SAFEGUARDS AND COMPROMISES UNDER INTERNATIONAL INVESTMENT LAW: A SOUTH-ASIAN PERSPECTIVE

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Abstract

Historically it is sufficiently evident that foreign merchants/investors were entitled to legal protections, and under contemporary international investment law, these protections are significantly high. This paper examines how in guaranteeing these protections the host states are compromising their national interests. For instance, the direct access to international arbitral mechanism and wider inclusion/interpretation of state responsibility are the two safeguard tools that have been scrutinized through this paper. The outcome of this paper shows that economically weaker countries like South-Asian countries are more indifferent than the developed countries concerning their national interests in inviting foreign investment.

1. Introduction

Historically, the development of international law was primarily concerned to be the law of peoples and/or nations as these are the products of the will of the human being involved.[1] Thus, international law was primarily linked with the objective of alien protection since the

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[1] BARDO FASSBENDER & ANNE PETERS, THE OXFORD HANDBOOK OF THE HISTORY OF INTERNATIONAL LAW 1 (2012).

availability of legal remedies for the aggrieved is the *sine qua non* of any legal system.[2] Although it is difficult to track the first development of international law regarding alien treatment, still historically, it is sufficiently evident that foreigners were entitled to legal protections. In fact, before forming the modern nation-state, the need for a minimum degree of protection for the alien, especially for the foreign merchants, emerged in the late-middle age, which was all about the basic protection of life, security, and property. [3] Chronologically, these protections had received formal shape under the customary rules and thereby under modern international law.[4] Hence, the growth and development of international investment law surrounding foreign investors' protection are as old as international law.

Nowadays, states are more concerned about attracting foreign investment to promote their economic growth, and conversely, foreign investors are concerned with their protections.[5] Therefore, host states ensure the safeguards foreign investors ask, even knowing that those might cause some adverse impact on them, and this tendency is more prominent among the economically weaker countries. This paper will examine how the safeguards guaranteed to foreign investors are becoming the compromise of the host states' interests, and it will especially be focused on the South-Asian (SA) context. It will scrutinize two different safeguard tools available for foreign investors under the contemporary investment law regime, firstly, the direct access to international arbitral mechanism, and secondly, a wider

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[2] Charles Cheney Hyde, *How Far is the Position of Resident Aliens Recognized and Protected by International Law*, 5 P. ASIL A.M. 32, at 32 (1911).

[3] Francesco Francioni, *Access to Justice, Denial of Justice and International Investment Law,* 20 EJIL 729, 730 (2009).

[4] *Id.* at 730-732.

[5] TULLIO TREVES ET AL., FOREIGN INVESTMENT, INTERNATIONAL LAW AND COMMON CONCERNS 1 (2014).

inclusion/interpretation of state responsibility. Then it will emphasize how these safeguards are causing a threat or compromise for the host states.

2. Direct Access to International Arbitral Mechanism

Access to justice is the core of any legal system, and access to the effective remedial mechanism is the primary requirement of legal protection. Therefore, while investing in any foreign territory, foreign investors' first consideration is about the redressal mechanism in case any risk occurs toward their investment. Definitely, access to the domestic court is an open recourse in any jurisdiction. However, it is not an attractive solution from the investors' perspective as they cannot rely on that; thereby, the third-party arbitral mechanism has received immense popularity among foreign investors.[6] Thus, host states are deliberately signing Bilateral Investment Treaties (BITs) to ensure extra protection schemes to the foreign investors and allowing them direct access to the international arbitral mechanism in case of any dispute concerning their investment. Simultaneously, this form of liberal access to justice mechanism might boost a denial of justice situation for the civilian group or individual of the host-state when their rights would be adversely affected by the foreign investment because foreign investors may easily bypass the domestic court's jurisdiction while any decision will be passed against them, as they have direct access to international arbitral mechanisms.

Article 26 of the ICSID Convention[7] allows its parties to impose domestic administrative or judicial remedy exhaustion as the pre-condition of its consent to arbitration before the ICSID tribunal. However, my study on about eighty-seven BITs signed and currently in force by six SAARC countries, excluding Bhutan and Maldives (Bhutan and Maldives have no existing

[6] RUDOLF DOLZER & CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 235-236 (2nd ed. 2012).

[7] Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Mar. 18, 1965, 575 U.N.T.S. 159.

BIT in force currently),[8] shows none of these mandatorily requires prior exhaustion of domestic remedy to move to the international arbitral mechanism. Even fifty-one of these have no mention about domestic remedy exhaustion, and the rest of the thirty-six BIT mentions prior exhaustion of available domestic remedies only as an optional means.

Under the contemporary international investment arbitral regime, on several occasions, foreign investors successfully invoked this safeguard against the host states, which is prejudicial to the sovereign capacity of the host states' judicial mechanism. In the *Shell Brand v. Nicaragua*[9] case, a Dutch company, 'Shell Oil Company,' sought an arbitration claim before the ICSID tribunal against the Nicaraguan domestic court's decision instead of preferring an appeal. In this case, the Republic of Nicaragua introduced legislative measures to compensate the victims of any public health-related injuries caused by using pesticides, namely, DBCP, which was manufactured under the brand name *Nemagon*. Moreover, it was legislated that the quantum of compensation to be satisfied by the defendant company manufactured it, and if the defendant fails to satisfy the judgment, the claimant will have the right to auction off the company's trademark to be compensated from the proceeds of the auction. Thus, upon a complaint, the Nicaraguan court ordered the Dow Chemical Company, Shell Oil Company, Standard Fruit, and Dole Food Corporation to pay $489 million in damages. However, Shell Oil refused to satisfy the judgment, and in the aftermath, the Nicaraguan court seized the Shell logo and trademark in Nicaragua. Thereafter, Shell requested an ICSID arbitration alleging that their trademark seizure constitutes an unlawful expropriation of its asset. Subsequently, Nicaragua's Court of Appeal reversed the lower court's decision upon the application of the

[8] International Investment Agreement Navigator, INVESTMENT POLICY HUB (Mar. 22, 2021, 2:42:34 AM), https://investmentpolicy.unctad.org/international-investment-agreements.

[9] Shell Brand International AG and Shell Nicaragua SA v. Republic of Nicar., ICSID Case No. ARB/06/14, Discontinuation Order, (Mar. 12, 2007).

other appellants and ordered the return of the trademark. Consequently, Shell Oil abandoned the ICSID claim. Here, the Dutch investor could bypass the domestic jurisdiction and instituted an ICSID claim because Article 9(1) of the Netherland-Nicaragua BIT [10] doesn't require prior exhaustion of available domestic remedies to avail the arbitration.

Similarly, in *Saipem v. Bangladesh*[11] case, the claimant Saipem S.p.A., an Italian company, sought an expropriation claim before the ICSID arbitration tribunal against the decision of the High Court Division (HCD), the second-highest court of the People's Republic of Bangladesh, without exhausting the available appellate remedy. The fact was, Saipem entered into a contract with Petrobangla, a Bangladeshi state-owned oil, gas, and mineral distribution company, concerning the construction of a pipeline. The project started, but due to protests from local people, Saipem could not complete the project within due time and thus claimed compensation from Petrobangla for the delay. Petrobangla refused to pay compensation, claiming that Saipem caused damage to the local property, which raised the protest. After that, Saipem initiated an arbitration claiming compensation under the dispute settlement clause of the contract, which was seated at Dhaka, Bangladesh. After the commencement of the proceeding, Petrobangla sought several procedural requests before the tribunal, which were rejected. Thereafter, Petrobangla sought to suspend the tribunal's authority to proceed further due to arbitrators' misconduct before the Dhaka Court, which had supervisory power over the tribunal and consequently Dhaka Court ordered affirmatively. Nevertheless, the arbitration tribunal continued proceeding, ignoring the stay order, held Petrobangla responsible for paying compensation. Petrobangla further filed a writ petition claiming the set aside of the arbitration

[10] Agreement Agreement on Encouragement and Reciprocal Protection of Investments Between the Republic of Nicaragua and the Kingdom of the Netherlands, Neth.-Nicar., Aug. 28, 2000, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2066/download.

[11] Saipem S.p.A v. The People's Republic of Ban., ICSID Case No. ARB/05/07, Final Award, (June 30, 2009).

award before the HCD. The HCD declined the petition stating that there is no award to set aside in the eye of law since the tribunal was incompetent to make any award.[12] Eventually, Saipem requested an ICSID arbitration under Article 5 of the Bangladesh-Italy BIT[13] instead of preferring an appeal against the decision. Saipem argued that the Bangladeshi court's decision had expropriated its right to enforce the arbitration award, and the ICSID tribunal decided the case accordingly against Bangladesh.

This decision has a far-reaching adverse impact on future investment disputes concerning the local remedy exhaustion rules since the host-state's judicial division's sovereign capacity has been impaired to some extent. Thus, the host-state's local population may face a denial of justice before the domestic court against any adversity they suffer due to the foreign investment. Saipem could bypass the Bangladeshi court's appellate jurisdiction because Article 9(2) of the Bangladesh-Italy BIT allows the foreign investors to seek protection before the international arbitral mechanism without exhausting local remedies.

Conversely, in the *Loewen Group v. the United States*[14] case, the ICSID tribunal refused to exercise jurisdiction due to the claimant's default in exhausting available local remedies. In this case, Loewen Group, a Canadian company, was sued by a local business enterprise before the Mississippi court for unfair business practices. The court of Mississippi awarded a verdict of US$500 million in compensation against the Canadian investor. Loewen Group could appeal against the decision under Mississippi law. However, it required the posting of a financial bond

[12] *See Id.* at ¶ 50.

[13] Agreement Between the Government of the Republic of Italy and the Government of the People's Republic of Bangladesh on the Promotion and Protection of Investments, Ban.-It., Mar. 20, 1990, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/268/download.

[14] Loewen Group, Inc. and Raymond L. Loewen v. U.S.A., ICSID Case No. ARB(AF)/98/3, Final Award, (June 26, 2003), 10 ICSID Rep. 443, (2004).

in the amount of 125% of the award to suspend its execution pending the appeal. So, it is obvious that an investor would not be able to comply with this unrealistic condition to exhaust local remedies. Therefore, Loewen Group requested an ICSID arbitration claim under the North American Free Trade Agreement (NAFTA)[15] Chapter 11, arguing a violation of the claimant's substantive right of national treatment under Article 1102, the minimum standard of treatment under Article 1105, denial of justice under Article 1105 for the unrealistic bond requirement for exhaustion of local remedy, and ultimately which constitutes an expropriation under Article 1110. Whereas the respondent, the United States, argued that the court of Mississippi's decision has not been adopted or maintained by them, and state responsibility only arises when there is any finality of a decision by the state's judicial system as a whole. Moreover, the United States has not waived the procedural requirement of local remedy exhaustion under NAFTA Article 1121. The United States characterized the exhaustion of local remedies as a requirement for judicial finality and judicial finality as a substantive requirement for denial of justice claim. The tribunal accepted this contention and decided that under NAFTA Article 1121, the claimant must exhaust all available local remedies to initiate an ICSID claim.

Likewise, in *Mondev v. USA* case, the ICSID tribunal observed that it is not the function of NAFTA tribunals to act as courts of appeal if NAFTA parties seek local remedies and lose on the merit.[16] In particular, concerning the NAFTA cases, investment tribunals can give a very restrictive interpretation of the local remedy exhaustion requirement because NAFTA Article 1121 allows the member states to impose a mandatory requirement of local remedy exhaustion.

[15] North American Free Trade Agreement, Can.-Mex.-U.S., Dec. 17, 1992, 32 I.L.M. 289.

[16] Mondev International Ltd. v. U.S.A., ICSID Case No. ARB(AF)/99/2, Final Award, ¶ 126 (Oct. 11, 2002), 6 ICSID Rep. 192, (2004).

After analysing the aforementioned, it can prudently be affirmed that foreign investors' protection concerning direct access to the international arbitral mechanism without prior exhaustion of all available domestic remedies is a definite threat of denial of justice for the local people as such a compromise with the national interest. Still, SA countries are indifferent concerning this.

3. Wider Inclusion/Interpretation of State Responsibility

Another significant safeguard for foreign investors under the contemporary international investment law regime is the wider inclusion/interpretation of the attributability of state responsibility. Article 4(1) of the ILC Draft Articles on State Responsibility incorporates that conduct of any state organ, whether exercising executive, legislative and judicial functions, can be considered as the conduct of the state, and Article 4(2) includes any person or entity that exercises these functions as the state organ.[17] The ICSID tribunal has also acknowledged a similar approach in *CMS v. Argentina*[18] case. The tribunal observed that as long as international liability is concerned, it does not matter whether some actions were taken by the judiciary, the executive, or the legislative branch of the state.[19] In the *Saipem* case, the ICSID tribunal affirmed that the action of the state's judiciary is attributable to the state.[20] Again, Article 7 of the Draft Articles makes it explicit that if any state organ performs any *ultra vires* activities, that will also be attributable to the state.[21] Therefore, an ultra vires conduct of any state official

[17] ILC Draft Articles on Responsibility of States for Internationally Wrongful Acts 2001 art. 4, Int' Law Comm'n, Rep. on the Work of lts Fifty-third Session, U.N. Doc. A/56/10, at 40 (2001) [hereafter ILC Draft Articles on State Responsibility].

[18] CMS Gas Transmission Company v. Arg. Republic, ICSID Case No. ARB/01/8, Decision on Jurisdiction, (July 17, 2003), 42 I.L.M. 788, (2003).

[19] *See Id.* at ¶ 108.

[20] See The People's Republic of Ban., ICSID Case No. ARB/05/07 at ¶ 189

[21] ILC Draft Articles on State Responsibility, *supra* note 17, art. 7, at 45.

that can be attributed to any state organ is also attributable to the state. Furthermore, under contemporary investment arbitration practice, it is now well recognized that state agencies' actions like police/army are also attributable to the state. In *Amco v. Indonesia* case, it is observed by the ICSID tribunal that for any proven intentionally wrongful conduct by any army/police personnel, state responsibility can be attributed. [22]

Therefore, this attributability can bring a fatal consequence in a country where the law and order situation is not that mature, and corruption is a common practice among the public agencies, which is the reality for some SA countries. However, the host states are not only responsible for the acts of their agencies but also for the omission to perform their obligation to protect foreign investors. For instance, if an armed conflict occurs on a host-state's territory and they fail to provide the standard of protection required to provide, it will incur international responsibility. In the *AAPL v. Sri Lanka* case, the ICSID tribunal observed that a host state should not be held responsible for its failure to provide the standard of protection unless that is required to provide either by treaty or customary law. [23]

In addition, under contemporary practice, almost all BITs stipulate the affordable standard of protection in armed conflict, revolution, civil disturbance, insurrection or riot, or other similar events. Therefore, the protection afforded by the host states under the BIT mechanism constitutes the primary obligations, and failure to comply with imposes international responsibility. Similarly, an extensive and consistent state practice supports the host-state's

[22] Amco Asia Corporation and others v. Republic of Indo., ICSID case no. ARB/81/1, Final Award, ¶ 172 (Nov. 20, 1984), 1 ICSID Rep. 413, (1993).

[23] Asian Agricultural Products Ltd. v. Republic of Sri., ICSID Case No. ARB/87/3, Final Award, ¶ 72 (June 27, 1990), 4 ICSID Rep. 246, (1991).

duty to exercise due diligence to protect foreign investors.[2425] Moreover, in *Vivendi v. Argentina* case, it was decided by the ICSID tribunal that the action of the provincial government is attributable to the state.[26] Hence, in a conflicting political regime between the provincial and federal governments, this risk is more prominent, as in some SA countries. Therefore, at the end of the saga, it is explicit that this aforementioned wider inclusion/interpretation of state responsibility has some simultaneous risk upon the host states.

4. Conclusion

This paper aimed to articulate two different safeguard tools available for foreign investors and scrutinized how these may adversely impact the host-state's interests that amount to a compromise. This paper showed how the liberal and predominant access to justice mechanism, i.e., direct access to international arbitration, available under the contemporary investment law regime, creates room for denial of justice for the host-state in contrast. Still, economically weaker countries like SA countries ensure this by impairing their domestic courts' sovereign capacity, which is tantamount to a denial of justice for the local people. On the other hand, economically developed countries like NAFTA parties are very cautious in allowing foreign investors direct access to international arbitral mechanisms without prior exhaustion of domestic remedies. Further, wider inclusion/interpretation of state responsibility guaranteed under BITs, general international law, and customary international law is truly an immense threat to host states. Therefore, it can be concluded that the extensive safeguards guaranteed to the foreign investors are often amounting to compromises for the host states.

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[24] *See Id.*

[25] IAN BROWNLIE, SYSTEM OF THE LAW OF NATIONS: STATE RESPONSIBILITY 162 (1st ed. 1983).

[26] Vivendi Universal S.A. v. Arg. Republic, ICSID Case No. ARB/97/3, Final Award, ¶ 49 (Nov. 21, 2000).