only a very small part of the investment area; the most important rule is still either derived from more general provisions and applied specifically to investment matters or left to the national authorities to develop. For a more comprehensive structure that creates more legal certainty, there should be a specialized investment-related set of measures. This rule should state not only the original measures, but also the measures based on customary law that one might be tempted to take for granted.

In summary, the most important characteristics of the regime as settled by the EC Treaty provisions are:

- The non-discrimination principle;³⁰¹
- The lack of any apparent direct effect;
- A false impression of equal treatment for EU Member States' nationals and third countries' nationals, when in fact there are many exceptions to the initial liberalization principle;
- The focus on regulating rather than liberalizing;
- The lack of reference to international or customary law.

As exemplified by the Economic and Partnership Agreement between the EC and thirteen CARIFORUM countries, international investment agreements where the EC is a party present a significant step towards systematic, complete, and balanced international foreign investment regulation. This argument also illustrates the attempt to introduce new provisions into international foreign investment regulation which take into consideration the interests of foreign investors and home and host states and establish a nuanced balance between divergent interests. Such an agreement creates a favorable regulatory environment by liberalizing entry of foreign investment and including commitments concerning investment promotion. This effort is complemented by a network of provisions which guarantees the sustainable-development orientation and effectiveness of foreign investment provisions, aimed at ensuring the maximization of benefits from foreign investment. However, the unwillingness of

³⁰¹ See Koen Lenaerts, *L'Egalité de Traitement en Droit Communautaire*, 27 CAHIERS DE DROIT EUROPÉEN 3 (1991); see also Case 8/78, *Milac GmbH v. Hauptzollamt Freiburg*, 1978 E.C.R. 1721, ¶ 18; Case C-442/00, *Caballero v. Fondo de Garantía Salarial (Fogosa)*, 2002 E.C.R. I-11915, ¶¶ 30-32.

the EU to include private investor or home state obligations concerning their adherence to sustainable-development objectives weakens the effective implementation of development policies and questions the overall development orientation of the Economic and Partnership Agreement between the EC and thirteen CARIFORUM countries.

2. *The North American Free Trade Agreement*

a. *Main Characteristics of the Regime*

NAFTA Chapter 11 organizes a very experimental and complete regime for investments. It is the first regional agreement to have a specific chapter on investment. One of the most important innovations of such a regime is the investor-State dispute resolution mechanism, which gives investors the right to directly defend their rights in front of a State that may have violated these rights. This mechanism diverges from the legal schemes of prior investment arrangements where investors had to rely exclusively on the diplomatic protection of their own State. It is useful to underline the characteristics of the NAFTA regime. The main principles at the basis of Chapter 11 are:

- The most-favored-nation principle;³⁰²
- The national treatment principle;³⁰³
- The minimum standard regime (Article 1105);³⁰⁴
- More rules than exceptions: the aim is to liberalize not to

³⁰² See U.N. CONFERENCE ON TRADE & DEV., MOST-FAVoured-NATION TREATMENT at 1, U.N. Sales No. E.99.II.D.11 (1999); see also Amarasingha & Kokott, *supra* note 137, at 125; *supra* text accompanying note 139.

³⁰³ National treatment is “the principle whereby a host country extends to foreign investors treatment that is at least as favourable as the treatment that it accords to national investors in like circumstances. In this way, the national treatment standard seeks to ensure a degree of competitive equality between national and foreign investors.” U.N. Conference on Trade & Dev., National Treatment at 1, U.N. Sales No. E.99.II.D.16 (2000); see also GATT art. III, XVII; TRIPS art. 3; *supra* text accompanying note 113.

³⁰⁴ According to an international investment arbitration tribunal, minimum standards of treatment provide “a floor below which treatment of foreign investors must not fall, even if a government were not acting in a discriminatory manner.” *S.D. Myers, Inc. v. Canada, Partial Award*, ¶ 259 (NAFTA Ch. 11 Arb. Trib. Nov. 13, 2000); see also NEWCOMBE & PARADELL, *supra* note 49, chap. 6.

regulate;

- Direct access of private parties to the settlement of disputes system; and
- Application to all investments, including those of third countries to the provisions of Articles 1106 (performance requirements) and 1109 (environmental measures).

b. Overview of the Existing Rules

Chapter 11 of the NAFTA is controversial because it deals with obligations of NAFTA parties to foreign investors and rules for resolving disputes that inevitably arise. Chapter 11 essentially provides an arbitration process whereby private corporations in one NAFTA country can sue the government of another NAFTA party if they feel that their investment rights under NAFTA were violated.³⁰⁵ Chapter 11 is divided into two sections. One concerns investment (Section A) and the other, dispute settlement (Section B).

i. Investment

Section A of Chapter 11 covers the measures adopted by a Party (i.e., any level of the government) that affect:³⁰⁶

- investors of another Party;³⁰⁷
- investment of investors of another Party;³⁰⁸ and
- for purposes of the provisions on performance requirements and environmental measures, all investments in the territory of the Party.³⁰⁹

NAFTA Article 1101 also recognizes the right of a Party to perform functions, such as enforcement of provisions, and to

³⁰⁵ Millar Kreklewetz LLP, Investor Disputes Under Chapter 11 of the North American Free Trade Agreement (NAFTA), http://taxandtradelaw.com/Content/Practice_Index/NAFTA_Chapter_11.html (last visited Oct. 23, 2009).

³⁰⁶ This section does not apply to any measure to the extent it is covered by Chapter 14 relating to financial services.

³⁰⁷ North American Free Trade Agreement, Dec. 17, 1992, U.S.-Can.-Mex. art. 1101 1(a), 32 I.L.M. 289 [hereinafter NAFTA].

³⁰⁸ *Id.* art. 1101 1(b)

³⁰⁹ *Id.* art. 1101 1(c).

provide social welfare and health services. Some exceptions concerning Mexico are also stated.³¹⁰

In this section, two different types of measures are found: liberalizing measures (Articles 1102 to 1104 and 1106) and protective measures (Articles 1105 and 1110). These provisions are discussed below.

*A. Investment liberalization measures -
Articles 1102 to 1104 and 1106 of the
NAFTA*

NAFTA Article 1102 sets out the obligation of national treatment for investors and their investments “with respect to establishment, expansion, management, conduct, operation, and sale or other disposition of investments.”³¹¹ National treatment means that a Party will treat investors of other Parties and their investments as favorably as it treats its own investments, in like circumstances.³¹² It actually means the best treatment provided by a government to any investor or investment, both in the pre- and post- establishment phases.³¹³ The second most important principle of the NAFTA—the most-favored-nation (MFN) principle—is found in Article 1103.³¹⁴ Article 1104 entitles a party to the most favorable treatment provided by either national treatment or the most-favored nation principle.³¹⁵ Article 1106 prohibits the imposition and enforcement of a certain number of specified performance requirements and the use of specified performance requirements as conditions. This includes preferencing domestic sourcing of goods and restricting domestic sales by tying such sales to export performances.³¹⁶ Permitted measures include the necessity to protect human, animal, and plant life or health.

³¹⁰ *Id.* art. 1101 4.

³¹¹ *Id.* art. 1102.

³¹² See SICE—Foreign Trade Information System, available at <http://www.sice.oas.org> (last visited Oct. 23, 2009).

³¹³ *Id.*

³¹⁴ NAFTA, *supra* note 307, art. 1103.

³¹⁵ *Id.* art. 1104.

³¹⁶ *Id.* art. 1106.

*B. Investment protection measures—NAFTA
Articles 1105 and 1110*

Investment protection measures are highly important as they reduce any sort of risk in investment. Article 1105 is one of the most original creations of NAFTA Chapter 11. It provides for treatment in accordance with international law, aiming at settling a minimum standard of treatment for investments of NAFTA investors. The treatment is based on long-standing principles of customary international law.³¹⁷ Article 1110 provides that no party may expropriate investments of investors of another party, except for a public purpose on a non-discriminatory basis, in accordance with due process of law, and on payment of compensation.³¹⁸

ii. Settlement of Disputes

Section B of Chapter 11³¹⁹ sets out the dispute settlement procedures necessary to resolve complaints between investors and NAFTA party governments and attempts to establish a mechanism for the settlement of investment disputes that assures equal treatment with the principle of international reciprocity and due process before an impartial tribunal.³²⁰ Even though the NAFTA system is mainly based on a state-to-state settlement system, Chapter 11 has the particularity of introducing an investor-State system; an investor from a NAFTA state may commence arbitral

³¹⁷ For a detailed discussion of Article 1105 of the NAFTA, see Meg Kinnear et al., *INVESTMENT DISPUTES UNDER NAFTA: AN ANNOTATED GUIDE TO NAFTA CHAPTER 11* (Kluwer Law International 2006); P. Dumberry, *The Quest to Define 'Fair and Equitable Treatment' for Investors under International Law: The Case of the NAFTA Chapter 11 Pope & Talbot Awards*, 3 *JOURNAL OF WORLD INV.* 657 (2002); Patrick Foy & Robert Deane, *Foreign Investment Protection under Investment Treaties: Recent Developments under Chapter 11 of the North American Free Trade Agreement*, 16 *ICSID REV.: FOREIGN INV. L.J.* 299 (2001).

³¹⁸ NAFTA, *supra* note 307, art. 1110.

³¹⁹ Chapter 11, Section B (Settlement of Disputes between a Party and an Investor of Another Party) establishes a mechanism for the settlement of investment disputes that assures both equal treatment among investors of the Parties to the Agreement in accordance with the principle of international reciprocity and due process before an impartial tribunal. See Project on International Courts and Tribunals, *North American Free Trade Area Dispute Settlement Procedures*, <http://www.pict-pcti.org/courts/NAFTA.html> (last visited Oct. 23, 2009).

³²⁰ See Millar Kreklewetz LLP, *supra* note 305.

proceeding for breach of any of the provisions in section A of Chapter 11.³²¹

As Kreklewetz argues, it is important to recognize that not everyone may bring a claim for dispute settlement, and that the Chapter 11 mechanism is effectively limited to investors of a party to NAFTA and, more specifically, a national or corporation of a party to NAFTA that “seeks to make, is making or has made an investment,”³²² in another NAFTA country.³²³ Also important to note is that, generally speaking, investors may not bring NAFTA claims against their own governments for harm to investments made in their own country.³²⁴

The initial process is governed by Article 1116 (2), which requires that claims must be brought within three years of when “the investor first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor has incurred loss or damage.”³²⁵ One should also note that Article 1118 indicates that parties “should” first attempt to settle a claim through consultation or negotiation, and that should this consultation or negotiation process fail, then the disputing investor is required to file a notice of intention to submit a claim to arbitration at least ninety days before the claim is submitted, provided that six months have elapsed since the event giving rise to the claim.³²⁶

There is, therefore, first an intention to solve disputes through consultation or negotiation.³²⁷ If this consultation does not solve the problem, then under Article 1120,³²⁸ the investor may begin an arbitration procedure under any of the following sets of rules: 1) International Center for the Settlement of Investment Disputes Convention (ICSID);³²⁹ 2) Additional Facility Rules of ICSID; or

³²¹ *See id.*

³²² NAFTA, *supra* note 307, art. 1139.

³²³ *See* Millar Kreklewetz LLP, *supra* note 305.

³²⁴ *See id.*

³²⁵ NAFTA, *supra* note 307, art. 1116(2).

³²⁶ *See* Millar Kreklewetz LLP, *supra* note .

³²⁷ *See id.*

³²⁸ *See* NAFTA, *supra* note 307, art. 1120.

³²⁹ Since neither Canada nor Mexico is yet a member of the ICSID Convention, this

3) United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules.³³⁰ Note that Article 1130 requires that, “unless the disputing parties agree otherwise,” the arbitration occur “in the territory of a Party that is a party to the New York Convention” according to the rules of the arbitration forum.³³¹ The dispute shall be decided “in accordance with [NAFTA provisions] . . . and applicable rules of international law.”³³² The final award is binding only on the disputing parties and in regards to their specific case.³³³

To sum up the NAFTA investment provisions and regionalism, Edward Graham and Christopher Wilkie argue that the investment provisions of NAFTA have instituted the most comprehensive rules on investment to date for multinational corporations and nation states. These provisions “represent a further step towards a new *lex mercatoria* and international legal standing that nation-states and increasingly globalized firms are seeking. More broadly, the NAFTA investment provisions have further endorsed a rules-based international system in which the complementarity of trade and investment issues is implicitly recognized.”³³⁴

In conclusion, knowledge gained from the use of regional agreements will benefit the establishment of a multilateral framework for investment for two reasons. First, there is a real need for multilateral rules in the FDI field. This, however, does not suggest the replacement of the current regional investment regime nor that the existing regional regimes are inadequate. Second, there is a difficulty in designing coordinated rules

option is presently unavailable. See List of Contracting States and Other Signatories of the Convention (as of July 29, 2009), <http://icsid.worldbank.org> (follow Member States hyperlink; List of Contracting States hyperlink; then English (last visited Oct. 23, 2009).

³³⁰ See generally Marc R. Poirier, *The NAFTA Chapter 11 Expropriation Debate Through the Eyes of a Property Theorist*, 33 ENVTL. LAW 851 (2003) (providing an overview of the rules of an arbitration procedure).

³³¹ NAFTA, *supra* note 307, art. 1130.

³³² *Id.* art. 1131(1).

³³³ See *id.* art. 1136(1).

³³⁴ Edward M. Graham & Christopher Wilkie, *Regional Economic Agreements and Multinational Firms: The Investment Provisions of the NAFTA*, in GLOBAL COMPETITIVE STRATEGIES IN THE NEW WORLD ECONOMY: MULTILATERALISM, REGIONALISM AND THE TRANSNATIONAL FIRM, 97, 113 (Hafiz Mirza ed., 1998).

between the NAFTA and the EU. Although the NAFTA and EU approaches to investment differ, their aim is the same—the protection and liberalization of investments. Nevertheless, the mechanisms used are very different and, for a possible multilateral investment agreement, it is important to see how these two conceptions could converge.

The NAFTA approach to investment is based on international law principles and is aimed at both liberalization and protection of investments. NAFTA Chapter 11, which creates a very complex regime for investment, elaborates it on the basis of the main principles of international law.³³⁵ This dual approach (liberalization and protection) is also observed in the BITs signed by the United States.³³⁶ The deciding issues of NAFTA for a potential multilateral framework for investment are its top-down approach, overly strong and ambitious anti-expropriation protection, broad definition of foreign investment, and lack of investment incentives regulation.³³⁷

The EU regime, on the other hand, is not only more basic, but also focuses essentially on the protection of investment. It is organized around the principles of free movement of capital and freedom of establishment. After the failure of the MAI, the EU prefers a bottom-up, positive list approach to treat the establishment of FDI.³³⁸

E. Multilateralism

It has been argued that, generally, there is a correlation

³³⁵ See NAFTA, *supra* note 280, art. 1105 (providing for “treatment in accordance with international law, including fair and equitable treatment and full protection and security”).

³³⁶ See Bilateral Investment Treaties, <http://www.ustr.gov/trade-agreements/bilateral-investment-treaties> (last visited Oct. 23, 2009) (providing an overview of the U.S. BIT program).

³³⁷ See Benno Ferrarini, *A Multilateral Framework for Investment?*, in *The Singapore Issues and the World Trading System: The Road to Cancun and Beyond*, 1, 12 (State Secretariat of Economic Affairs & Simon J. Evenett eds., 2003), available at http://www.cid.harvard.edu/cidtrade/Papers/ferrarini_wti_investment.pdf.

³³⁸ See generally Communication from the European Community and Its Member States, *Concept Paper on Modalities of Pre-Establishment*, WT/WGTI/W/121 (June 27, 2002).

between the level of internationalization and the commitment to further internationalization. Studies have shown that “[p]sychic barriers are perceived to be lower as internationalization proceeds.”³³⁹ Mark Casson argues that integration supports economic activities and that this applies to both developing countries and groups of developed countries linked through trade and investment. The removal of these political constraints then facilitates integration.³⁴⁰ In this sense, Edward Graham argues that “although the MAI itself is dead, this agenda [of creating a multilateral investment treaty] is still alive, if not necessarily well.”³⁴¹

In this section, after providing some background on previous attempts to liberalize investment at a multilateral level, we shall analyze the WTO’s Agreement on Trade-Related Investment Measures (TRIMs) and the Energy Charter Treaty as examples moving toward a multilateral framework for investment.

1. Some Background

The issue of a multilateral framework for investment (MFI) is very broad and complicated. There are two positions that divide the international community: Continuous support of the MFI initiative, mainly by the countries of the EU and reticence to this initiative, which is expressed by developing countries. The solution is either to lower the standards for investment or to proceed to a trade-off with other areas of negotiation. Moreover, the MFI is a moving target if we consider that the WTO’s Doha Round is currently underway and that there are no certitudes concerning its results.³⁴² As of now, there is no coherent regime concerning investment at the multilateral level.

International actors have attempted to liberalize and regulate investment, but they have either failed or seen results only at a

³³⁹ See PETER J. BUCKLEY, *FOREIGN DIRECT INVESTMENT AND MULTINATIONAL ENTERPRISES* 24 (Macmillan Press Ltd 1995).

³⁴⁰ See MARK CASSON, *ENTERPRISE AND COMPETITIVENESS* (Oxford Univ. Press, 1995).

³⁴¹ Graham, *supra* note 150, at 14.

³⁴² See LEAL-ARCAS, *THEORY & PRACTICE*, *supra* note 119, at 486-500; see also Leal-Arcas, *supra* note 249, at 339-461 (analyzing the legal and political implications of the Doha Round).

bilateral or regional level. In this sense, it is pertinent to bear in mind the failure of the MAI in 1998 in the framework of the OECD, and the impact of this bad experience on the Parties to this Agreement.³⁴³ Developing countries have shown that they find it difficult to move on from the MAI's shadow. This, however, should not be interpreted as a signal to abandon the search for an MFI.³⁴⁴ Rather, one should infer that governments have not yet identified an adequate negotiating agenda for multilateral investment regulation.³⁴⁵

When addressing multilateralization of investment law, the danger lies in the fact that one could get lost in the immensity of the subject. There is a trinity of subjects in connection with a possible MFI: The protection of investment, the liberalization of investment, and the settlement of disputes.³⁴⁶ Each of these three subjects opens the path to a number of secondary issues. The duty of academics in this uncertain and evolving environment is to focus on the content of these multilateral rules and to make a variety of proposals to decision-makers. The political will to negotiate such rules may not yet be present, but States generally acknowledge their necessity. Therefore, all studies on this matter have a practical purpose and a militant role; they are meant to provoke an open discussion on the matter and to propose a variety of options.³⁴⁷

³⁴³ See OECD, Report by the Committee on International Investment and Multinational Enterprises (CIME) and the Committee on Capital Movements and Invisible Transactions (CMIT), A Multilateral Agreement on Investment, DAFFE/CMIT/CIME (95) 13/FINAL (May 5, 1995); see also OECD, Draft Consolidated Text, The Multilateral Agreement on Investment, DAFFE/MAI (98) 7/Rev1 (April 22, 1998); Ministerial Statement on the Multilateral Agreement on Investment (MAI) (April 28, 1998) (summarizing investment negotiations in the OECD framework).

³⁴⁴ See Philippe Gugler, *Towards a Coherent Multilateral Framework on FDI*, AIB INSIGHTS (Acad. of Int'l Bus.), Spring 2006, available at http://aib.msu.edu/publications/insights/insights_v006n01.pdf.

³⁴⁵ See generally HOWARD MANN, KONRAD VON MOLTKE, LUKE ERIC PETERSON, & AARON COSBEY, IISD MODEL INTERNATIONAL AGREEMENT ON INVESTMENT FOR SUSTAINABLE DEVELOPMENT (Int'l Inst. for Sustainable Dev. 2006) (2005), available at http://www.iisd.org/pdf/2005/investment_model_int_handbook.pdf.

³⁴⁶ See Kurtz, *supra* note 151, at 713.

³⁴⁷ See, e.g., Zdeněk Drábek, *A Multilateral Agreement on Investment: Convincing the Sceptics*, in THE POLICY CHALLENGES OF GLOBAL FINANCIAL INTEGRATION (Jan Joost

Investment issues have been at the center of WTO multilateral negotiations since the 1999 WTO Ministerial Conference in Seattle.³⁴⁸ At that conference, the EC, together with Japan, prepared a “new issues”-oriented agenda that was particularly interested in investment and competition matters.³⁴⁹ The African Union (AU) and the least-developed countries group³⁵⁰ firmly expressed their views of no additional liberalization.³⁵¹ At the WTO Ministerial Conference in Doha in 2001, both the EC and Japan resolved to weaken their positions on investment and competition.³⁵² This clearly shows that even though investment is brought into discussion for negotiation, the result is always weak. Concerning the design of these possible new provisions, the EC proposed a positive list agreement based on the General Agreement on Trade in Services (GATS).

Looking at the history of the various rounds, one can easily see that investment has frequently appeared on the trade agenda.

Teunissen ed., 1998); Ferrarini, *supra* note 337; Gugler, *supra* note 344; Kurtz, *supra* note 151; Muchlinski, *supra* note 142; United Nations Conference on Trade and Development, UNCTAD Series on Issues in International Investment Agreements, New York and Geneva, 1999, *Lessons from the MAI*, UNCTAD/ITE/IIT/MISC. 22; Thomas L. Brewer & Stephen Young, *Investment Policies in Multilateral and Regional Agreements: A Comparative Analysis*, 5 TRANSNAT'L CORP 9 (1996).

³⁴⁸ See generally World Trade Organization, Ministerial Declaration of 13 December 1996, WT/MIN(96)/DEC; World Trade Organization, Ministerial Declaration of 14 November 2001, WT/MIN(01)/DEC/1; World Trade Organization, Ministerial Statement of 14 September 2003, WT/MIN(03)/20; Decision Adopted by the General Council on 1 August 2004, *Doha Work Programme*, WT/L/579 (Aug. 2, 2004); *WTO Members Fail to Make Progress at Mini-Ministerial*, BRIDGES WEEKLY TRADE NEWS DIGEST (Int'l Centre for Trade and Sustainable Dev., Geneva, Switz.), June 25, 2003, at 1-2.

³⁴⁹ See generally World Trade Organization, The Third WTO Ministerial Conference, http://www.wto.org/english/thewto_e/minist_e/min99_e/min99_e.htm (last visited Oct. 23, 2009) (containing press releases, meeting summaries, and background materials related to the conference).

³⁵⁰ See generally Chakriya Bowman, *The Pacific Island Nations: Towards Shared Representation*, in MANAGING THE CHALLENGES OF WTO PARTICIPATION: 45 CASE STUDIES (Peter Gallagher, Patrick Low, Andrew L. Stole eds., 2005) (explaining the difficulties of the least-developed countries (LDCs) within the world trading system).

³⁵¹ See generally Third WTO Ministerial Conference, *supra* note 349.

³⁵² See World Trade Organization, The Fourth WTO Ministerial Conference, http://www.wto.org/english/thewto_e/minist_e/min01_e/min01_e.htm (last visited Oct. 23, 2009).

There is a clear tendency to include more and more issues on the international trade agenda. These new issues are always tackled in two steps. First, there is a long negotiation process, the aim of which is to converge towards a common position among the negotiators. Second, there is a will to have a signed and binding act, which occurs when the Parties agree to some common provisions. In the case of investment, the international community ended in an abortive first step. There are two positions on including investment as part of the international trade agenda for multilateral negotiations, both of which have a negative result: Those who are totally opposed to having investment on the trade agenda and those who argue that, by agreeing to common provisions on investment, it would weaken their own negotiating position. This shows how far the international community is from completing the first step.

2. *Investment under the WTO: The TRIMs Agreement*

This section will focus on the multilateral approach to investment law from the WTO perspective. However, as will be seen in the next section, there are other ways to tackle the multilateral approach to investment law, such as the Energy Charter Treaty or human rights regimes. As a matter of fact, one could argue that the Energy Charter Treaty of 1994 is in effect a multilateral agreement for the protection of investment in the energy sector.³⁵³

A point of consideration is the position of developing countries in the WTO framework. According to Claus-Dieter Ehlermann, the main difference between GATT and the WTO is the role of developing countries.³⁵⁴ That said, today there is still a lot of skepticism among developing countries regarding the WTO and its relevance to them. The power of the EC and the United States at

³⁵³ See generally Energy Charter Treaty, <http://www.encharter.org/index.php?id=28> (last visited Oct. 23, 2009).

³⁵⁴ See generally Claus-Dieter Ehlermann & Lothar Ehring, *Decision-Making in the World Trade Organization: Is the Consensus Practice of the World Trade Organization Adequate for Making, Revising and Implementing Rules on International Trade?* 8 J. INT'L ECON. L. 51, 51-75 (2005) (describing the differences in Member participation and decision-making between the GATT and the WTO).

the WTO is still intimidating.³⁵⁵

The WTO's Agreement on Trade-Related Investment Measures (TRIMs)³⁵⁶ sets out certain rules relating to FDI.³⁵⁷ TRIMs indicates an investment-related measure that has an impact on international trade. The TRIMs rules forbid countries from maintaining performance requirements on investors, namely governmental policies regulating investment by, for instance, requiring local content. The TRIMs Agreement does not contain the expansive definition of investment or the extensive new investor right which exist in the NAFTA and were proposed for global application through the MAI. "However, expanding the scope of the WTO's investment rules and the nature of investor rights granted by WTO were part of the push by the EU to launch new negotiations at the Cancún WTO Ministerial on the so-called new issues," which are referred to as the Singapore issues.³⁵⁸

The TRIMs Agreement mandates notification of all non-conforming TRIMs and requires that they be eliminated within two years for developed countries, five years for developing countries and seven years for least-developed countries.³⁵⁹ It establishes a Committee on TRIMs which will, among other things, monitor the implementation of these commitments.³⁶⁰ The TRIMs Agreement also provides for consideration, at a later date, of whether it "should be complemented with provisions on investment and competition policy" more broadly.³⁶¹

There are a few problems with the TRIMs Agreement that make it a problematic model for a multilateral investment framework. First, the TRIMs Agreement does not govern different investment laws, but only designs regulations on trade in goods. The Agreement recognizes that certain investment measures restrict and distort trade. It provides that no contracting

³⁵⁵ See generally LEAL-ARCAS, THEORY & PRACTICE, *supra* note 119, at 485-590; Leal-Arcas, *supra* note 249, at 339-461.

³⁵⁶ See TRIMs Agreement, *supra* note 165, art 5.

³⁵⁷ See Civello, *supra* note 164, at 97.

³⁵⁸ Wallach, *supra* note 4, at 9.

³⁵⁹ TRIMs Agreement, *supra* note 165, art. 5(2).

³⁶⁰ *Id.* art. 7.

³⁶¹ *Id.* art. 9.

party shall apply any TRIM inconsistent with GATT Articles III (national treatment) and XI (prohibition of quantitative restrictions).³⁶² To this end, an illustrative (i.e., non-exhaustive) list of TRIMs agreed to be inconsistent with these articles is appended to the agreement.³⁶³ The list includes measures which require particular levels of local procurement by an enterprise³⁶⁴ or which restrict the volume or value of imports such an enterprise can purchase or use to an amount related to the level of products it exports.³⁶⁵ Second, there is no generic definition of a TRIM, and a temporary deviation for balance of payments purposes is allowed for developing countries.³⁶⁶ Third, the illustrative list of TRIMs is inconsistent with the obligations of national treatment.³⁶⁷ Fourth, the TRIMs Agreement does not apply to services and is a compromise between developed and less-developed countries.

Dispute resolution under the TRIMs Agreement has revealed that WTO Members may not apply investment measures that are inconsistent with the principle of national treatment (GATT Article III) or otherwise violate the general prohibition of quantitative restrictions on imports and exports (GATT Article XI). This is demonstrated in three of only four cases where the TRIMs Agreement has been involved in the WTO, namely EC—Bananas,³⁶⁸ Indonesia—Autos,³⁶⁹ and Canada—Autos.³⁷⁰ The fourth case, India—Autos,³⁷¹ will not be analyzed.

³⁶² *Id.* art. 2(1).

³⁶³ *Id.* art. 2(2).

³⁶⁴ *See id.*, Annex ¶ 1.

³⁶⁵ *See* TRIMs Agreement, *supra* note 165, Annex ¶ 2.

³⁶⁶ *Id.* art. 4.

³⁶⁷ *Id.* Annex.

³⁶⁸ Appellate Body Report, *European Communities—Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R (Sept. 9, 1997).

³⁶⁹ Panel Report, *Indonesia—Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R (July 2, 1998) [hereinafter *Indonesia Panel Report*].

³⁷⁰ Panel Report, *Canada—Certain Measures Affecting the Automotive Industry*, WT/DS139/R, WT/DS142/R (Feb. 11, 2000).

³⁷¹ Appellate Body Report, *India—Measures Affecting the Automotive Sector*, WT/DS146/AB/R, WT/DS175/AB/R (March 19, 2002).

a. *EC—Bananas III (Ecuador)*

Claims were raised under Articles III(4) of the GATT³⁷² and 2.1 of the TRIMs Agreement³⁷³ regarding aspects of the European Communities' import licensing procedures for bananas. The Panel decided to treat both claims together.³⁷⁴ The Panel found that the allocation to certain operators of a percentage of the licenses allowing the importation of third-country and non-traditional African, Caribbean, and Pacific countries' (ACP)³⁷⁵ bananas at in-quota tariff rates was inconsistent with the requirements of GATT Article III(4).³⁷⁶ In light of that finding, the Panel did not consider it necessary to make a specific ruling on whether this aspect of these import licensing procedures was also inconsistent with Article 2.1 of the TRIMs Agreement.³⁷⁷ The Panel also found that in the absence of "conflict" between GATT 1994 and the TRIMs Agreement, both agreements applied equally. This finding would not have been necessary had the Panel considered that the TRIMs Agreement was a *lex specialis* in relation to GATT 1994.

³⁷² See General Agreement on Tariffs and Trade, art. III(4), Oct. 30, 1947, 61 Stat. A-11, A-18, 55 U.N.T.S. 194, 206 [hereinafter GATT] stating that:

The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

³⁷³ See TRIMs Agreement, *supra* note 165, art. 2.1 (stating that "[w]ithout prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994").

³⁷⁴ Panel Report, *European Communities—Regime for the Importation, Sale and Distribution of Bananas*, ¶ 7.168, WT/DS27/R/ECU (Sept. 25, 1997) [hereinafter EC Panel Report].

³⁷⁵ The African, Caribbean and Pacific countries (ACP) Group was formed when the first Lomé Convention was signed with the European Economic Community in 1975. In 2002, it encompassed 78 states (48 African states, 16 Caribbean states, 14 Pacific states), which all have preferential trading relation with the European Community. See The Secretariat of the African, Caribbean and Pacific Group of States, <http://www.acpsec.org>.

³⁷⁶ EC Panel Report ¶ 7.182.

³⁷⁷ *Id.* ¶¶ 7.185-7.187.

b. Indonesia—Autos

This case involved various Indonesian measures, including tax incentives and customs duty benefits linked to local content requirements.³⁷⁸ Japan, the EC, and the United States challenged these measures as being inconsistent with the TRIMs Agreement. The Panel agreed, holding that an advantage, conditional on the use of domestic goods, violates the TRIMs Agreement, even if the local content rule is not binding. This is the only case where the Panel finding was made under the TRIMs Agreement.³⁷⁹

Regarding the facts of the case, a set of measures of the Indonesian Government grouped under the name of “the 1993 Program”³⁸⁰ and the “1996 National Car Program”³⁸¹ was inconsistent with various obligations of Indonesia under the GATT and the TRIMs Agreement. Certain local content measures applied by Indonesia violated the provisions of GATT Article III(4) and Article 2.1 of the TRIMs Agreement. The three parties to the dispute were Japan, the EC, and the United States. As stated by the Panel, there was a violation of the TRIMs Agreement because “first, the measure [was] an ‘investment measure related to trade in goods’³⁸² and second, the measure [was] ‘inconsistent with the provisions of [GATT] Article III or Article XI.’”³⁸³

In relation to the so-called “1993 program,” the Panel found that the “local content requirements” linked to certain sales tax benefits and customs duty benefits violated Article 2 of the TRIMs Agreement and that the sales tax discrimination aspects violate Article III(2)³⁸⁴ of GATT 1994.³⁸⁵ As for the so-called “1996

³⁷⁸ Indonesia Panel Report, *supra* note 369.

³⁷⁹ *Id.*

³⁸⁰ *See id.* ¶ 2.4. (describing the components of the 1993 Program and the Incentive System).

³⁸¹ *See id.* ¶¶ 2.16-2.17. (describing the 1996 National Car Program which “provides for the grant of ‘pioneer’ or National Car company status to Indonesian car companies that meet specified criteria as to ownership of facilities, use of trademarks, and technology . . . The benefits provided are exemption from luxury tax on sales of National Cars, and exemption from import duties on parts and components.”).

³⁸² *See id.* ¶ 6.70.

³⁸³ *Id.* ¶ 6.70.

³⁸⁴ GATT art. III(2) stating:

The products of the territory of any contracting party imported into the

National Car Program,” the Panel found that Indonesia acted inconsistently with Article 2 of the TRIMs Agreement and Articles I and III(2) of GATT 1994 and that the EC had demonstrated that Indonesia had caused serious prejudice to EC interests within the meaning of Article 5(c) of the Agreement on Subsidies³⁸⁶ and Countervailing Measures.³⁸⁷

Indonesia argued that the TRIMs Agreement was not a *lex specialis* at any dispute because Article 2.1 states that the Agreement operates “without prejudice to other rights and obligations under GATT 1994.” GATT Article III(2), Article III(4), and the TRIMs Agreement each impose legally distinct obligations on Members, and a single measure may be found to be inconsistent with the three. The Panel decided to examine first the claims under the TRIMs Agreement on the grounds that “the TRIMs Agreement is more specific than GATT Article III(4) as far as the claims under consideration are concerned.”³⁸⁸ The Panel found that the measures were inconsistent with Article 2(1) of the TRIMs Agreement. In its report of 23 July 1998, the Dispute Settlement Body adopted the Panel Report.³⁸⁹

Indonesia also argued that the TRIMs Agreement did not impose any new obligation as it restated GATT Article III. The main argument was a paragraph of the Panel Reports on *EC—Bananas*, which states that “with the exception of its transitional provisions,³⁹⁰ the TRIMs Agreement essentially interprets and

territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

³⁸⁵ See Indonesia Panel Report, *supra* note 369, ¶ 15.1(a)-15.1(b).

³⁸⁶ Agreement on Subsidies and Countervailing Measures art. 5(c) (stating that “[n]o Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.: (c) serious prejudice to the interests of another Member”).

³⁸⁷ See Indonesia Panel Report, *supra* note 369, ¶ 15.1(a)-15.1(d).

³⁸⁸ *Id.* ¶ 14.63.

³⁸⁹ See *id.*

³⁹⁰ EC Panel Report, *supra* note 346, ¶ 7.46 (footnoting that “[w]e have already dismissed the Complainants' claim under the transition provisions of Article 5 of the

clarifies the provisions of Article III (and also Article XI) where trade-related investment measures are concerned. Thus the TRIMs Agreement does not add to or subtract from those GATT obligations, although it clarifies that Article III(4) may cover investment-related matters.³⁹¹

To a certain extent, the TRIMs Agreement codifies the GATT 1947 panel jurisprudence concerning Article III(4) arising out of such cases as *Italian Tractors*,³⁹² *EEC—Parts and Components*,³⁹³ and *Canada—Administration of the Foreign Investment Review Act (FIRA)*.³⁹⁴ As panel decisions were not binding, Indonesia was not bound by this jurisprudence. However, with the *Japan—Taxes on Alcoholic Beverages* report of the Appellate Body adopted on November 1, 1996, Indonesia became bound by this jurisprudence, as codified in the TRIMs Agreement. The TRIMs imposed a new obligation on Indonesia.

c. *Canada—Autos*

The Canadian measure at issue in this appeal was the duty-free treatment provided to imports of automobiles, buses and specified commercial vehicles by certain manufacturers under the Custom Tariff, the Motor Vehicles Tariff Order of 1998 (the “MVTO 1998”) and the Special Remission Orders (the “SRO’s”). Under the MVTO 1998, manufacturers of motor vehicles received duty-free treatment on imports “from any country entitled to the Most-Favoured-Nation Tariff,” so long as they met three conditions.³⁹⁵ These three conditions are connected to content requirements:³⁹⁶

TRIMs Agreement because Article 5 was not listed in the request for the establishment of the Panel as required by Article 6.2 of the DSU.”

³⁹¹ *Id.* ¶ 7.185.

³⁹² GATT Panel Report, *Italian Discrimination against Imported Agricultural Machinery*, L/833-7S/60 (Oct. 23, 1958).

³⁹³ Panel Report, *European Economic Community—Regulation on Imports of Parts and Components*, L/6657-37S/132 (May 16, 1990).

³⁹⁴ Panel Report, *Canada—Administration of the Foreign Investment Review Act*, L/5504-30S/140 (Feb. 7, 1984).

³⁹⁵ Appellate Body Report, *Canada – Certain Measures Affecting the Automotive Industry*, ¶ 9, WT/DS139/AB/R, WT/DS142/AB/R (May 31, 2000) (quoting Motor Vehicles Tariff Order, 1998 SOR/1998-43 (Can.)).

³⁹⁶ *Id.*

(1) [The manufacturer] must have produced in Canada, during the designated “base year,” motor vehicles of the class imported; (2) the ratio of the net sales value of the vehicles *produced in Canada* to the net sales value of all vehicles of that class *sold for consumption in Canada* in the period of importation must be “equal to or higher than” the ratio in the “base year”, and the ratio shall not in any case be lower than 75:100 (the “ratio requirements”); and (3) the amount of Canadian value added in the manufacturer’s local production of motor vehicles must be “equal to or greater than” the amount of Canadian value added in the local production of motor vehicles of that class during the “base year[.]”

Claims under GATT Article III(4) pertained to conditions concerning the level of Canadian value-added and the maintenance of a certain ratio between the net sales value of vehicles produced in Canada and net sales value of vehicles sold for consumption in Canada.

Complainants under the TRIMS Agreement argued that the conditions regarding Canadian value added were inconsistent with Article 2.1 of the TRIMs Agreement. The EC claimed that the conditions regarding the maintenance of a ratio between the net sales value of motor vehicles produced in Canada and the net sales value of motor vehicles sold for consumption in Canada were also inconsistent with that provision.

The Panel decided to follow the panel perspective in *European Communities—Regime for the Importation, Sale and Distribution of Bananas*, and considered the claims first under Article III(4) of the GATT. The Panel recognized, however, that if it followed the principle in *Indonesia—Certain Measures Affecting the Automobile Industry*,³⁹⁷ a claim should be examined first under the agreement which is the most specific with respect to that claim. For the purposes of this case, the Panel decided that following that principle would not provide an efficient resolution to the dispute.

3. *The Energy Charter Treaty*

“The Energy Charter Treaty [ECT] provides a multilateral framework for energy cooperation that is unique under

³⁹⁷ Indonesia Panel Report, *supra* note 369.

international law. It is designed to promote energy security through the operation of more open and competitive energy markets, while respecting the principles of sustainable development and sovereignty over energy resources.”³⁹⁸ In the early 1990s, public debates took place on how to improve energy cooperation between Eastern and Western Europe.³⁹⁹ Russia was rich in energy but in great need of investment in order to reconstruct its economy at a time when Western European countries were trying to diversify their energy supply sources. Therefore, there was a recognized need to set up a commonly accepted legal framework for energy cooperation among countries of the Eurasian region. This gave rise to the Energy Charter process.⁴⁰⁰ The ECT is therefore the only binding multilateral legal instrument dealing with intergovernmental cooperation in the energy sector.

The first step in the Energy Charter process was the adoption and signing of the European Energy Charter in The Hague in December 1991. The European Energy Charter was a political declaration of principles and therefore did not constitute a legally binding treaty. That said, it contained guidelines for the negotiation of a subsequent binding treaty, later to become the ECT.⁴⁰¹ The ECT and the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects were eventually signed in December 1994 and entered into force in April 1998. All twenty-seven EU Member States and the EC have ratified the ECT. Russia, however, has signed but not yet ratified the treaty.⁴⁰²

³⁹⁸ Energy Charter Treaty, Dec. 17, 1994, 34 I.L.M. 381.

³⁹⁹ See Kaj Hobér, *The Role of the Energy Charter Treaty in the Context of the European Union and Russia*, in INVESTMENT PROTECTION AND THE ENERGY CHARTER TREATY 235-305 (Graham Coop & Clarisse Ribeiro eds., JurisNet 2008) (describing the role of the Energy Charter Treaty in the EU-Russia context).

⁴⁰⁰ Graham Coop, *The Energy Charter Treaty: More than a MIT*, in INVESTMENT ARBITRATION AND THE ENERGY CHARTER TREATY 4-9 (Clarisse Ribeiro ed., JurisNet 2006).

⁴⁰¹ Craig Bamberger, Jan Linehan, & Thomas Wälde, *The Energy Charter Treaty in 2000: In a New Phase*, in ENERGY LAW IN EUROPE (Martha Roggenkamp, ed., Oxford Univ. Press 2000).

⁴⁰² See Rafael Leal-Arcas, “The EU and Russia as Energy Trading Partners: Friends or Foes?” 14 EUROPEAN FOREIGN AFFAIRS REVIEW 337, 359 (2009).

V. Why is There a Need for a Multilateral Investment Treaty?

The need for harmonization of international rules on investment and the creation of a homogeneous framework for investment is recognized both by economists and legal scholars.⁴⁰³ The attempts to create multilateral rules (from the Havana Charter in 1948 to the failure of the MAI negotiated at the OECD between 1995 and 1998) show that there is an ongoing process of creation and thinking in this direction. In order to achieve a multilateral framework for investment, we have to be aware of the various ways in which we can model it. Since the Havana Charter, different approaches to investment liberalization have been envisioned. The MAI⁴⁰⁴ is a good example of one of these approaches,⁴⁰⁵ even though it never entered into force and, currently, there are no plans to re-initiate negotiations. Another example is the gap between the EU's and NAFTA's approach to this issue, although the economic objectives are identical.

A. Practical and Structural Reasons for an MFI

There is a strong case to be made for a comprehensive approach to investment within a broader context of good governance and consideration of the legitimate interests of developed countries, developing countries, and investors alike. Such an approach would require a shift from the current primary focus of international investment rules and investor protection, to considerations of the environment, labor standards, and sustainable development.

It is a fact that foreign investors are keen to reduce political risks in host States and therefore prefer to have their investments covered by international law where possible. The relevant international legal framework has changed quite dramatically over

⁴⁰³ See generally Amarasinha & Kokott, *supra* note 137 (analyzing past attempts at multilateral investment reform as a precursor to future actions).

⁴⁰⁴ Org. for Econ. Co-Operation and Dev., *The Multilateral Agreement on Investment: Draft Consolidated Text*, DAFFE/MAI(98)7/REV1 (Apr. 22, 1998).

⁴⁰⁵ See Global Policy Forum, *Multilateral Agreement on Investment*, <http://www.globalpolicy.org/globalization/globalization-of-the-economy-2-1/multilateral-agreement-on-investment-2-5.html> (last visited Oct. 26, 2009) (compiling series of articles on MAI).

the past decade. With this context in mind, there are several reasons for having a MFI: 1) The increased importance of foreign-owned production and distribution facilities in most countries is cited as tangible evidence of globalization;⁴⁰⁶ 2) the role of FDI in the development of less-developed countries;⁴⁰⁷ 3) the creation of an MFI is a way to increase efficiency;⁴⁰⁸ 4) the fear that, failure to reach a multilateral agreement will result in a slowdown of FDI flows;⁴⁰⁹ and 5) the perception that trade and FDI are simply two alternative, but increasingly complementary and interlinked, ways of servicing foreign markets.⁴¹⁰ Of course, there are concerns over possible negative effects of FDI. Home countries are concerned that FDI may decrease jobs and lower wages. Host countries worry about the effect FDI may have on their government's ability to control the economy. In addition, some critics are wary of a multilateral agreement that binds signatories to national FDI rules, viewing it as "pre-empting a country's right to manage inflows of FDI."⁴¹¹

Various questions arise: Should a multilateral investment treaty be a stand-alone agreement as was the case of the MAI or should it be institutionalized somewhere, such as in the WTO framework? If the former, other issues come to mind, such as the need for secretariat support, a dispute settlement mechanism, enforceability of awards, and possible retaliatory measures. If the latter, how can a multilateral investment treaty be created in the WTO framework? Whatever the option, the MAI can certainly help as a point of departure for establishing guidelines for a future multilateral investment treaty. Another source of inspiration may be the recent proposal for a Model International Agreement on Investment for Sustainable Development (IISD Model

⁴⁰⁶ See generally DAVID SCHNEIDERMAN, *CONSTITUTIONALIZING ECONOMIC GLOBALIZATION: INVESTMENT RULES AND DEMOCRACY'S PROMISE*, 25-6 (Cambridge Univ. Press 2008) (describing economic globalization and the constitutional-like framework of international investment rules).

⁴⁰⁷ Report, WTO, Trade and Foreign Direct Investment, 5 (Oct. 9, 1996) available at http://www.wto.org/english/news_e/pres96_e/pr057_e.htm.

⁴⁰⁸ *Id.* at 75.

⁴⁰⁹ *Id.* at 4.

⁴¹⁰ *Id.* at 3.

⁴¹¹ *Id.* at 4-5.

Agreement)⁴¹² presented by the International Institute for Sustainable Development.

As noted by the Canadian Mission to the WTO, it is worth investigating how possible elements of a prospective international investment agreement would interact with each other as well as with other provisions within the WTO system that deal with international investment.⁴¹³ In Canada's view, balance-of-payments is an important element when discussing possible exceptions to a prospective WTO investment agreement.⁴¹⁴ For example, exceptions facilitating temporary balance-of-payments safeguards exist in many trade and investment agreements. In Canada's view, exceptions, whether for balance-of-payments or for any other purpose, are an integral component of international investment agreements.

Generally, the scope of any given agreement is determined by an overarching Article, definitions of agreement terms, and any limitations on the "reach" of the provisions.⁴¹⁵ "Exceptions effectively serve to limit the scope of the agreement by accommodating sectors, issue areas, or circumstances where provisions of the agreement would not apply."⁴¹⁶ According to the Canadian Mission to the WTO,

[reservations] usually refer to individual country measures to which certain negotiated provisions of the agreement do not apply. Importantly, in sensitive sectors where it may be difficult to define precisely the measures that may be necessary to effectively limit the scope of the agreement, reservations may also be negotiated with respect to future measures.⁴¹⁷

Therefore, exceptions and reservations could provide much of the necessary flexibility in any investment agreement in the WTO

⁴¹² Int'l Inst. for Sustainable Dev. [hereinafter IISD], *IISD Model Int'l Agreement on Investment for Sustainable Dev.* (Apr. 2005), available at http://www.iisd.org/pdf/2005/investment_model_int_agreement.pdf.

⁴¹³ Working Group on the Relationship Between Trade and Investment, *Communication from Canada*, ¶ 2, WT/WGTI/W/146 (Sept. 17, 2002).

⁴¹⁴ *Id.* ¶ 3.

⁴¹⁵ *Id.* ¶ 7.

⁴¹⁶ *Id.*

⁴¹⁷ *Id.* ¶ 7.

framework.⁴¹⁸

To sum up, a future multilateral framework for investment in the WTO context could clarify the relationship among the GATS, TRIMs Agreements, and BITs. The future MAI could also add substantive rules on environmental and labor standards to the current system of international investment law.

B. Need for Coherence

The need for an MFI can be perceived in the dramatic proliferation of international investment agreements in recent years. Many of these agreements have been concluded bilaterally, regionally, or even multilaterally. With approximately 2,700 BITs, 200 regional cooperation arrangements, and 500 multilateral conventions governing cross-border investment flows, it is no wonder that investors are facing difficulties in choosing which regulatory regime suits them best. Different agreements often have different coverage of issues and may apply different rules. Separate negotiations increase the danger of inconsistent rules being established in different agreements. This leads to confusion, legal conflict, and uncertainty.⁴¹⁹

Furthermore, the current fragmented international investment regime may encourage regulatory competition among the various models of international investment agreements. Moreover, the dispute settlement mechanism does not rely on a uniform dispute settlement body or institutional mechanisms that ensure consistency and predictability in the decision-making process of arbitral tribunals. Rather, it rests on *ad hoc* arbitration panels with limited State oversight. Therefore, forum shopping and inconsistency of arbitral awards in dispute resolution seem to be the primary reasons why the creation of an MFI is necessary. The future of international investment thus arguably needs this coherent legal structure. If we agree that there are customary

⁴¹⁸ Working Group on the Relationship between Trade and Investment, *supra* note 413, at ¶ 7.

⁴¹⁹ See Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 *FORDHAM L. REV.* 1521, 1528-35 (2005); see also Serge Brunner & David Folly, *The Way to a Multilateral Investment Agreement* (NCCR Trade Regulation, Working Paper No. 2007/24, 2007).

international law rules concerning investment, why not create an international framework that codifies existing rules? Would this framework not serve to provide coherence, predictability, and legal security?

One of the difficulties in designing and establishing a common and unique framework for investments is the high number of mostly nonbinding provisions already in existence at the bilateral, regional, and even multilateral level. Their number also reflects their differences. In order to find common ground, the question arises: In what way would a single provision represent the different standards and levels of development of the regulation? The situation was completely different concerning trade in services and intellectual property rights, as before the negotiation of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) and the GATS, when there were no preexisting rules that the drafters had to take into account.

Three more issues complicate the creation of an MFI. First, due to the many diverse interests of States and corporations, there may not be any consensus over an MFI. States do not necessarily agree on what constitutes investment stability. This is because of differing views on the impact of macroeconomic implications. Second, even if the international community ends up having a treaty similar to GATT, GATS, or the TRIMs Agreement, there will always be contentious concepts such as expropriation, protectionism,⁴²⁰ essential security, or the principles of national treatment and most-favored-nation treatment. States may still end up with bilateral side letters to clarify certain terms relating to specific industries. Third, in relation to conflicting arbitral awards and forum shopping, investments comprise many forms and stretch over many industries. The facts of each case may be different making it difficult to glean specific rules from different arbitral decisions. Consensus would only be possible when dealing with broad rules. For example, the notion of “public order” as applied in one specific case may be different for another

⁴²⁰ See Karl P. Sauvant, *Driving and Countervailing Forces: a Rebalancing of National FDI Policies*, in *THE YEARBOOK ON INTERNATIONAL INVESTMENT LAW AND POLICY 2008-2009* (Oxford Univ. Press 2009) (discussing the difficulties of defining FDI protectionism).

case.

Ideally, a coherent and unified multilateral framework for investment would not contradict but rather reinforce the current fragmented system. It would create a synergy from the existing bilateral, regional, and multilateral rules. This means that the system would become more predictable, more secure, and would encourage FDI and all its positive effects. As long as investors feel more secure, FDI flows will benefit from it. The benefits from a coherent legal framework are not only visible with respect to the volume of FDI but also, and perhaps more importantly, with respect to the nature and structure of FDI.

VI. How to Design a Multilateral Framework for Investment

One way to design an MFI is by seeking common ground between the various regions of the world that already possess an investment protection mechanism such as NAFTA,⁴²¹ Mercosur, or the EU. In this section, however, we shall examine the input from BITs into a potential MFI, the WTO as the international organization that may take the initiative of designing an MFI, and the various policy considerations resulting from such an initiative.

So far, this research has taken existing investment rules and case law as the basis for the design of a multilateral, unified framework for investment. The difficulty of this field is, at first glance, a methodological one, given that the way in which the subject is addressed determines the result of the research. So why use an inductive approach?⁴²² Why is case law relevant? First, one can see that BITs and regional agreements leading to disputes. Second, one can identify issues that are most inclined to pose a problem in a multilateral framework for investment. Third, one can see the different interpretations of investment and how judges of various backgrounds and education judge the subject. Finally, one can have a whole exposé of the various existing procedures

⁴²¹ See generally NAFTA INVESTMENT LAW AND ARBITRATION: PAST ISSUES, CURRENT PRACTICE, FUTURE PROSPECTS (Todd Weiler ed., Transnational 2004) (discussing procedural issues in investment arbitration awards and investment protection in NAFTA).

⁴²² By inductive approach, we mean the process of deriving general principles from particular facts or instances.

(before various institutions) so as to reach a multilateral framework.

Agreements on international commercial/trade law are generally very vague. They are built in general terms in order to cover the largest number of situations. The role of courts, therefore, is to apply these vague provisions to very specific circumstances. So why study investment case law? The study of case law related to investment matters provides an overview of the problems and important issues on the subject. The aim of this methodology is to identify problems and to make suggestions concerning possible policy conclusions and actions.

Because rules are general and vague, gaps will inevitably occur while applying these rules. This is especially true in the case of investment, where there are strong divergences on certain issues. The role of the judiciary is therefore to fill in the gaps by interpreting the text. That said, as Ernst-Ulrich Petersmann argues, “the judicial ‘filling of gaps’ in the European Community Treaty by the European Court of Justice has sometimes been criticized as ‘judicial legislation.’”⁴²³ According to Hersch Lauterpacht, the ICJ, as well as its predecessor, the Permanent Court of International Justice, has been subject to strong criticism, as they have often based themselves on broad legal principles in order to overcome imperfections of international treaty law⁴²⁴ and, “on occasions, paved the way for the introduction of far-reaching changes.”⁴²⁵ Lauterpacht further argues that “judicial law making is a permanent feature of administration of justice in every society.”⁴²⁶

In relation to the scholarly literature on FDI, an obvious evolution is the shift from national to international measures. The

⁴²³ ERNST-ULRICH PETERSMANN, *THE GATT/WTO DISPUTE SETTLEMENT SYSTEM: INTERNATIONAL LAW, INTERNATIONAL ORGANISATIONS AND DISPUTE SETTLEMENT* 92 (Kluwer Law International 1997) (quoting Eric Stein, *Lawyers, Judges and the Making of a Transnational Constitution*, 75 AM. J. INTL L. 1 (1981)).

⁴²⁴ SIR HERSCH LAUTERPACHT, *THE DEVELOPMENT OF INTERNATIONAL LAW BY THE INTERNATIONAL COURT* 156 (Grotius Publications 1982).

⁴²⁵ *Id.* at 156.

⁴²⁶ *Id.* at 155; see generally ALAN BOYLE & CHRISTINE CHINKIN, *THE MAKING OF INTERNATIONAL LAW* (Malcolm Evans & Phoebe Okowa eds., Oxford University Press 2007) (analyzing law-making beyond the judiciary).

issues affecting FDI were mainly solved by national laws. The national character was justified by a certain fear of investment; a perception of investment as a possible threat to national sovereignty. One of the consequences of this change is the recognition of a series of international duties of investors and the promotion of national and international measures to ensure the proper functioning of the market.⁴²⁷

A. Input from BITs into a Potential Multilateral Framework for Investment

Is it a valid view to consider that bilateralism should be used as a form of negotiation and evolution of negotiating positions prior to multilateral negotiations? In this sense, BITs could be an interesting tool to foster the positions of the Parties on FDI.

Bilateral treaties may be considered a contribution to the emergence of an MFI. Many of these treaties contain a clause admitting that contractual obligations may be the object of a specific engagement of the host State at the conventional level. These are the so-called umbrella clauses.⁴²⁸ While some argue that these clauses do not change the contractual relationship between the involved parties, Charles Leben argues that under these clauses, the violation of contractual obligations by a State becomes a violation of international law, direct or indirect.⁴²⁹ This conclusion is contested in customary international law.

It is therefore relevant to note that, under the influence of bilateral treaties, the contractual obligations of the host State were internationalized. Today, this is a common consideration even though there are still opponents both in the legal scholarship and among developing countries.

⁴²⁷ See generally UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, TRENDS IN INTERNATIONAL INVESTMENT AGREEMENTS: AN OVERVIEW, U.N. Doc. UNCTAD/ITE/IIT/13, U.N. Sales No. E.99.II.D.23 (1999) (providing overview of the international legal framework for foreign direct investment).

⁴²⁸ Some international investment agreements require that host states observe any obligations or commitments undertaken towards investments. This type of clause is often referred to as the "umbrella clause" because obligations undertaken by the host state in contracts or other arrangements are brought under the umbrella of protection of the treaty. See NEWCOMBE & PARADELL, *supra* note 49, at 437.

⁴²⁹ See Leben, *supra* note 101.

B. The WTO as a Potential International Organization to Create an MFI

Given that WTO membership encompasses most countries in the world—more than 150 Members at present—the WTO seems to be an adequate forum to debate the creation of a multilateral investment framework. In this sense, one could argue that the failure of the MAI in the framework of the OECD was due to the fact that negotiations were conducted by a group of industrialized countries, while developing countries were expected to just stand-by during the negotiations and eventually ratify the agreement upon its conclusion. If the WTO is to be the forum for negotiating a multilateral investment framework, developing countries “could raise their concerns and shape the outcome” of a future investment agreement because of the consensus-based decision-making process at the WTO.⁴³⁰ Some NGOs and commentators, however, argue that the WTO’s decision-making process limits the effective participation of the smaller and poorer developing countries at the WTO.⁴³¹ Other commentators argue that “[d]eveloping countries have proved first that they can modify the outcome, then that they can block a settlement, and finally that they can initiate their own issues”⁴³²

Another reason for choosing the WTO as a forum for an MFI is that trade and investment are strongly linked. Indeed, some of the investment-related issues are already covered to some extent in WTO Agreements such as GATS and the TRIMs Agreement. In this sense, GATS could serve as a model for a potential MFI, given how successful the liberalization effort has been in trade in services. To ensure coherence between these two agreements and a future multilateral agreement on investment, WTO Members should consider existing WTO investment-related Agreements and

⁴³⁰ Ferrarini, *supra* note 337, at 47.

⁴³¹ Gerry Helleiner, From Doha to Kanaskis Conference Paper, *Reflections on Global Economic Governance* 3 (Mar. 2000), available at http://www.yorku.ca/robarts/archives/doha/pdf/doha_helleiner2.pdf.

⁴³² Overseas Development Institute Globalization and Poverty Programme [ODI], *Developing Countries: Victims or Participants-Their Changing Role in International Organizations* 4 (2003) (prepared by Sheila Page), <http://www.odi.org.uk/resources/download/1735.pdf>.

focus on issues that are not yet within the existing WTO Agreements.⁴³³ Moreover, the link between trade and investment has already been examined by the WTO Working Group on Trade and Investment.

Another explanation for choosing the WTO as a forum for an MFI is that the WTO Agreements contain “special and differential treatment” provisions for developing countries, meaning that they can safeguard their economic and social concerns and needs. These provisions include transitional time periods for implementing agreements and technical support. For example, Article 5.2 of the TRIMs Agreement stipulates that “[e]ach Member shall eliminate all TRIMs . . . within two years of the date of entry into force of the WTO Agreement in the case of a developed country Member, within five years in the case of a developing country Member, and within seven years in the case of a least-developed country Member.”⁴³⁴ An example of technical support for developing countries is GATS Article XXV.2, namely, “[t]echnical assistance to developing countries shall be provided at the multilateral level by the Secretariat and shall be decided upon by the Council for Trade in Services.”

During the 1996 Singapore WTO Ministerial Conference a committee was formed to examine the feasibility of drafting an instrument on investment that could be administered by the WTO within its already existing mechanisms. The Doha Ministerial Conference decided to continue work on the possibility of a legal instrument for investment recognizing the need for “a multilateral framework to secure transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign direct investment, that will contribute to the expansion of trade”⁴³⁵

There are several issues for discussion concerning the possibility of having such an instrument in the WTO.⁴³⁶ The first

⁴³³ U.N. Conference on Trade and Dev. [UNCTAD], *Discussion Paper: Strategic Options Available to Developing Countries with Regard to a Multilateral Agreement on Investment*, U.N. Doc. UNCTAD/OSG/DP/134 (April 1998) (prepared by A.V. Ganesan).

⁴³⁴ TRIMs Agreement, *supra* note 165, art. 5(2).

⁴³⁵ WTO, Ministerial Declaration of 14 November 2001, ¶ 20 WT/MIN(01)/DEC/1 (2001).

⁴³⁶ These issues are the same as those discussed at the Cancún WTO Ministerial

issue is mentioned by Claude E. Barfield, who believes that there will be questions in the future on the democratic legitimacy and the national sovereignty of WTO Members because of a constitutional flaw.⁴³⁷ He argues that there is an “imbalance between the highly efficient dispute settlement system and the ineffective consensus-plagued, rule-making procedures.”⁴³⁸ This imbalance creates pressures to legislate over new rules through adjudication. On a sensitive issue such as FDI, the WTO system may not be the most adaptable forum from an institutional point of view. The difficulty lies in the gap between the judicial branch and the legislative branch, namely that the unaccountability of the judicial branch and the lack of procedures that would allow the overruling of panels’ decisions.⁴³⁹ Some call this a matter of democratic deficit.⁴⁴⁰

A second issue is the usual bargaining within the WTO: The three most active members on investment negotiations (the EC, Japan, and South Korea) are also arguably the most defensive on agricultural issues. In order to provide a general assessment of the situation before the WTO Ministerial Conference in Cancún, one could argue that there were two extreme positions: The proponents of investment rules and those who refused them. However, the majority was willing to decide on investment depending on the other issues on the agenda. In this sense, this bargaining that characterizes the WTO has a negative impact on the evolution of FDI positions. For example, there is a general understanding of the need of liberalization, and developing countries are encouraged to take unilateral measures in this respect. The negative impact of the WTO takes place when developing countries do not take unilateral measures because they keep investment measures as a possible bargaining tool during the

Conference in September 2003.

⁴³⁷ CLAUDE E. BARFIELD, *FREE TRADE, SOVEREIGNTY, DEMOCRACY: THE FUTURE OF THE WORLD TRADE ORGANIZATION* 8-9 (The AEI Press 2001).

⁴³⁸ *Id.* at 14.

⁴³⁹ The problem seems to be the imbalance between a strong judiciary and the nonexistence of a legislative body. This transforms the judiciary into a second-hand or spontaneous legislative branch with, of course, its lack of legitimacy.

⁴⁴⁰ See generally LEAL-ARCAS, *THEORY AND PRACTICE*, *supra* note 119, at 428-29 (discussing the issue of democratic deficit in EC trade policy-making).

multilateral negotiations. If they took unilateral measures, they would lose one of the weapons to place pressure on other sectors.

C. Policy Considerations

The aim of this section is to formulate policy concerns for a future multilateral framework for investment.

1. Tendency: Broader Areas, but Lower Standards?

WTO members that supported investment and competition rules at the Seattle WTO Ministerial Conference in 1999 had to weaken their positions at the 2001 WTO Ministerial Conference in Doha. Considering the technical problems of negotiations,⁴⁴¹ the main factor being the need to weaken positions, it is arguable that there is a risk of seeing areas of international trade law broadening, but their standards lowering. One wonders whether an MAI would imply lower standards on the grounds that agreeing multilaterally is more difficult than regionally or bilaterally. Furthermore, a future MAI should find a balance between investor's rights and obligations. The future agreement should therefore regulate the control of transnational corporations' activities such as competition, protection of the environment, and corrupt practices in order to achieve a balance between investor's rights and obligations.

2. Regulation v. Liberalization

The balance between investor rights and obligations is necessary for conciliation of developed countries' requirements and developing countries' needs. This is true even though investment nowadays is not as divided between developed and developing countries, at least at a regional level as evidenced by NAFTA. An MFI will have to swing between regulation and liberalization. Liberalization is needed because many investment incentives represent inefficient and inequitable government

⁴⁴¹ See generally Robert Schuman Center for Advanced Studies, *Making and Breaking Impasses in International Regimes. The WTO, Seattle and Doha* (EUI Working Papers, RSC No. 2003/2, 2003) (prepared by John S. Odell) (discussing how negotiations in international organizations shape the effectiveness and legitimacy of regime rules).

intervention, and lead to wasteful bidding among countries. Moreover, many investment-related regulations designed at the national level are aimed at protecting national investors, industries or national sovereignty, even in cases where nothing justifies this protectionist attitude.⁴⁴² Regulation is the complementary face of a multilateral framework, as some incentives are economically justifiable due to positive or negative externalities. However, this regulatory need should be exempt from political arguments, concentrating instead on economic arguments.

These two positions are far from being accommodated. Developing countries ask for a framework that would take into account their special situation, this is to say, the creation of exceptions to the principle of automatic compensation. For example, in the case of a measure being taken because it was necessary for the development of the country in question.

3. *Overlapping Between Existing and New Rules—A Question of Coordination*

Prior to the GATS, there were no rules regarding trade in services.⁴⁴³ There was, however, a multitude of rules regarding investment. One of the issues to deal with, therefore, is how to design multilateral rules in such a way as to build upon precedents without overlapping.

4. *Dispute Settlement*

Concerning the settlement of disputes, the main issue to deal with is, of course, the place of private parties in this process. Given that the existing bilateral or regional rules make it possible for foreign investors to take direct action against a State, a multilateral framework not allowing this freedom would be perceived as a step backwards. In this sense, it would be interesting to see the place occupied instead by ICSID in a multilateral negotiation. A future multilateral investment agreement should therefore include a dispute settlement

⁴⁴² Even though the protection exists, it is more difficult to identify it because it is not a direct and open protection, but a more sophisticated and indirect protection.

⁴⁴³ See generally Leal-Arcas, *supra* note 249 (analyzing trade in services in the framework of the Doha Round).

mechanism that provides a state-state and investor-state dispute settlement process.

VII. Conclusions

The current international investment regime shows the complexity and confusion of a system with many contracting parties, some bilateral, others regional or even multilateral, as in the case of WTO Agreements. This fragmented regime may encourage regulatory competition among the various models of international investment agreements as well as contribute to confusion, legal conflict, and uncertainty. This fragmented regime may also create an incentive for treaty shopping by those foreign investors who seek protection even in situations where their country has not concluded or ratified investment agreements that offer the same level of protection as those achieved in other countries.

Moreover, as mentioned above, the proliferation of investor-state arbitrations is evidence of the fact that, for the time being, bilateral and regional governance of investment via BITs and investment chapters of FTAs will be the prevailing means of governing FDI. That said, much of investor-state arbitration causes issues of conflicting arbitral awards and forum shopping. All of this would be solved by creating a stable, non-discriminatory multilateral investment treaty.

Furthermore, as analyzed above, environmental and labor standards—which until now have only been treated marginally in international investment agreements—are increasingly seen as inseparable from foreign investment. Therefore, from a substantive point of view, it is essential to ensure that they are incorporated in a future multilateral framework for investment. This will be even more justified as globalization continues to be a reality that affects the social and environmental responsibilities of foreign investors.

A comprehensive multilateral framework for investment would serve as a template for a new generation of bilateral and regional investment treaties as well as a more coherent international framework for regulating FDI. It would also help to reduce transaction costs and enhance the economic benefits of FDI.

Regarding the design of such a multilateral framework for investment, the WTO has the opportunity to encapsulate years of development of an international framework for investment in the first truly multilateral agreement for investment. Such an agreement in the WTO context would not replace current bilateral and regional investment regulatory regimes, but could clarify the relationship among the GATS, the TRIMs Agreement, and BITs. Although the success of this project remains unknown, much work has already been inherited via BITs, GATS, NAFTA, the ECT, the TRIMs Agreement, and the failed MAI. The WTO has the chance to build upon these experiences. It will not be easy, but no pain, no gain!

