Iuris
Dictio.
Revista de Derecho

Re-thinking the requirement of making an investment in accordance with domestic laws as a substantive right and a cause of action for host States under the BITs[1]

Repensar el requisito de realizar una inversión en concordancia con el derecho doméstico como derecho sustantivo y pretensión accionable para los Estados bajo los BITs

Félix Antolín Martínez[2]
Albagli Zaliasnik Law Group

Summary

This paper challenges one of the most traditional notions in International Investment Arbitration, which is that host States do not possess any substantive rights under the BIT's framework. This work's thesis is that the current BIT framework actually grants the host State a substantive right, and as a result, a cause of action in the investment arbitration system. This right emanates from the requirement articulated in the BIT that the investment be in accordance with the host State's law. The paper explains that there is a line of both BIT and ICSID cases holding that the requirement of compliance with the host State's laws is autonomous, and that this autonomy imports a substantive right for the host States grounded solely in the BITs. This idea is also supported by the spirit and objectives of both the ICSID Convention and the BITs.

Keywords

Investment / Host State Law / Substantive Right / Investment Arbitration / ICSID / BITs.

Resumen

Este artículo desafía una de las nociones más tradicionales del Arbitraje Internacional de Inversiones: que los estados que reciben las inversiones no tienen derechos sustantivos bajo el sistema de los BITs. La tesis de este trabajo es que la actual red de BITs otorga a los Estados receptores un derecho sustantivo y así una pretensión accionable en Arbitraje Internacional de Inversiones. Este derecho emana del requisito consistente en que la inversión debe realizarse conforme al derecho del estado receptor. Existe una línea tanto de BITs como de casos seguidos en ICSID que sostiene que la exigencia de cumplimiento con el derecho del Estado receptor es autónoma, y que esta autonomía confiere un derecho sustantivo para los estados receptores consagrado en los BITs. Esta idea también se apoya en el espíritu y los objetivos tanto de la Convención de ICSID como de los BITs.

Palabras clave

Inversión / Derecho del Estado Receptor / Derecho Sustantivo / Arbitraje de Inversiones / ICSID / BITs.

1 Recibido: 15/07/2018 – Aceptado: 05/10/2018

2 Abogado de la Universidad Adolfo Ibáñez, Viña Del Mar, Chile y LL.M de la New York University, Estados Unidos. Asociado Senior del estudio jurídico Albagli Zaliasnik, en Santiago de Chile, desde 2017.

Félix Antolín Martínez (2018). Re-thinking the requirement of making an investment in accordance with domestic laws as a substantive right and a cause of action for host states under the BITs, *Iuris Dictio 22,* 101-114.
ISSN 1390-6402 / e-ISSN 2528-7834.
DOI: http://dx.doi.org/10.18272/iu.v22i22.1188

1. Introduction: the state of the matter

In the last few years, there have been increasing concerns about how effective the ICSID system and the BIT network are in practice (the concerns regarding the BIT network stem from the fact that it has developed as an ICSID product). Both systems have largely only provided benefits for foreign investors. Since the famous *Salini* case, the international community has been focused on the requirement that the investment contribute to the development of the host State in order to seek protection under ICSID (ICSID, 2000, *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, ¶¶ 52, 57). While several authors have tried to determine if the BITs favor the developing countries' economy, only a few of them have considered the substantive legal inequality between the foreign investor and the host State (Rose-Ackerman and Tobin, 2009, pp. 131-143). This inequality refers to the general understanding of the BITs universe as a system in which only the investor has substantive rights, and is therefore the only party entitled to a cause of action —against the host State— arising from the BITs (Toral and Schultz, 2009, pp. 577-578).

In two interesting pieces, Mehmet Toral and Thomas Schultz, on the one hand, and Gustavo Laborde, on the other, agree that the BITs, as have been drafted and applied until today, do not confer any substantive right to the host State (Toral and Schultz, 2009, pp. 577-578). In different ways, the authors of both articles present possible solutions to this problem.

For Toral and Schultz, the existing BIT framework is being slowly pushed by International Law towards imposing obligations on the investors. These authors explain how International Law on Human Rights and sustainable development, as applied by the host State in its country, are not only binding for the State but also for the foreign investor. These norms establish outer limits for how the foreign investment is to be conducted (Toral and Shultz, 2009, pp. 578-589). On the other hand, Laborde explains that the most effective way to overcome this problem is by introducing changes to the terms of the future generation of BITs by introducing two elements: to re-establish privity between the foreign investor and the host State, and to confer substantive rights to the latter (he suggests using a reverse umbrella clause) (Laborde, 2010, pp. 102-122).

This problem is not only exposed by authors, but also is reflected in ICSID arbitration case law. In the history of ICSID arbitration, only four cases have been initiated by the host State, i.e., in only those four cases the State has acted as claimant (excluding cases of counterclaims). Furthermore, in all of those cases the claims have been based exclusively on contract rights, not on substantive treaty rights:

In *Gabon v. Société Serete S.A.*, (ICSID, 1976), the host State initiated arbitration proceedings regarding a contract for the construction of a hospital maternity ward. In 1978, this case was settled and the proceedings were discontinued (ICSID, 1978, *Gabon v. Société Serete S.A.*; Laborde, 2010, pp. 100, 120; Toral and Schultz, 2009, p. 589).

In *Tanzania Electric Supply Company Limited v. Independent Power Tanzania Limited* (ICSID, 1998), the host State (TANESCO) started proceedings asserting two claims against the investor (IPTL), a Tanzanian-Malaysian joint venture, for the alleged breaches of a Power Purchase Agreement and its Addendum No. 1, regarding the design, construction, operation and maintenance of an electric generating facility. In 2001, the arbitral tribunal rendered the final award, which largely incorporated the parties' agreement of the disputed issues. While interpretation proceedings were pending, the tribunal issued an order, taking note of the discontinuance of the arbitration (ICSID, 1998, *Tanzania Electric Supply Company Limited v. Independent Power Tanzania Limited*; Laborde, 2010, pp. 100-101; Toral and Schultz, 2009, pp. 589-595).

 Iuris Dictio 22 (2018), 101-114. ISSN 1390-6402 / e-ISSN 2528-7834. DOI: http://dx.doi.org/10.18272/iu.v22i22.1188

In *Government of the Province of East Kalimantan v. PT Kaltim Prima Coal and others* (ICSID, 2007), the Government of the Province of East Kalimantan initiated proceedings as a representative of the State of Indonesia, against several companies (referred together as "KPC Respondents"), alleging breaches of the so-called KPC Contract, an agreement to conduct coal-mining operations. In 2009, the arbitral tribunal rendered an Award on Jurisdiction, deciding that it lacked jurisdiction to decide the dispute, because the State of Indonesia denied the claimant's authority to act as a party in the ICSID arbitration (ICSID, 2007, *Government of the Province of East Kalimantan v. PT Kaltim Prima Coal and others;* Laborde, 2010, p. 101; Toral and Schultz, pp. 589-591, 595-600).

Finally, in *Republic of Peru v. Caravelí Cotaruse Transmisora de Energía S.A.C.* (ICSID, 2013), the host State sued the foreign investor in connection with monetary sanctions that arose from a previous ICSID arbitration initiated by the investor. Indeed, in *Caravelí Cotaruse Transmisora de Energía S.A.C. v. Republic of Peru* (ICSID, 2013), the investor started arbitration proceedings against the host State regarding concession contracts for the construction of energy transmission lines. In 2013, the arbitral tribunal rendered the final award, rejecting all of the investor's claims and ordering it to pay the State's costs and expenses of the arbitration. In December 2013, the parties of both arbitrations and the investor's shareholders (who also initiated an ICSID arbitration independently, that was pending at the time) signed an "Integral Agreement", in which they ended the three arbitrations, and the foreign investors agreed to pay US$40,000,000 to the Republic of Peru (ICSID, 2013, *Republic of Peru v. Caravelí Cotaruse Transmisora de Energía S.A.C.*).

Further, as anticipated, there have been instances in which a State has initiated a counterclaim against an investor. Two notable examples worth mentioning are the cases of *Perenco Ecuador Limited v. Republic of Ecuador* (ICSID, 2008) and *Burlington Resources, Inc. v. Republic of Ecuador*, (ICSID, 2008). In both cases, the counterclaims were based upon the investor contract, not on the governing BIT, such as the precedent cases explained above. Ecuador's counterclaims arose under a production-sharing contract entered into by both parties for the exploration and exploitation of Ecuador's hydrocarbon resources. Therefore, these cases present issues distinct from those examined in this article because neither involved claims brought by the State under the BIT.

The host States' lack of substantive rights under the BIT and their inability to file purely treaty-based claims is also connected to one of the most recurrent critiques of the ICSID system regarding a perceived bias against host States. This problem is clearly explained by George Kahale, III, who explains that this does not have to do with the statistical number of cases that the States have won, but rather with a feeling that, no matter what the statistics are, there exists a bias against the States anyways (Kahale, 2014).

Although Kahale, III does not explain why this perceived bias exists, it seems to be grounded —at least in some way— in the problems addressed in this paper. This paper suggests that one of the reasons why this bias exists is because the host State is always the defendant in ICSID arbitrations. As a matter of fact, Toral and Shultz have also suggested this intuitive point in their piece, in the following terms: "[p]ut more prosaically, the investor is almost systematically cast in the role of the claimant in disputes in opposition to the State that hosts the investment. The structure of investment arbitration is thus seen as primarily benefiting the investor to the detriment of the State" (Toral and Schultz, 2009, p. 578).

Therefore, the issue at hand is of significant importance and is worth exploring in depth. Moreover, the solutions proposed by authors who have considered this issue are unsatisfactory. While some authors point to very marginal areas of substantive protection to the States International Law on Human Rights and sustainable development, others seem to depend on the re-drafting of a whole new generation of BITs, which will take a very long time (and a large amount of effort) to happen.

This paper will focus on proposing a more feasible, immediate, and comprehensive solution to the issue presented. The thesis put forth in this essay is that the host State possesses a substantive right under the current BIT framework. This right emanates from the requirement that the investment must be in accordance with the host State's law. Even if this requirement is only considered a part of the concept of "investment" established in the BITs and developed substantially in the ICSID case law (in the objections to jurisdiction context), there is a clear line of BIT and ICSID cases suggesting that this has been treated in both contexts as an autonomous requirement. This autonomous element can give rise to a substantive right for host States under investment treaties, and as a result, a cause of action based on the BITs. We think this understanding is also consistent with the objectives and spirit of both the ICSID Convention and the majority of the BITs.

In a few words, when the host State deploys the BIT's agreed standards of protection in order to protect a foreign investment, it is entitled to receive an investment that will contribute to the development of its economy. In this sense, such an investment must comply with the host State's law if such a contribution is to be made. Thus, if the investment violates the host State's domestic law, (at the beginning or through its development) the host State should have a cause of action before ICSID for a breach of the BIT.

The present work is organized in the following way: (II) Reasons why it is convenient for the States to have substantive rights and a cause of action that rests solely in the investment treaties; (III) A discussion of the line of ICSID cases and BITs from which the autonomy of the requirement of compliance with the host State's laws flows, and how this autonomy provides the host State with a substantive right, which as a result, can lead to a cause of action grounded exclusively in the investment treaties; (IV) How the ICSID Convention and some BITs show that the objectives and spirit of both support the proposed thesis; (V) Conclusions on how this substantive right and cause of action can take shape and operate, as well as some limits that should be considered.

2. Why would it be convenient for the host States to have substantive rights and a cause of action arising solely under the BITs?

Usually a foreign investor and a host State, under the framework of a binding BIT, sign an investment contract in order to regulate the terms under which the investment will be made. It is perfectly possible that this contract either: includes a dispute resolution clause that only provides access to the domestic courts (or domestic arbitration) or does not have a dispute resolution clause at all, and thus the general subsidiary jurisdiction and competence rules of the host State apply.

Generally when this occurs, it is the investor that wants to avoid the domestic *fora* agreed by the parties in the investment contract. This has given rise to the doctrine of umbrella clauses, and their extension to disputes that arise not only from the BITs but also from investment contracts. Under the current status of the system, however, only the investor is entitled to seek ICSID arbitration by exercising the BITs' umbrella clause (which are worded to benefit the investors), or simply by interpreting the host State's breaches of contract also as breaches of the standards of protection that the respective BITs grant. On the contrary, the State is not able to rely on the BITs in order to avoid the contract *fora*.

Even though it has not received much attention, as we will see below, there are reasons why States would prefer to avoid the *fora* agreed upon in an investment contract. States may prefer to resort to recourse through ICSID under the respective BIT. Additionally, there might be situations where it will be more beneficial to the host State to bring claims based on a BIT, and not on the investment contract.

From the analysis of the ICSID case law, we propose the following 5 hypotheticals: in each of them the State would benefit, either from a procedural, substantive or even political standpoint, by having the protection of a substantive right and a cause of action granted by the BITs.

2.1. Fear of corruption

According to Toral and Laborde, in *TANESCO v. IPTL*, it seems the State initiated ICSID proceedings on the grounds of:

> [W]ell-grounded fear of the corruption of its own national courts and the possibility that they would be partial and decide in favor of the investor, IPTL. This mistrust in its own domestic institutions would have been the reason for T[ANESCO] to seek justice elsewhere —ICSID was thus resorted to as an impartial and independent tribunal (Toral and Schultz, 2009, pp. 591).

Even though investors may fear that the host State's judiciary might be corrupt, or aligned with the government's States, it is possible to imagine a scenario in which the judiciary power is totally independent of the host State government (e.g. when the government only has a very small influence in the appointment of judges), or when corruption is at a level so high that officials simply sell themselves to the best buyer, irrespective of their nationality (ICSID, 1998, *Tanesco v. IPLT*). In a situation like this, the state might prefer to assert its rights before an impartial tribunal, such as ICSID, which exists without domestic pressures.

2.2. Avoiding potential international liability

What happens when the foreign investor breaches its obligations towards the State? In these cases generally the State has two options (when it does not have a contract right to bring claims before ICSID): to start proceedings in its domestic courts, or directly intervene in the foreign investment, usually by an expropriation. If the State engages in such conduct (even if it does so by enforcing a domestic court judgment), the investor can initiate arbitration proceedings before ICSID. Thus, in the arbitration, the tribunal could find for the claimant, and decide that the measures adopted by the State produced damages to the foreign investor. In such a scenario, the State will be held liable for damages, an amount of which would have been produced by the host State precisely for exercising the only available measures it had for the alleged investor's breach.

This problematic situation could be avoided if the State had the right to resort directly to ICSID. Likewise, this option will seriously diminish the problem of having parallel ICSID proceedings and litigation at the host State's courts.

2.3. Incentive to gain or keep international reputation

Several authors sustain that by signing BITs, States (especially developing ones) intend to demonstrate to foreign investors that their investments will have strong guarantees and protections. Through the BIT, the State is also showing a commitment that can be enforced through an investment treaty, independently of the flaws or shortcomings of their domestic rule of law (Rose-Ackerman and Tobin, 2009, p. 131).

Then, it may be possible that the host States have this same incentive in preferring to defer to ICSID arbitration *in lieu* of exercising their rights in its domestic courts. If States have a cause of action emanating from the BITs and are seen as an equal acting party in the ICSID system, then it would be likely that the choice of *forum* on the part of the State would be a variable in statistical studies or surveys. This in turn, would determine which States are more committed to the BITs framework and in principle would provide more guarantees to the foreign investments in their countries. In sum, the preference of using ICSID rather than the State's domestic courts will improve the State's reputation as a convenient place to invest.

2.4. It is easier to enforce an ICSID award in foreign jurisdictions than a judgment from the domestic courts

According to Toral, Schultz, and Laborde, sometimes the State will prefer to file a claim before ICSID instead of its own domestic courts because it would be easier to enforce an ICSID award in foreign jurisdictions, rather than a judgment from the local courts (Toral and Schultz, 2009, p. 101). This idea is based on the Commitment that the ICSID Convention's Contracting States made under Article 54(1) (Laborde, 2010, p. 101); Moreover, this seems to become especially relevant when the investor's assets in the host country are insufficient to satisfy the amounts owed to the host State.

Although this theory maybe seems compelling, it is not as clear cut as it seems. Even though it's true that The Hague Convention on the Recognition and Enforcement of Judgments has not been widely adopted among States, we would have to determine if enforceability of the ICSID awards is more effective than reciprocal relationships and comity between States, which can be strong ways to facilitate the enforcement of domestic judgments in favor of the host State in foreign nations (especially among those States who are strong or have a lot of political allies).

2.5. When substantive rights under the BIT are better than contract rights

This last proposition is purely hypothetical, as it is based on an assumption that substantive rights for the host States under the BITs are recognized. It could be possible to conceive of a situation where the substantive right exists (i.e. the right of the host State to receive an investment in compliance with its laws), and it is stronger or more comprehensive than the substantive protections negotiated with the foreign investor in the investment contract. This may be the case for a small developing country that is negotiating an investment contract with one of the world's biggest companies regarding a multi-million dollar investment, and as a result the State got caught in a bad contract deal with the investor.

3. The autonomy of the requirement of compliance with the host State's laws, as described by the BITs and understood by ICSID case law

As anticipated in the sections above, the requirement that the investment comply with the host State's laws has been developed in the context of cases with objections to the Centre's jurisdiction. Specifically, this requirement has been formed as a part of a list of factors that an investment should (or must, according to some ICSID tribunals) fulfill in order to qualify as an "investment" in the terms of Article 25 of the ICSID Convention. As we know, only investments complying with this provision are entitled to the standards of protection outlined in the BITs.

 Iuris Dictio 22 (2018), 101-114. ISSN 1390-6402 / e-ISSN 2528-7834. DOI: http://dx.doi.org/10.18272/iu.v22i22.1188

The development of the requirement that the investor comply with the host State laws began with *Salini*. The arbitral tribunal in *Salini* ruled that a protected investment was to one that contributed to the development of the host State (ICSID, 2000, *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, ¶¶ 52, 57). Several cases followed *Salini*, expanding or re-thinking this reasoning, and therefore making slight modifications to this requirement and adding new ones in the same spirit. The most important of these cases for our purposes is *Phoenix Action, Ltd. v. The Czech Republic* (ICSID, 2006) in which the arbitral tribunal added two factors to the *Salini* test: that the investment be "made in accordance with the laws of the host State" (this element was considered by the *Salini* tribunal, but not added as a factor in the test), and "in good faith" (ICSID, 2006, *Phoenix Action, Ltd. v. The Czech Republic,* ¶¶ 45, 49). All of these cases found that it was relevant to analyze every factor in these tests to determine if an investment was to be considered a protected one under the BITs (although the approaches to the tests varied among the tribunals).

Other arbitral tribunals went in the opposite direction of *Salini*, finding that the list of factors provided there and in subsequent cases were not dispositive in determining if the investment qualified as a protected one under the terms of Article 25. For these tribunals, the most important element to be considered in the definition of investment was the agreement of the parties, considering the deferential treatment given, among other sources, by the *travaux préparatoires* of the ICSID Convention to the party autonomy in this matter. Good examples of these cases are *Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania*, ICSID Case No. ARB/05/22 and *Malaysian Historical Salvors SDN BHD v. The Government of Malaysia*, ICSID Case No. ARB/05/10.

Even if both lines of cases do not give the same weight to the factors or requirements the investment has to fulfill, it seems every arbitral tribunal, when determining whether an investment is protected, recognizes the existence of these factors, and usually uses them (to one degree or another) in order to reach a decision. Thus, the requirement that an investment complies with the host State's laws is, at least, a probative criterion in order to determine if an investment shall be protected by a BIT in any given dispute.

Now that we have briefly explained the development of the requirement that the investment be made in accordance with the host State's law, it is pertinent to briefly describe its treatment in the ICSID system. Firstly, let's try to define the nature of the requirement. For some authors and tribunals, the requirement is not a proper objection to the Centre's jurisdiction, but rather an objection of admissibility of the claim. The particular relevance of this distinction is that objections of admissibility are usually considered to be issues pertaining to the merits of the dispute, and therefore have a substantive character, unlike objections to jurisdiction.

In a very clear piece, Andrew Newcombe argues that "admissibility can be a useful tool for approaching questions of investor misconduct." He equates admissibility with the merits, and describes "investor misconduct" "(such as fraud, illegality and corruption)" (2010). Even more, he considered the fact that this criterion has been applied in several investment arbitrations, such as in *Plama Consortium Limited v. Republic of Bulgaria*. From this view, it is possible to assume that the nature of the requirement of compliance with the host State's laws is a substantive one. This element is relevant when the idea is to move this requirement from an objection to a substantive right, as will be shown below.

Secondly, it is important to describe the treatment of the requirement of compliance with the host State's laws in terms of the consequences (as determined by arbitral tribunals) which result when the investment lacks such a requirement and is therefore unprotected. In other words, the issue is what happens with the investment when it does not comply with the host State's laws. Ursula Kriebaum has categorized the tribunals' decisions as follows:

> Tribunals use three approaches: 1) Tribunals that denied jurisdiction have either held that there is no protected investment or that there is no consent to arbitrate. 2) In other cases they decided that there was an investment, but that it is not protected and hence dismissed the case on the merits. 3) In situations where the respondent successfully invoked violations of host State law as a justification for an interference, tribunals decided that no substantial violation had occurred (2010, s. n.).

The importance of these categorization lies above all in approach number three: as we can see, some arbitral tribunals have considered that this requirement justifies *ex-post* the host State's interventions in a given investment (commonly expropriations). The problem with this approach is what happens when the alleged violations are not successfully invoked by the State. As we will see below, this scenario, and the treatment of the requirement of compliance with the host State's laws as an objection or defense, in many cases, can force the host State to take unreasonable risks of incurring international liability.

Turning now to the main purpose of this section: to show that the compliance with the host State's law requirement is an autonomous one, being different from the other requirements an investment has to fulfill in order to be entitled to the protections of the BITs. The autonomy of this requirement is acknowledged by the BITs and by the ICSID arbitral tribunals in three ways: (a) the requirement of compliance with the host State's law is included in the definition of investment provision, but is not specified in the different forms that the investment can take; (b) the requirement is included in the so-called "in accordance with host State law" clauses (Kriebaum, 2010, p. 307); and (c) even in the absence of the element in the BITs, ICSID arbitral tribunals have found that the investment still has to fulfill this requirement. Let's review these three ways.

(a) BITs usually include the requirement that investors act in accordance with the host State's law within the definition of the term "investment." These kinds of clauses usually provide a general statement defining the term "investment" and listing the different modalities that such an investment might take. Several BITs have included the requirement of compliance with the host State's laws in this term. The Czech-Israel BIT, for example, defines investment as follows: "[t]he term 'investments' shall compromise any kind of assets invested in connection with economic activities by an investor of one Contracting Party in the territory of the other Contracting Party in accordance with the laws and regulations of the latter and shall include, in particular, though not exclusively:" (1997) Other BITs, such as the Germany-Philippines BIT (1998) and the Peru-Spain BIT (1994), relevant for *Republic of Peru v. Caravelí Cotaruse Transmisora de Energía S.A.C.* (ICSID, 2013), have followed a very similar definition, including the express requirement of accordance with the host State's laws.

The fact that the requirement of compliance with State laws is included in the definition provision of investments strongly suggests that this requirement is different from the other elements necessary for an investment to qualify as protected pursuant Article 25 of the ICSID Convention. In particular, this idea has been supported by ICSID case law.

In *Salini*, the tribunal faced with the question of determining the content of the requirement of compliance with the host State laws', held that:

> The Tribunal cannot follow the Kingdom of Morocco in its view that paragraph 1 of Article 1 refers to the law of the host State for the definition of "investment". In focusing on "the categories of invested assets [...] in accordance with the laws and regulations of the aforementioned party," this provision refers to the validity of the investment and not

 Iuris Dictio 22 (2018), 101-114. ISSN 1390-6402 / e-ISSN 2528-7834. DOI: http://dx.doi.org/10.18272/iu.v22i22.1188

> to its definition. More specifically, it seeks to prevent the Bilateral Treaty from protecting investments that should not be protected, particularly because they would be illegal (ICSID, 2000, *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, ¶ 46).

The tribunal in *Inceysa Vallisoletana, S.L. v. Republic of El Salvador* (ICSID, 2003), shared this view. In this case the tribunal reasoned:

> There are various forms by which States establish the "accordance with the laws of the host State clause." Among the mechanisms used to include this limitation is to add it into the definition of *investment* itself, making it clear that for the purposes of that reciprocal protection agreement only those made in accordance with the laws of the host State will be deemed *investments*.

(b) The idea that the requirement of compliance with the host State's laws is autonomous is even stronger when it is included in a specific, independent clause in the BITs, the so-called "in accordance with host State law" clause. This provision essentially establishes that the host States shall admit foreign investments only if they are made in accordance with its domestic laws. This means that if the investment is illegal in the eyes of the host state, it has the right not to accept it. This mechanism of including the requirement as its own clause is "[o]ne of the most commonly used," and can coexist with the definition of investment that also contains the requirement (ICSID, 2003, *Inceysa Vallisoletana. v. Republic of El Salvador*, ¶ 185). As the Netherlands-Czech BIT puts it in its Article 2: "[e]ach Contracting Party shall in its territory promote investments by investors of the other Contracting Party and shall admit such investments in accordance with its provisions of law" (1992). A similar provision can be found, for example and among many others, in the Spain-El Salvador BIT (1996).

This view is also supported by case law. As we have seen, the *Inceysa Vallisoletana, S.L. v. Republic of El Salvador* (ICSID, 2003) tribunal considered that the requirement of accordance with the host state's laws, can be included in both the definition of investment and in the specific article that deals with this requirement (in the provisions related to "Protection" or in the "Promotion and Admission" chapter of the BIT).

(c) Finally, the autonomy of the requirement is shown by the fact that some ICSID tribunals have found it to apply to foreign investments even if it is not included in the investment treaties. Tribunals have applied the requirement to determine if the investment qualifies as protected. This trend opens the door to finding that the protection favors the State and is different from the elements an investment must satisfy in order to enter into the realm of protection of the BITs.

In *Plama Consortium Limited v. Republic of Bulgaria* (ICSID, 2003), a case dealing with a foreign investment under the Energy Charter Treaty (ECT), the arbitral tribunal held that:

> Unlike a number of Bilateral Investment Treaties, the ECT does not contain a provision requiring the conformity of the Investment with a particular law. This does not mean, however, that the protections provided for by the ECT cover all kinds of investments, including those contrary to domestic or international law.

The tribunal in *Phoenix Action, Ltd. v. The Czech Republic* followed this position in the following terms:

> In the Tribunal's view, States cannot be deemed to offer access to the ICSID dispute settlement mechanism to investments made in violation of their laws. If a State, for example, restricts foreign investment in a sector of its economy and a foreign investor disregards such restriction, the investment concerned cannot be protected under the ICSID/BIT system. These are illegal investments according to the national law of the host State and cannot be protected through an ICSID arbitral process. And it is the Tribunal's view that this condition —the conformity of the establishment of the investment with the national laws— is implicit even when not expressly stated in the relevant BIT.

Consequently, the BITs and the line of cases described support the contention that if the requirement of compliance with the host State's law is autonomous or independent, and of a substantive nature, it can arise as more than a mere objection of jurisdiction or admissibility. If the requirement is treated as a substantive right, there would be a cause of action for the host State. In the next section we will demonstrate how this thesis is also supported by the objectives and spirit of both the ICSID Convention and the BIT framework.

4. The objectives and spirit of both the ICSID Convention and the BITs are consistent with granting the host states a substantive right (and a cause of action)

As explained in the section above, the substantive right of the State to receive a foreign investment in accordance with its domestic law, and therefore a corresponding cause of action, should be considered a standard accorded for the benefit of the state in the BITs, as understood by ICSID case law. This understanding, as detailed below, is reinforced by the object and spirit of both the ICSID system and the BITs network.

Let's start with the developing documents of the ICSID system. From the reading of the constituent documents of both the World Bank and ICSID, it is easy to realize that, among the objectives of both institutions, the development of the States takes a central place. Indeed, Article 1 (Purposes) of the World Bank's Articles of Agreement establishes as a purpose of ensuring the "encouragement of the development of productive facilities and resources in less developed countries" (2012). This purpose has been acknowledged in the UNCTAD Course on Dispute Settlement in International Trade, Investment and Intellectual Property, one of the cornerstones of the "specialized subject-matter jurisdiction" of ICSID (Escobar, 2003).

Then comes the famous preamble of the ICSID Convention, according to which the Contracting States considered "the need for international cooperation for economic development, and the role of private international investment therein. (2006)" As seen above, the preamble, and especially this phrase, are the sections that *Salini* and its following line of cases have used in order to establish the requirement that an investment must contribute to the development of the host State.

This idea also conforms with the objectives of the BITs, which seek to provide reciprocal benefits between the contracting parties arising from the promotion of foreign investments, and as a result, develop the States economically. Indeed, the UK-Indonesia BIT (1977), relevant in the *Government of the Province of East Kalimantan v. PT Kaltim Prima Coal and others* case (ICSID, 2007), stated in its preamble that the contracting states recognized "that the encouragement and reciprocal protection under international agreement of such investments will be conductive to the stimulation of individual business initiative and will increase prosperity in both States" (p. 1977).

Other BITs have followed the language of this treaty in a similar way, such as the Finland-Estonia BIT (1993), the Czech-Israel BIT (1997), and the Germany-Philippines

BIT (1998). All of these treaties seek the "prosperity" of both contracting states through foreign investments[3].

Furthermore, the Netherlands-Czech BIT went even further in creating this principle with clear language, as it refers directly to the State's "economic development": "[r]ecognizing that agreement upon the treatment to be accorded to such investments will stimulate the flow of capital and technology and the economic development of the Contracting Parties and that fair and equitable treatment is desirable" (1992).

Now, it is clear that the BITs and the ICSID documents have some objectives in common and that a central role is given to ensuring benefits to the development, prosperity, or economy of the host States. Therefore, the substantive right of the State to receive an investment in accordance with its laws can be inferred from the premise that foreign investments should contribute to the development of the host States. It is simply unreasonable to think that an illegal investment can provide benefits or prosperity to a country.

In this regard, when analyzing the connection between these documents and the treatment of the requirement of compliance with the host's law, the following conclusion is inevitable: it is difficult to imagine that both the framers of the ICSID Convention and the negotiating parties of the first generation of BITs thought of a system in which the host State won't have any cause of action against the investor. Even worse, they probably did not think that this lack of protection to the host would leave the State with only one solution: to expropriate or intervene in the foreign investment when the investor engages in illegal activities.

This fallout, which as explained has been traditionally supported or at least tolerated by the ICSID case law, seems to be clearly against the objectives of the promotion of foreign investment and of the development of the State, as it produces instability and leaves the system useless in preventing these kinds of situations.

DOSSIER

Additionally, if we look at the reciprocity promoted by the BITs, it seems that some "consideration" that has to be given to the State, in exchange of providing protection to the foreign investor (according to the BITs' international standards): this "consideration" would be to receive an investment that at least complies with the laws of the host state; is the minimum assurance that the host State can have that the foreign investment would be a contribution to the country.

Finally, we have seen that the objection to jurisdiction based on the non-compliance of the foreign investment with the State's law is considered to be an objection of admissibility, i.e. part of the merits discussion, and therefore a substantive nature. Consequently, it does not seem to be a problem with the nature of this objection when it comes to treating it as a substantive right.

3 The Finland-Estonia BIT states: "[r]ecognizing the need to protect investments by investors of both Parties and to stimulate the flow of capital and individual business initiative with a view to the economic prosperity of both Parties". *Agreement between the Government of the Republic of Finland and the Government of the Republic of Estonia for the Promotion and Protection of Investments*, Preamble (1993). The Czech-Israel BIT states: "[r]ecognizing that the reciprocal promotion and protection of investments on the basis of the present Agreement will be conductive to the stimulation of individual business initiative and will increase prosperity in both States. *Agreement between the Government of the Czech Republic and the Government of the State of Israel for the Reciprocal Promotion and Protection of Investments, supra* note 27, at Preamble. The Germany-Philippines BIT states: "[r]ecognizing that encouragement and protection of such investments will benefit the economic prosperity of both States". *Agreement between the Federal Republic of Germany and the Republic of Philippines for the Promotion and Reciprocal Protection of Investments*, supra note 28, at Preamble (1998).

5. Conclusions

It seems feasible to consider the possibility that host States are entitled to bring claims arising out directly of a substantive right granted in the BITs. This could be beneficial for the entire ICSID system.

Under this approach, host States would be allowed to bring a claim under the BITs based on a right to receive an international investment in accordance with its domestic law. This arises both from the terms agreed upon by the Contracting Parties in investment treaties and the objectives of those instruments, as well as from the ICSID Convention. Compromising with this view could be very helpful to meet the ideal of the host States being more active as claimants in ICSID arbitrations, without making any changes to the BITs' designs, and could extend to violations in any area of the State's law that is connected with the investment.

As discussed in this piece, this thesis could be supported by the treatment that has given to the "in accordance with host State laws" requirement by a line of cases and BITs. In a nutshell, it is possible to argue that the understanding of this requirement as a one of admissibility, and the fact some BITs include a specific provision regarding investments' compliance with the laws of the host State, means implicitly this requirement has a substantive dimension, apart from its jurisdictional one.

Nevertheless, it is important to state two precautions: first, this article in no way pretends to suggest that host States could force foreign investors to make investments in the country, but to demand the legality of the investments that are already made or in progress, as agreed by the respective parties; second, the issues analyzed and proposed in this paper are subject to the interpretation of the practitioners in international investment arbitration, and adopting this idea would require a creative effort and a breakthrough with respect to how host State's rights have been understood until today.

Then, in order to allow the host States to exercise this right, the parties of investment treaties and of investment disputes, and especially the ICSID Secretariat and the ICSID tribunals should make this type of compromise.

As explained by authors, a participation of the host States as claimants will most likely fortify the ICSID system, giving all of the actors a sense of stability, equality and commitment to the ICSID tribunals' arbitral awards. Plus, it will contribute to the further promotion of foreign investments (Laborde, 2010, p. 120-122).

Of course, the exercise of this substantive right will have to be subject to certain limits that do not allow for its abuse by the host State. Those limits will need to be based on the earlier case law dealing with the requirement of comporting to the host State's law, when filed as an objection to jurisdiction.

Relatedly, the State should not be able to exercise this right if the host state itself has violated its own law. In other words, the State should be precluded from exercising its right with regards to a foreign investment if the claimed illegalities consist of the host State's own violations of its laws (Kriebaum, 2010, p. 310).

Additionally, the State should not be able to exercise this right if it makes changes to its domestic law after the investment was agreed or it has started, with the sole purpose of making that investment illegal, so the state can be excused from complying with its obligations. As explained by Guido Tawil, even if the foreign investor and the host State haven't signed a stabilization clause, "[a]ction taken through changes in the domestic law which is aimed at abrogating the contractual relationship or at establishing a framework under which the investor can no longer operate will not have to be accepted" (2003).

Bibliographic references

Escobar, A. (2003). *UNCTAD Course on Dispute Settlement in International Trade, Investment and Intellectual Property, module 2.5* 5. Geneva: United Nations.

Kahale, G. (2014). III, *Keynote Speech during the Eight Annual Juris Investment Treaty Arbitration Conference*. Washington, D.C. <https://www.curtis.com/siteFiles/Publications/8TH%20Annual%20Juris%20Investment%20Treaty%20Arbitration%20Conf.%20-%20March%2028%202014.pdf>.

Kriebaum, U. (2010). Chapter V: Investment Arbitration. Illegal Investments. In C. Klausegger, P. Klein, et al. (eds.). *Austrian Arbitration Yearbook 2010*. London: C.H. Beck, Stämpfli & Manz.

Laborde, G. (2010). The Case for Host State Claims in Investment Arbitration. *Journal of International Dispute Settlement,* 97, 111-113. https//:doi.org/10.1093/jnlids/idp008

Newcombe, A. (2010). The Question of Admissibility of Claims in Investment Treaty Arbitration. *Kluwer Arbitration Blog*. < http://arbitrationblog.kluwerarbitration.com/2010/02/03/the-question-of-admissibility-of-claims-in-investment-treaty-arbitration/>.

Rose-Ackerman, S. and Tobin, J. (2009). Do BITs Benefit Developing Countries? In C. A. Rogers and R. P. Alford (eds.). *The Future of Investment Arbitration* (pp. 131-143). Oxford: Oxford University Press.

Tawil, G. (2003). *UNCTAD Course on Dispute Settlement in International Trade, Investment and Intellectual Property, module 2.6* 16. Geneva: United Nations.

Toral, M. and Schultz, T. (2009). The State, a Perpetual Respondent in Investment Arbitration? Some Unorthodox Considerations. In M. Waibel et al. eds, *The Backlash Against Investment Arbitration* (pp. 577-578). London: Wolters Kluwer.

DOSSIER

Decisions

ICSID (1978). *Gabon v. Société Serete S.A.*, ICSID Case No. ARB/76/1.

— (1998). *Tanzania Electric Supply Company Limited v. Independent Power Tanzania Limited*, ICSID Case No. ARB/98/8, Final Award (2001) <https://icsid.worldbank.org>.

— (2000). *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction (2003), in *42 International Legal Materials* ¶¶ 52, 57.

— (2003). *Inceysa Vallisoletana, S.L. v. Republic of El Salvador*, ICSID Case No. ARB 03/26, Award (English translation) ¶ 186 (2006) <https://icsid.worldbank.org>.

— (2003). *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB 03/24, Award ¶138 (2008) <https://icsid.worldbank.org>.

— (2005). *Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award ¶¶ 310, 312-318 (2008) <https://icsid.worldbank.org>.

— (2005). *Malaysian Historical Salvors SDN BHD v. The Government of Malaysia*, ICSID Case No. ARB/05/10, Decision on the Application for Annulment ¶¶ 71-80 (2009) <https://icsid.worldbank.org>.

— (2006). *Phoenix Action, Ltd. v. The Czech Republic*, ICSID Case No. ARB/06/5, Award ¶¶ 100-105, 134 (2009) <https://icsid.worldbank.org>.

— (2007). *Government of the Province of East Kalimantan v. PT Kaltim Prima Coal — others*, ICSID Case No. ARB/07/3, Award on Jurisdiction (2009) <https://icsid.worldbank.org>.

— (2008). *Burlington Resources, Inc. v. Republic of Ecuador.* ICSID Case No. ARB/08/5. Decision on Counterclaims (2017) <https://icsid.worldbank.org>.

— (2008). *Perenco Ecuador Limited v. Republic of Ecuador*, ICSID Case No. ARB/08/6, Interim Decision on Environmental Counterclaim (2015) <https://icsid.worldbank.org>.

— (2011). *Caravelí Cotaruse Transmisora de Energía S.A.C. v. Republic of Peru*, ICSID Case No. ARB/11/9, Final Award (2013) <https://icsid.worldbank.org>.

— (2013). *Republic of Peru v. Caravelí Cotaruse Transmisora de Energía S.A.C.*, ICSID Case No. ARB/13/24, Procedural Order Acknowledging the Discontinuance of the Proceedings (2013) <https://icsid.worldbank.org>.

Legislation

Government of the Czech Republic / Government of the State of Israel (1997). Agreement between the Government of the Czech Republic and the Government of the State of Israel for the Reciprocal Promotion and Protection of Investments.

Government of the Republic of Finland / Government of the Republic of Estonia (1993). Agreement between the Government of the Republic of Finland and the Government of the Republic of Estonia for the Promotion and Protection of Investments, Preamble.

Federal Republic of Germany / Republic of Philippines (1998). Agreement between the Federal Republic of Germany and the Republic of Philippines for the Promotion and Reciprocal Protection of Investments, Article 1.

Government of the United Kingdom of Great Britain and Northern Ireland / Government of the Republic of Indonesia (1977). Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Indonesia for the Promotion and Protection of Investments, Preamble.

Republic of Peru / Kingdom of Spain (1994). Agreement for the Promotion and Reciprocal Protection of Investments between the Republic of Peru and the Kingdom of Spain, Article 1.

Kingdom of Spain / Republic of El Salvador (1996). Agreement for the Promotion and Reciprocal Protection of Investments between the Kingdom of Spain and the Republic of El Salvador, Article 2.

Kingdom of the Netherlands / Czech and Slovak Federal Republic (1992). Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic, Article 2.

ICSID (2012). International Bank for Reconstruction and Development, Articles of Agreement, Article I.

— (2006). International Centre for Settlement of Investment Disputes, ICSID Convention, Regulations and Rules 11.