A Coherence Perspective of Bilateral Investment Treaties

A thesis submitted to The University of Manchester for the degree of

Doctor of Philosophy (Ph.D.)

in the Faculty of Humanities

2012

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<tr>
<td>ASEAN</td>
<td>Association of Southeast Asian Nations</td>
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<tr>
<td>BIT</td>
<td>Bilateral Investment Agreement</td>
</tr>
<tr>
<td>CAFTA-DR</td>
<td>Dominican Republic-Central America Free Trade Agreement</td>
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<tr>
<td>CIME</td>
<td>Committee on International Investment and Multinational Enterprise</td>
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<td>CMIT</td>
<td>Committee on Capital Movements and Invisible Transactions</td>
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<td>EFTA</td>
<td>European Free Trade Association</td>
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<td>EU</td>
<td>European Union</td>
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<td>FCNs</td>
<td>Friendship, Commerce and Navigation Treaties</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>FTAs</td>
<td>Free Trade Agreements</td>
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<tr>
<td>GATS</td>
<td>General Agreement on Trade in Services</td>
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<td>GATT</td>
<td>General Agreement on Tariffs and Trade</td>
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<tr>
<td>ICC</td>
<td>International Chamber of Commerce</td>
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<td>ICJ</td>
<td>International Court of Justice</td>
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<td>ICSID</td>
<td>International Centre for the Settlement of Investment Dispute</td>
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<td>IFC</td>
<td>International Financial Corporation</td>
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<td>IIAs</td>
<td>International Investment Agreements</td>
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<tr>
<td>IISD</td>
<td>International Institute for Sustainable Development</td>
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<td>ILA</td>
<td>International Law Association</td>
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<td>ILC</td>
<td>International Law Commission</td>
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<tr>
<td>INEF</td>
<td>Institute of Development and Peace</td>
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<td>MAI</td>
<td>Multilateral Agreement on Investment</td>
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<tr>
<td>MFN</td>
<td>Most-Favoured-Nation Treatment</td>
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<td>MIGA</td>
<td>Multilateral Investment Guarantee Agency</td>
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<td>Acronym</td>
<td>Full Form</td>
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<td>NAFTA</td>
<td>North American Free Trade Agreement</td>
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<td>NIEO</td>
<td>New International Economic Order</td>
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<td>OECD</td>
<td>Organisation for Economic Cooperation and Development</td>
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<tr>
<td>PSNR</td>
<td>Permanent Sovereignty of States over their Natural Resources</td>
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<tr>
<td>TNCs</td>
<td>Transnational Corporations</td>
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<tr>
<td>TRIMs</td>
<td>WTO Agreement on Trade Related Investment Measures</td>
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<tr>
<td>UN</td>
<td>United Nations</td>
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<tr>
<td>UNILC</td>
<td>United Nations International Law Commission</td>
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<tr>
<td>UNCITRAL</td>
<td>United Nations Commission on International Trade Law</td>
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<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
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<td>UNCTC</td>
<td>United Nations Centre on Transnational Corporations</td>
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<tr>
<td>UNGA</td>
<td>United Nations General Assembly</td>
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<tr>
<td>VCLT</td>
<td>Vienna Convention on the Law of Treaties</td>
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<td>WTO</td>
<td>World Trade Organisation</td>
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Acknowledgement

In the course of writing this thesis I have received support from a great number of people. I am, of course, particularly thankful to my generous supervisor, Prof. Asif Qureshi, who has been instrumental in keeping the thesis on track. I owe sincere thanks to my second supervisor Dr. Yenkong Ngangioh-Hodu for his guidance and support. I also wish to extend my warmest thanks to all my colleagues and friends who have made this journey brighter, especially to Patricia, Jackie, Mary, Stephen and many others.

I owe a depth of gratitude that extends beyond thanks and admiration to my family. It would have not been possible to complete this thesis without the unconditional love and support of my parents – you are the ‘rock’ of my life. I am also very grateful to my brothers and sisters Eid, Eman, Reem and Moh’d for making me feel very special.

Throughout this thesis, I have received constant support, both emotionally and intellectually, from my beloved husband Ahmad who has kindly listened to my monologues on coherence and bilateral investment treaties over the last years. This ‘marathon’ would have not been the same without him. I am grateful also to my mother and father in-law for their continuous kindness and care.

This thesis is dedicated with love to my son ‘Moh’d Khair’ who was born during the closing stages of writing and ever since has been a real inspiration to me – you have filled my heart with love. It is also dedicated to my beloved parents – all I have and will accomplish are only possible due to their love and sacrifices.
Abstract

Foreign investment is mainly protected through national laws. However the wide-spreading network of bilateral investment treaties aims to ensure a certain standard of protection. These treaties demonstrate far-reaching implications at both treaty level and international level. The implications raise an important question as to whether bilateral investment treaties are coherent or not. Coherence can be viewed as an attempt to prettify the law and minimise the effect of politics which may leave the law incoherent. It is obvious that bilateral investment treaties need to be coherent for a number of reasons. Firstly, incoherent treaties may create problems in relation to the development policy of member countries. Secondly, coherence reassures that negotiators of such treaties would not encounter possible contradictions and inconsistencies amongst the countries’ agreement network as well as between the treaties and domestic laws. Thirdly, coherence is critical to treaty interpretation as it is necessary to avoid further complications which may arise from contradictory awards.

The aim of this thesis is mainly to elucidate the meaning of coherence and use it to provide an understanding as to how coherent these treaties are. The coherence of bilateral investment treaties will be evaluated in a number of aspects: coherence between bilateral investment treaties and the fundamental principles of international investment law; coherence between bilateral investment treaties and their objectives of investment promotion and investment liberalisation; coherence within the bilateral investment treaties network; coherence between bilateral investment treaties and customary international law on foreign investment; coherence between bilateral investment treaties and free trade agreements; coherence between bilateral investment treaties’ obligations and non-investment obligations of states.
**Introduction**

Four decades ago, the international law pertaining to foreign investment was relatively underdeveloped. However, within a short period of time the economic interests of states made the law of foreign investment become one of the most rapidly changing areas of international law, with far-reaching implications for both home and host countries. The importance of this branch of law is related to foreign direct investment (FDI), which is the largest single source of external finance for developing countries. In 2011 FDI flows to developing countries increased by 12 per cent, reaching a record level of US$777 billion.

States are keen on improving their investment climate to attract FDI. The improvements are brought about by a range of economic policy reforms which include inter alia fiscal consolidation, privatisation of state enterprises, greater openness to trade and other market-oriented reforms. Changes in laws and regulations have also resulted in forming legal systems that are more favourable to foreign investment. As part of enhancing their legal frameworks for foreign investment, states have concluded bilateral investment treaties.

Bilateral investment treaties are defined as ‘agreements between two countries for the reciprocal encouragement, promotion and protection of investment in each other’s
territories’. These treaties are considered the most important instrument in respect of the international protection of foreign investment. They are the first international agreements which exclusively focus on the treatment of foreign investment. The majority of these bilateral investment treaties were concluded in the 1990s, and today they number 2,833 worldwide.

Bilateral investment treaties cover four substantive areas: admission, treatment, expropriation of foreign investment and settlement of disputes. However, over the past few years the text of these treaties has evolved due to a number of factors. Firstly, whereas in the past these treaties were only concluded between developed and developing states, they are now also concluded between developing countries. Prior to this, these treaties existed between developed countries acting as the capital exporting countries and developed countries acting as the capital importing countries. On one hand, developed countries would enter such an agreement to guarantee high standards of protection for their investors abroad. On the other hand, developing states agreed to sign these treaties as a way of improving their investment climate and to attract foreign investment. However, as from the 1990s this pattern has changed. Developing countries have moved from being capital importing countries to capital exporting countries and have started to take a more active role in the drafting of these treaties.

Secondly, the growing number of investor-state disputes has influenced the evolution of bilateral investment treaties. Although the investor-state dispute resolution mechanism was

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6 This definition is stated by the UNCTAD and is available at [http://wwwunctadvi.org/templates/Page_1006.aspx](http://wwwunctadvi.org/templates/Page_1006.aspx)
9 Dolzer and Stevens, Bilateral Investment Treaties, op. cit., at xii.
11 Ibid.
13 Ibid.
introduced in the 1960s, very few cases were known until 1995.\textsuperscript{14} It is after that period when the number of disputes started to multiply, reaching 450 cases by the end of 2011.\textsuperscript{15} Consequently, problems with interpreting treaties’ provisions have recently seen a massive growth, an issue that requires clarification in order to reduce the risk of disputes in the future.

Finally, the emergence of free trade agreements as well as other treaties dealing with various forms of economic cooperation has played an influential role.\textsuperscript{16} As a result of these agreements the scope of investment related treaties started to expand. In this respect, bilateral investment treaties evolved to deal with further issues such as services, intellectual property and industrial policy.\textsuperscript{17} In addition, a number of extensive implications started to emerge related to human rights, environment and health protection.\textsuperscript{18} Thus, bilateral investment treaties had to change over the years in response to the political and economic realities of the world.

In light of all of these changes, the question as to whether bilateral investment treaties can be seen as coherent has become a pertinent one. Coherence is an attempt to prettify the law and minimise the effect of politics which may leave the law untidy.\textsuperscript{19} The idea of coherence was first introduced in the theories of truth and knowledge.\textsuperscript{20} Recently, coherence became influential in the area of law and legal justification.\textsuperscript{21} Coherence theories of the law provide


\textsuperscript{17} Ibid.

\textsuperscript{18} Ibid.


answers as to the importance of coherence and what makes law coherent. The coherence of a legal system is reflected in how the legal rules and regulations fit together to form one unified and tightly structured whole. It is regarded as a matter of degree which includes a number of criteria.

Coherence has been the main focus of different theories which address the question of when law is considered coherent. Although scholars seem to agree on the importance of coherence in relation to law, they provide diverse explanations as to the criteria of coherence. Each scholar has examined the concept of coherence from a different perspective. For some scholars such as Dworkin, the meaning of coherence is limited to mere consistency. On the other hand, scholars including MacCormick, Alexy and Peczenick assert that the concept of coherence entails consistency along with a number of additional elements.

In the context of bilateral investment treaties, coherence constitutes an important feature due to a number of factors. Firstly, incoherent treaties may create problems for the development of a country. Although agreements present an opportunity for countries to seek tailor-made solutions for their individual development needs, signing incoherent treaties prevent countries from making the best use of such treaties and achieving certain development goals. Secondly, coherence assists treaties’ negotiators in avoiding any possible contradictions and inconsistencies within the investment agreement network of their countries as well as between treaties and domestic laws. This is because incoherence puts countries in the position of losing organisational knowledge of the specific content of the investment treaties they

22 Ibid.
concluded. Thirdly, coherence is an important feature of interpretation as it helps in avoiding further complications arising from contradictory awards.

This thesis is based on two main pillars. One is coherence and the other is the bilateral investment treaties. The title gives a sense as to how in this study coherence is of equal importance to bilateral investment treaties. This thesis approaches the coherence of bilateral investment treaties by focusing on coherence as a concept and a tool which can be used to enhance bilateral investment treaties. Thus, the importance of coherence justifies the title ‘A Coherence Perspective of Bilateral Investment Treaties’ as it links coherence to bilateral investment treaties rather than emphasising one at the expense of the other. It is in this context that this thesis aims to analyse the coherence of bilateral investment treaties and review treaties’ provisions to improve their overall coherence.

This thesis is not about policy coherence grounded in a country’s overall development strategy. It does not examine coherence among a host state’s government offices or domestic legislation. Rather, it is concerned with policy coherence in the context of keeping bilateral investment treaties as coherent as possible in respect to a number of aspects, namely: coherence between bilateral investment treaties and the principles of international investment law, coherence between bilateral investment treaties and treaties’ objectives of investment promotion and investment liberalisation, coherence within the bilateral investment treaties network, coherence between bilateral investment treaties and customary international law, coherence between bilateral investment treaties and free trade agreements and coherence between bilateral investment treaties and states’ non-investment obligations.
Coherence between bilateral investment treaties and the fundamental principles of international investment law will demonstrate how the political and economical reality of the world affected the evolution of this branch of law. Coherence is used to examine the opposing views of developed and developing countries and their effect on states’ practice towards foreign investment. In this respect, coherence will determine how bilateral investment treaties fit in relation to these views.

The other aspect is coherence between bilateral investment treaties and their two main objectives, which are investment promotion and investment liberalisation. In applying coherence, an understanding as to whether treaties’ provisions were drafted in accordance with these objectives will be provided. In doing so, it will look at the major provisions which are included in virtually all bilateral investment treaties. These provisions include investment definition, admission clauses, standards of treatment, expropriation and compensation, capital and labour movement and dispute settlement.

The coherence within bilateral investment treaties is essential. It ensures that states make better-informed decisions when it comes to drafting and negotiating these treaties, helps states to administer their international obligations and makes them aware of the arguments that may succeed or fail in the case of arbitration. In this respect, coherence will be examined in regard to the application of the MFN clauses along with the provisions of investor-state dispute settlement.

The relation between bilateral investment treaties and customary international law on foreign investment is controversial. While some view these treaties as tools which influence and enhance customary international law, others argue that the sweeping practice of bilateral
investment treaties makes them the new customary international law. Coherence is used to provide an understanding as to how each of these arguments contributes to the overall coherence of these treaties.

However, the emergence of investment provisions is not exclusive to bilateral investment treaties. Currently, almost all free trade agreements include a complete set of investment rules which cannot be ignored. Thus, it is important to ensure some level of coherence between these provisions and bilateral investment treaties in order to prevent the possibility of states committing themselves to contradictory obligations when concluding such treaties.

Finally, one of the major challenges facing international investment law today is how to strike a balance between principles regarding the protection of foreign investment on one hand and those regarding the protection of society and public interest (including sustainable development, human rights and environment), on the other. There is no doubt that investment has had a considerable social and environmental impact besides economic growth. However, states’ compliance with their obligations towards foreign investors is occasionally confronted with questions regarding the public interest and the rights of the citizens. In this context, coherence is applied to evaluate the relation between investment and non-investment obligations of states.

Accordingly, Chapter 1 will provide an understanding as to what is meant by coherence in the context of bilateral investment treaties. Chapter 2 will apply coherence to the evolution of the fundamental principles of foreign investment law and bilateral investment treaties. Chapter 3 will examine the coherence of bilateral investment treaties in respect of treaties’ objective of investment promotion. How these treaties cohere with the objective of investment
liberalisation will be assessed in Chapter 4. Chapter 5 will focus on the coherence between bilateral investment treaties and customary international law related to the protection of foreign investment. Chapter 6 will analyse the coherence between the obligations imposed by bilateral investment treaties and states’ non-investment obligations. This study will conclude by recommending reforms in the text of bilateral investment treaties to enhance overall coherence.
Chapter 1

Coherence: Concept and Scope

1. Introduction

Coherence had long been influential in different areas of philosophy before finding its way into the philosophy of law. It is mainly featured in the theory of knowledge which is also known as epistemology. The theory of knowledge is an old branch of philosophy concerned with how knowledge of the world around us can be obtained and justified. In that area, the theory of coherence gained its importance from solving epistemological problems.

Recently, coherence theories have attained substantial popularity in the area of law and legal justification. Coherence theories of the law hold that the law is coherent if its components fit together in a coherent way. Within these theories one is likely to find answers to what makes a legal system coherent as well as to why the law should be coherent. Nevertheless, these theories seem not to agree on unified criteria of coherence, rendering it somewhat vague.

A number of scholars have dedicated their efforts to explain when a legal system is to be considered coherent. In doing so, they have proposed definitions and criteria in order to clarifying what is meant by coherence in legal philosophy. In addition, they have examined the issue of coherence at the points of formation and interpretation of legal rules. As a result,

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25 Coherence is considered one of the major theories of truth and knowledge see Cornelius, 'Coherence Theory of Truth', op. cit., at 58. O'Brien, An Introduction to the Theory of Knowledge, op. cit., at 77-86.
26 For more information about epistemology see E. Sosa and E. Villanueva (eds.), Epistemology (Boston, Oxford: Blackwell Publishers, 2004).
28 See Peczenik, On Law and Reason, op. cit..
29 Ibid.
30 For an example see Dworkin, Law's Empire, op cit; Alexy and Peczenik, 'The Concept of Coherence and Its Significance for Discursive Rationality', op cit; J.M. Balkin, 'Understanding Legal Understanding', Yale Law Journal, 130 (1994), 105-76; and Raz, 'The Relevance of Coherence', op. cit..
most of these studies have shown that it is necessary to fulfil a number of criteria in order for a legal system to be coherent.

This chapter aims at developing a special concept of coherence to be used in examining how coherent bilateral investment treaties are. Considering the previous work done in this area, a new concept and criteria of coherence will be adopted. The chapter will begin by providing a general understanding of the origins of coherence theory within the theory of knowledge. It will then proceed to examine the different concepts and types of coherence with an attempt to clarify what kind of characteristics and elements are used to form a coherent system. It will then move on to explain how coherence was introduced into legal philosophy and provide a survey of the different approaches adopted. On the basis of these studies a new concept of coherence (which is specially tailored to bilateral investment treaties) will be developed. Finally, the chapter will provide an understanding as to how this new concept of coherence will be used in subsequent chapters.

2. The Origins of the Theory of Coherence

The theory of knowledge asserts that a belief constitutes knowledge if it is based on justification. The justification of a belief depends on the supportive evidence provided by other beliefs which are called ‘putatively justified beliefs’. To know a proposition (A1) there must be a reason (A2) which provides evidence in support of (A1) and (A2) must be supported by (A3) and so on. The chain of reasons might well be endless which contradicts the fact that support cannot be obtained by means of endless regress. This problem is

33 Cling, 'The Epistemic Regress Problem', op. cit., at 402.
34 Ibid.
referred to as the epistemic regress problem.\textsuperscript{35} The two theories that address this problem are the foundationalism theory and the coherence theory.\textsuperscript{36}

The foundationalism theory argues that at the end of the chain of justification there are basic or foundational beliefs.\textsuperscript{37} These beliefs bring the regress to an end as they are self-justified beliefs which do not depend on supportive evidence.\textsuperscript{38} On the other hand, the coherence theory deals with the regress problem from a different perspective.\textsuperscript{39} It maintains the view that beliefs should be justified and that such justification derives from inferential relations to other beliefs.\textsuperscript{40} However, these beliefs form a system of beliefs held by the believer himself.\textsuperscript{41} Consequently, the justification of any belief depends not only on the inferential relations to other beliefs but also on the relation with the overall system of beliefs held by the considered believer.\textsuperscript{42}

The coherelist response to the regress problem rejects the idea of the linear in relation to justification.\textsuperscript{43} According to foundationalism, justification involves a asymmetrical order of reliance amongst the relevant beliefs.\textsuperscript{44} On the contrary, coherence theory preserves that justification must be holistic and non-linear by having all the beliefs in the system providing mutual support regardless of which belief is prior to the other.\textsuperscript{45} In this respect the system itself forms a primary unit of justification.\textsuperscript{46}

\begin{itemize}
\item \textsuperscript{35} Ibid.
\item \textsuperscript{36} See O'Brien, \textit{An Introduction to the Theory of Knowledge}, op. cit.
\item \textsuperscript{37} Ibid.
\item \textsuperscript{38} See Cling, 'The Epistemic Regress Problem', op. cit.
\item \textsuperscript{39} L. Bonjour, \textit{The Structure of Empirical Knowledge} (Cambridge, Massachusetts, London: Harvard University Press, 1985) at 87-110.
\item \textsuperscript{40} Ibid., at 89-93.
\item \textsuperscript{41} Ibid., at 93.
\item \textsuperscript{42} Ibid.
\item \textsuperscript{43} See B. Bosanquet, 'Appearances and the Absolute', \textit{The Philosophical Review}, 29/6 (1920), 571-74.
\item \textsuperscript{44} Bonjour, \textit{The Structure of Empirical Knowledge}, op. cit., at 17-25.
\item \textsuperscript{45} Ibid., at 89-101.
\item \textsuperscript{46} Ibid.
\end{itemize}
3. Concept and Types of Coherence

The most important question is what constitutes coherence. Literally, coherence is often defined as hanging together, ‘making sense as a whole’\(^\text{47}\), ‘consonance’\(^\text{48}\) and ‘speaking with one voice’.\(^\text{49}\) In applying those meanings to a system, coherence would be a matter of how the beliefs within that system fit together to form one unified and tightly structured whole.\(^\text{50}\) Hence, a coherent system would be one which is clear and carefully structured in such a way that all its parts connect and follow. Coherence is described as a form of supportive rationality\(^\text{51}\) or a kind of internal interconnectedness or plausible connection in which all its elements mutually support each other.\(^\text{52}\)

A very strict concept of coherence is adopted by the idealists.\(^\text{53}\) In their view a coherent system of beliefs is one in which each belief is a result and a cause of all other beliefs.\(^\text{54}\) In reality such strong conception is unrealisable.\(^\text{55}\) At the other end of the scale, an opposite extreme exists which defines coherence as mere logical consistency.\(^\text{56}\) However, being logically consistent is not enough to render beliefs as related and, therefore, may result in having no real degree of mutual support.\(^\text{57}\)

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\(^{47}\) Maccormick, ‘Coherence in Legal Justification’, op. cit., at 235.


\(^{49}\) Dworkin, *Law’s Empire*, op. cit., at 165.

\(^{50}\) Bonjour, *The Structure of Empirical Knowledge*, op. cit., at 93-94.


\(^{54}\) Ibid.


By adopting a middle view, coherence must fall along these extreme views. It is to be considered as a matter of degree including logical consistency and inferential interconnectedness. Accordingly, coherence can be regarded as a multi-layered concept. It often serves to highlight its three main elements, which are consistency, comprehensiveness and mutual support. In order to have a coherent system, the beliefs should be consistent, meaning that there is no logical contradiction between them. The system should be comprehensive, which means that it should include all beliefs which should rationally be accepted and exclude all beliefs that should rationally be rejected. Finally, a mutual supportive relationship should exist between the beliefs within the same system.

Moreover, some scholars explain the concept of coherence with reference to the main idea of coherence, the requirements of coherence and the properties analysing the concept of coherence. Starting with the idea of coherence, it can be explained as ‘The more the statement belonging to a given theory enhances and ensures a perfect supportive structure the more coherent the theory will be.’

Based on this idea, the existence of coherence within a theory depends on a number of characteristics. Firstly the theory has to be intelligible. Secondly, the statements belonging to a given theory should derive from or express a single and unified point of view. Finally, the statements belonging to a given theory should properly fit together and be mutually

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62 Ibid, at 97-98.
64 See Peczenik, On Law and Reason, op. cit., at 132.
65 Patterson (ed.), A Companion to Philosophy of Law and Legal Theory, op. cit., at 533.
66 Ibid.
supportive. In applying these requirements to the above characteristics the following properties are produced:

1. Consistency: A system is consistent if its principles and propositions logically flow without contradiction;
2. Comprehensiveness: A comprehensive system is that which is capable of providing answers to all questions arising within its scope. However, it is not necessary to resolve all related issues, meaning that a system will remain comprehensive even if some questions are not answered. It is enough to acknowledge that the system cannot answer that certain issue;
3. Completeness: A system is complete if it tackles all issues within its scope without leaving any gaps;
4. Monism: A system is monistic if it depends on a single principle or a set of principles enjoying a unified spirit;
5. Unity: A system obtains unity by having a set of principles which imply, justify and mutually support one another;
6. Articulateness: A system is said to be articulate if it uses expressed language to describe the methods for deciding issues, to integrate or unify its principles, or to resolve conflicts amongst competing principles rather than using merely intuitive techniques;
7. Justified: A system is justified if it provides reasons when resolving conflicts.

These requirements and properties allow for further internal distinctions among types of coherence. The two main types are epistemic coherence and constitutive coherence.
Epistemic coherence is concerned with justifying statements.\textsuperscript{71} In this regard, a statement is justified as long as it is permissible to hold it within a theory and if there is no defect in holding it.\textsuperscript{72} This type of coherence is not concerned with whether the statement is true or not.\textsuperscript{73} Epistemic coherence is applicable to all kinds of theories whether legal or non-legal.\textsuperscript{74} However, applying it to legal theory may result in some difficulties.\textsuperscript{75} Those difficulties exist due to the effect of “foundationalism theory” within jurisprudence.\textsuperscript{76} As mentioned earlier, the theory of foundationalism solved the regress problem of justification by claiming that at a certain point a person would fall back on statements that do not need justification. These statements are referred to as basic or foundational beliefs. Edmundson explained that if there was a counterpart to foundationalism in legal theory, then it would be ‘the position that some legal assertions are justified simply because they are authoritative, as ‘commands of sovereignty’’.\textsuperscript{77}

The other type of coherence is constitutive coherence.\textsuperscript{78} Under this form, coherence is evaluated by what makes propositions true or decisions correct.\textsuperscript{79} Constitutive coherence is the most relevant type of coherence to legal theory.\textsuperscript{80} It applies to either facts or norms and this allows for further distinctions among kinds of constitutive coherence such as narrative and normative.\textsuperscript{81} Narrative coherence is used for drawing inferences of facts from evidentiary facts.\textsuperscript{82} On the other hand, normative coherence applies to points of law rather than matters of

\textsuperscript{70} Raz, ‘The Relevance of Coherence’, \textit{op. cit.}, at 282-87.
\textsuperscript{71} Ibid, at 277.
\textsuperscript{72} Ibid.
\textsuperscript{73} Ibid.
\textsuperscript{74} Ibid, at 283.
\textsuperscript{75} Ibid, at 282-287.
\textsuperscript{77} Ibid, at 2.
\textsuperscript{78} Raz, ‘The Relevance of Coherence’, \textit{op. cit.}, at 275.
\textsuperscript{79} Ibid, at 283.
\textsuperscript{80} Ibid.
\textsuperscript{81} ‘In the specific context of legal justification we find that it(coherence) has two applications: to reasoning on matter of law, where what is in issue is ‘normative coherence’, and to drawing inferences of fact from evidentiary facts, where that is in issue is ‘narrative coherence’,’ Maccormick, ‘Coherence in Legal Justification’, \textit{op. cit.}, at 235.
\textsuperscript{82} Ibid, at 245-249.
fact. When applied to the legal theory, normative coherence is considered a feature of a legal system. This feature has been the main focus of different theories which address the question of when the law is considered coherent.

4. Coherence and the Legal Philosophy

As explained in the preceding paragraphs, a coherent theory is that which is intelligible and where all its parts fit together and are mutually supportive. In other words, coherence is the sense of intelligibility. Based on this idea the coherence theories in the philosophy of law agree on the importance of coherence. They do, however, provide different explanations as to the meaning and scope of coherence. This section will critically evaluate each theory and explain its relevance to this study.

4.1. Sartorius

In his work *The Justification of the Judicial Decision*, Sartorius was concerned with coherence in justifying judicial decisions. In doing so, he focused on the relevance of coherence in applying the law rather than coherence within the legal rules. In this context he argues that:

> 'If one is inclined to speak of justification in terms of coherence and correspondence,... one might put the point in the following manner. That to which a maximum of correspondence is to be sought is the total set of judicial obligations. In viewing the law as a systematic whole, there is a subset of this general class of obligations-the particular decisions which he is bound to follow and the particular rules and principles which he is obligated to apply- for which any particular judge must find a place within the system... Any particular decision will then be justified in terms of its

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83 Ibid, at 235-238.
84 R. Sartorius, 'The Justification of the Judicial Decision', *Ethics*, 78/3 (1968), 171-87. Hoffmaster is Sartorius student, he follows the assumption that legal justification aims at maximising coherence, see also B. Hoffmaster, 'A Holistic Approach to Judicial Justification', *Erkenntnis*, 15 (1980), 159-81 at 161.
coherence with the system which at any given time achieves a maximum of correspondence in this sense to of relevant existing judicial obligations.  

In this respect, it is understood that Sartorius views coherence in legal justification as being a formal relation of the whole system of law. In other words, in his point of view coherence is a property of an entire system of law and a legally justified judicial decision should strengthen this systemic coherence or should at least cohere best with the coherent system. The justification of any particular decision depends on whether it is coherent with the judge’s system, which is composed of those decisions and rules that he is obliged to follow and apply. However, some difficulty in justifying judicial decisions may arise due to conflicting legal principles.

Whenever a case involves conflicting principles and policies the correct decision would be that which results in maximal adherence to initial commitments. Maximum adherence is explained as follows:

“One thing which is clearly of great importance here is the degree of systematic connectedness involved; we will be more reluctant to give up a rule or principle which has many connections with other rules and principles we wish to hold on to than we will be to abandon or modify one which stands independence of other rules and principles.”

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88 Ibid.
89 Ibid, at 181-185.
90 Ibid, at 184
91 Ibid.
Accordingly, a clear link can be established between what Sartorius referred to as ‘systematic connectedness’ and the concept of coherence. It can be explained that coherence is capable of providing a solution for conflicting legal principles or policies. By looking at the degree of systematic connectedness between principles, a higher degree of adherence to initial commitments will be achieved and therefore, a correct decision will follow. However, to better understand his theory of coherence and legal justification it would have been helpful if he had provided a definition to what he believes is a coherent system.

Based on the above, Sartorius’ theory is useful to bilateral investment treaties only in relation to interpretation and examining whether the arbitral decisions ensure the coherence of these treaties as a whole. It will not assist in answering the question of whether bilateral investment treaties form a coherent system. For that reason, this theory does not provide a model on which the coherence of bilateral investment treaties can be examined.

4.2. MacCormick

MacCormick investigated the relation between coherence and consistency with regard to the terms ‘hanging together’ and ‘making sense’. He maintains the view that coherence cannot be fully satisfied by mere consistency. In so doing, he explains that justification entails two arguments, one from coherence and the other from consistency. In separating consistency from coherence he provides an explanation as to how a certain statute may be consistent but not coherent. He concludes the following:

‘I conclude that the coherence of norms is a matter of their ‘making sense’ by being rationally related as a set, instrumentally or intrinsically, either to the realisation of some common value or values; or to the fulfilment of

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some common principle or principles. At the level of the highest-order principle or values there is a further requirement of coherence... In short, the coherence of a set of norms is a function of its justifiability under higher order principle or values, principles and value being extensionally equivalent; provided that the higher or highest-order principles and values seem acceptable as delineating a satisfactory form of life, when taken together.\textsuperscript{96}

MacCormick's view of coherence raises two main issues. Firstly, his theory of coherence does not address the merit of the principle with which statutes and legal decisions should fit. In other words, coherence is regarded as an important criterion of justification and irrelevant to whether the legal system is well-founded or not. In applying this to bilateral investment treaties, coherence will not be related to whether these treaties guarantee the equality of all foreign investors or whether they provide for the superiority of certain foreign investors. That is because coherence is not a qualified standard for estimating the merit of values. Secondly, the theory is too modest as it does not explain the exact meaning and characteristics of coherence. Therefore, it will not be considered in looking at the coherence of bilateral investment treaties.

4.3. Dworkin
Dworkin’s legal theory of law as integrity is based on coherence.\textsuperscript{97} He argues that judges are obliged to decided cases in a manner that enhances the coherence of the law.\textsuperscript{98} He asserts that 'Law as integrity asks judges to assume, so far as this possible, that the law is structured by a coherent set of principles about justice and fairness and procedural due process'.\textsuperscript{99}

\textsuperscript{96} Ibid, at 238.
\textsuperscript{97} See Dworkin, Law's Empire, op. cit..
\textsuperscript{98} Ibid, at 243.
\textsuperscript{99} Ibid.
For Dworkin, integrity is both a legislative and an adjudicative principle.\textsuperscript{100} The legislative principle asks lawmakers to try to make the laws morally coherent.\textsuperscript{101} The adjudicative principle instructs that the law be viewed as coherent in that way, as far as possible.\textsuperscript{102} In this respect he explains:

\begin{quote}
'\textit{The adjudication principle of integrity instructs judges to identify legal rights and duties, so far as possible, on the assumption that they were created by a single author-the community personified-expressing a coherent conception of justice and fairness.}'\textsuperscript{103}
\end{quote}

Dworkin’s theory of adjudication is based on two dimensions: 1) The interpretation must fit with the legal standards of the community; 2) The judge must choose a justification that shows these standards in the best view.\textsuperscript{104} The historical legal principles and rules constitute the source of legal interpretation.\textsuperscript{105} However, what constrains interpretation is the way that judges view these historical legal materials along with their convictions about fit and whether their interpretation shows the legal material in its best light.\textsuperscript{106} This is when coherence becomes a useful idea, and in this respect, coherence is considered the ultimate standard of legal reasoning.\textsuperscript{107}

Apart from emphasising the importance of coherence, Dworkin does not provide an explanation as to what constitutes coherence. Moreover, he seems to limit coherence to

\begin{flushright}
\textsuperscript{100} Ibid, at 176.  
\textsuperscript{101} Ibid.  
\textsuperscript{102} Ibid.  
\textsuperscript{103} Ibid, at 225.  
\textsuperscript{104} Ibid, at 218.  
\textsuperscript{105} Ibid, at 227.  
\textsuperscript{106} Ibid, at 227-232.  
\textsuperscript{107} Ibid, at 177-224. When interpreting the law judges are asked to act in a way which promotes the coherence of the legal system as a whole. Therefore, the interpretation that coheres best is better than an interpretation that makes the legal system less coherent. Ibid, at 245-250.
\end{flushright}

\textsuperscript{107} Ibid, at 177-224. When interpreting the law judges are asked to act in a way which promotes the coherence of the legal system as a whole. Therefore, the interpretation that coheres best is better than an interpretation that makes the legal system less coherent. Ibid, at 245-250.
On the other hand, he claims that some legal standards and principles must be treated as established law. In this respect these standards and principles should be respected in interpretation without the need for justifying their existence. For that reason, Dworkin could be read as foundationalist in regards to settled precedent rather than coherentist. In other words, he seems to follow the foundationalism theory in legal interpretation, but not the coherence theory. The foundationalism theory is problematic to the legal theory for the same reasons as it is to the theory of knowledge. For those reasons Dworkin’s understanding of coherence will not be applied in this study.

4.4. Alexy and Peczenick

The work of Alexy and Peczenick focuses on explaining coherence as a concept. At the outset they define the relationship between coherence and consistency. They maintain that consistency is important to achieve coherence but it is not solely sufficient. Their work can be divided into three sections. The first section addresses the meaning and criteria of coherence. In this respect they explain the main idea of coherence it terms of support as ‘the more the statements belonging to a given theory approximate a perfect supportive structure, the more coherent the theory’. They then proceed to discuss the importance of the criteria of coherence by determining the degree of coherence through weighing and balancing the

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109 Ibid, at 240-244.
110 Ibid.
112 See the regress problem as explained in the preceding paragraphs.
113 Alexy and Peczenik, ‘The Concept of Coherence and Its Significance for Discursive Rationality’, op. cit..
114 Ibid, at 130.
115 Ibid.
116 Ibid. at 131. In order to clarify what they meant by the main idea the authors define each of the following terms: ‘theory’, ‘support’, ‘supportive structure’ and ‘perfect supportive structure’. The term ‘theory’ is used in a broad sense, covering both descriptive and normative or evaluative theories. As for ‘support’, they consider the term as a weak one since it can be characterised as follows ‘The statement p1 supports the statement p2 if, and only if, p1 belongs to a set of premises, S, from which p2 follows logically’. Accordingly they adopt a stronger concept of ‘support’ which they refer to as ‘supportive structure’. The ‘supportive structure’ is based on the relations between statements belonging to the theory in question which at the same time can be explained as the class of formal properties of the supportive relation between statements belonging to the theory. Finally, the term ‘perfect supportive structure’ concerns itself with the degree of perfection of a supportive structure depending on the degree to which the criteria of coherence are fulfilled. See ibid, at 132.
criteria against each other. The criteria are divided into three classes; the properties of the supportive structure constituted by the theory, the properties of concepts applied by it and the properties of the scope covered by it.¹¹⁷

Most of the criteria used in determining the degree of coherence are found under the properties of the supportive structure.¹¹⁸ These include; 1) The number of supportive relations,¹¹⁹; 2) The length of the supportive chains;¹²⁰ 3) Strong support;¹²¹ 4) The connection between supportive chains;¹²² 5) Priority orders between reasons;¹²³ 6) Reciprocal justification.¹²⁴ These criteria are featured in the various supportive relations that make a theory more coherent than any other alternative. Their relevance to coherence can be described in the following manner:

1. The more statements belonging to a theory are supported, the more coherent the theory;
2. The longer the chains of reasons belonging to a theory are, the more coherent the theory;
3. The more statements belonging to a theory are strongly supported by other statements, the more coherent the theory;
4. The greater the number of conclusions which are supported by the same premises belonging to the theory in question, the more coherent the theory;
5. The greater the number of independent sets of premises within the theory in question, so that the same conclusions follow from each one of these sets, the more coherent the theory;

¹¹⁷ Ibid, at 132.
¹¹⁸ Ibid.
¹¹⁹ Ibid, at 132-133.
¹²⁰ Ibid, at 133.
¹²² Ibid, at 136-137.
¹²³ Ibid, at 137.
¹²⁴ Ibid, at 137-139.
6. The greater the number of priority relations between the principles, the more coherent the theory. In other words, when using principles belonging to a theory as premises which justify a statement, it is required to formulate as many priority relations between the principles as possible;

7. The greater the number of reciprocal empirical relations between statements belonging to a theory, the more coherent the theory;

8. The greater the number of reciprocal analytic relations between statements belonging to a theory, the more coherent the theory;

9. The greater the number of reciprocal normative relations between statements belonging to a theory, the more coherent the theory;

The second class of criteria contains the properties of concepts applied by the theory.\textsuperscript{125} It involves two criteria, which are generality and conceptual cross-connections.\textsuperscript{126} Generality rests on the idea that the more general a theory is, the greater the number of objects it covers and thus the more coherent it would be.\textsuperscript{127} In this context the authors also refer to universality,\textsuperscript{128} generality in the strict sense\textsuperscript{129} and resemblances.\textsuperscript{130} The relevance of generality to coherence can be summarised as follows:

1. The more statements within individual names a theory uses, the more coherent it is.

2. The greater the number of general concepts belonging to a theory, and the higher their degree of generality, the more coherent the theory.

\textsuperscript{125} Ibid, at 140.
\textsuperscript{126} Ibid, at 140-142.
\textsuperscript{127} Ibid, at 140-141.
\textsuperscript{128} Universality is defined as using concepts designating all things belonging to a certain class and not merely names of individual objects. Ibid, at 140.
\textsuperscript{129} This type of generality is a matter of degree, the more general the concept in question the greater the number of objects it covers. Ibid.
\textsuperscript{130} Resemblances exist when the concept in question refers to a cluster of phenomena within which each phenomenon is similar to another, for example p1 is similar to p2, p2 is similar to p3, etc. Ibid.
3. The more resemblances there are between concepts that are used within a theory, the more coherent the theory.\(^{131}\)

As for conceptual cross-connections, there are two dimensions to consider. Firstly, the more concepts a given theory, T1, has in common with another theory, T2, the more coherent these theories are with each other.\(^{132}\) Secondly, the more concepts a given theory, T1, contains which resemble concepts used in another theory, T2, the more coherent these theories are with each other.\(^{133}\) Thus, it can be said that two theories are coherent to the extent that they use similar or analogous concepts, structures and rules.\(^{134}\)

Finally, the third category of criteria is the properties of the scope covered by the theory.\(^{135}\) This category entails both the number of cases a theory covers, as well as the diversity of fields to which the theory applies.\(^{136}\) In this respect, the greater the number of individual cases a theory covers and the greater the diversity of fields to which the theory applies, the more coherent the theory would be.\(^{137}\)

The purpose of the aforementioned criteria is to clarify the precise meaning of coherence. It is logically expected after such clarification that a detailed methodology of weighing these criteria would follow. To the contrary, the study does not provide a clear method as to how the criteria should be applied. Rather, Alexy and Peczenik choose to present a brief description of how the degree of coherence is determined by weighing and balancing the

\(^{131}\) Ibid, at 141.
\(^{132}\) Ibid.
\(^{133}\) Ibid.
\(^{134}\) It is noteworthy to highlight the example given to explain more this criterion which is that some conceptual tools used in economic theories, such as Pareto-optimality and indifference curves, can be used to analyse the weighing and balancing in legal and moral reasoning. Ibid, at 141.
\(^{135}\) Ibid, at 142.
\(^{136}\) Ibid, at 142-143.
\(^{137}\) Ibid.
criteria without any further explanation. In addition, they have pinpointed a possible problem in this regard, which is that in some cases one may find that the higher the degree of fulfilment of one criterion, the lower that of another.\textsuperscript{138} In such a case they claim that a more complicated act of weighing should be performed in order to decide which theory is more coherent, but without indicating the nature of such an act.\textsuperscript{139}

The second section of their work investigates the relation between coherence and practical rationality.\textsuperscript{140} In explaining this relation they compare two legal justifications, one which is supported by a coherent system and the other which has no such support.\textsuperscript{141} They conclude that justice requires legal justification to be based on a fairly coherent system.\textsuperscript{142} They further explain that a legal justification which does not explicitly nor implicitly refer to a system is considered an ad hoc justification that can neither be universal nor general.\textsuperscript{143}

An ad hoc justification is incapable of fulfilling the elementary demands of justice.\textsuperscript{144} Thus, the benefits of having a system can be described as follows:

1. In a system, statements are tested in a much more efficient way than within an unsystematic ad hoc justification;

2. The construction of a system results in new insights, which persons solely engaged in an ad hoc justification would hardly gain;

3. A system makes the work of the decision-maker easier. He can rely upon statements which have already been tested many times, and he does not need to return to the hopeless task of justifying everything at once in each case.\textsuperscript{145}

\textsuperscript{138} Ibid, at 143.
\textsuperscript{139} Ibid.
\textsuperscript{140} Ibid, at 143-145.
\textsuperscript{141} Ibid.
\textsuperscript{142} Ibid, at 144.
\textsuperscript{143} Ibid, at 143.
\textsuperscript{144} Ibid.
Accordingly, they argue that coherence is a central element to the concepts of justification, rationality and correctness by stating that:

‘If the norm- or value-system in question is more coherent than any competing system, then it is prima facia better justified and more rational than any competing system. If the norm- or value-system in question is more coherent than any competing system, then there exists a prima facia reason that it is correct.’146

The third and last section of Alexy and Peczenick’s work evaluates the disadvantages of coherence, which they also refer to as its limitations.147 The first disadvantage relates to coherence as a degree.148 As a degree, coherence is determined on the basis of weighing and balancing some partly incompatible demands.149 In applying the criteria of coherence, the result does not provide answers to whether one system is more coherent than the other.150 Moreover, in some circumstances it may even show that each system is more coherent in certain respects.151

The second disadvantage follows from the formal character of coherence.152 In this respect they explain that coherence does not concern itself with the content of normative systems.153 Although coherence contributes to rationality and justice, it does not restrict irrationality or eliminate the unjust within a normative system.154 Thus, by concluding that a normative system is coherent there is no guarantee that such a system no longer contains unjust and

145 Ibid, at 144.
146 Ibid, at 144.
147 Ibid, at 145-146.
148 Ibid, at 145.
149 Ibid, at 145.
150 Ibid.
151 Ibid.
152 Ibid.
153 Ibid.
154 Ibid.
unreasonable elements. The third disadvantage derives from the fact that normative systems tend to be incomplete, regardless of their degree of coherence. In conclusion they state that:

“These limitations do not destroy the idea of a coherent system of statements. However, they show that another level is also important, that is, the procedural level, in which persons and their acts of reasoning play a decisive role. The idea of justification connects these levels with each other. Justifications require two things. Firstly, it requires the creation of a system of statements as coherent as possible. Therefore, it is true, perhaps even analytically true, that if a norm or value system in question is more coherent than any competing system, then consensus about it would be prima facia rational. Secondly, justification requires a procedure of argumentation as rational as possible, which aims at a reasonable consensus.”

It is important to acknowledge that the work of Alexy and Peczenick clarifies a number of aspects related to the concept of coherence in a way that has not been done before. Although the concept, criteria, benefits and disadvantages of coherence were thoroughly explained, they did not elaborate on the procedure of measuring coherence through weighing and balancing the criteria. It remains vague how such criteria can be used in assessing whether a certain legal system is coherent or not. Therefore, while their study provides guidance as to the criteria of coherence, further work should be done in respect to the procedure of measuring the degree of coherence.

155Ibid.
156 Ibid, at 145-146.
4.5. Raz

Raz sets out to introduce a new perspective in relation to coherence within legal theory.\textsuperscript{157} The aim of his work, clearly reflected in the title, is the relevance of coherence in explaining the nature of law and adjudication.\textsuperscript{158} He starts by distinguishing between two types of coherence; epistemic and constitutive.\textsuperscript{159} Epistemic coherence is a condition of justified beliefs, regardless of whether the belief is true or false.\textsuperscript{160} Epistemic coherence claims that within a system a belief is justified if it coheres better than any alternative with the rest of the beliefs within the same system.\textsuperscript{161} On the other hand, constitutive coherence is a criterion of either correctness or truth.\textsuperscript{162} Accordingly, constitutive coherence alleges that coherence explains what makes a judicial decision correct or a legal proposition true.\textsuperscript{163} Thus, constitutive coherence is less flawed than epistemic coherence.

Raz does not question the relative importance of coherence. He agrees that what is coherent is intelligible, makes sense, is well expressed and has all its bits hanging together.\textsuperscript{164} He attempts to explain the appeal of coherence theories of belief justification.\textsuperscript{165} In so doing, he argues that epistemic theories use the word ‘coherent’ to mean something like ‘mutually supporting’.\textsuperscript{166} Taking this assumption into account means that two beliefs cohere if each makes belief in the other more reasonable than its rejection.\textsuperscript{167} However, different views exist as to the nature and meaning of mutually supporting.\textsuperscript{168} Despite the meaning of mutual

\textsuperscript{157} Raz, ‘The Relevance of Coherence’, \emph{op. cit.}
\textsuperscript{158} Ibid.
\textsuperscript{159} Ibid. at 275-282.
\textsuperscript{160} Ibid. at 275.
\textsuperscript{161} Ibid. at 276.
\textsuperscript{162} Ibid. at 283.
\textsuperscript{163} Ibid. at 298.
\textsuperscript{164} Ibid. at 276.
\textsuperscript{165} Ibid. at 277.
\textsuperscript{166} Ibid.
\textsuperscript{167} Ibid.
\textsuperscript{168} Ibid.
support, epistemic coherence-based explanations imply that justification is all about coherence.\textsuperscript{169} Raz criticises this statement by referring to four main objections.

Firstly, coherence on its own is not considered a sufficient condition for holding a justified belief.\textsuperscript{170} Further, he asserts that justified beliefs must not only be coherent, but they should also eliminate epistemic defects such as prejudice, obstinacy and superstition.\textsuperscript{171} Secondly, epistemic coherence allows the prejudiced, gullible and obstinate to avoid their mistakes.\textsuperscript{172} Thirdly, due to the notion of ‘fitting together’, reliable beliefs may be held faulty as they fail to cohere with prior beliefs which may not be reliable.\textsuperscript{173} Finally, in some cases it is justified to accept or hold inconsistent beliefs.\textsuperscript{174}

After his attack on epistemic coherence, Raz moves on to explain constitutive coherence.\textsuperscript{175} He claims that the preference for coherence cannot be the sole factor to make coherence play a role in an account of the law.\textsuperscript{176} Thus, he introduced the idea of what he calls ‘a base’, and that is what needs to be made coherent.\textsuperscript{177} Legal materials including legal decisions, statutes, rules and regulations along with principles, purposes and policies are all grouped together to form the legal base.\textsuperscript{178} This base provides the material to which coherence is applied.\textsuperscript{179}

\textsuperscript{169} Ibid, at 276-279.
\textsuperscript{170} Ibid, at 279-280
\textsuperscript{171} Ibid, at 280.
\textsuperscript{172} Ibid, at 280.
\textsuperscript{173} Ibid, at 281.
\textsuperscript{174} Ibid.
\textsuperscript{175} He justifies moving to the constitutive coherence theory by stating that ‘For one thing, we are now concerned not with coherence of beliefs but with the coherence of legal norms, rules, standards, doctrines and principles. Furthermore epistemic coherence is relative to each person. The justification of each person’s beliefs is relative to that person’s totality of beliefs. This makes it possible for each of the two people to be justified in holding beliefs that contradict those of the other. As justified beliefs may be false, there is no problem about that. A constitutive account of law cannot enjoy the same luxury. It cannot be person relative.’, ibid, at 283-284.
\textsuperscript{176} Ibid, at 284.
\textsuperscript{177} Epistemic accounts take the base to be a person’s belief set. However, that cannot be the base in constitutive coherence accounts, ibid.
\textsuperscript{178} Ibid, at 286.
\textsuperscript{179} Ibid.
Additionally, the base cannot be subjective and has to be the same for all persons. In support of his idea of a legal base, Raz states the following:

‘sSo the first lesson we learnt is that even according to coherence accounts, coherence is but one of at least two components in any theory of law. The other component provides the base to which the coherence account applies’.

In this respect, coherence theories of the law are understood as those which take a certain base, for example court decisions and legislative acts, and regard the law as the set of principles that makes the most coherent sense of it. Thus, the more unified the set of principles, the more coherent the law is. If all principles follow from one principle, this is known as monistic coherence. The smaller the group of principles from which other principles follow, the less coherent they are. However, it must be taken into consideration that it is not possible to determine in advance the precise meaning of coherence along with how precisely different accounts of law compare in the degree of coherence they reflect.

Raz rejects a number of arguments made by the defenders of coherence theory in relation to law. He rejects the assumption that coherence is needed in order to know the content of legal decisions. In this respect he argues that the base provides all we need for a theory of law, without the need for coherence. Moreover, he rejects the argument that it is unintelligible for people to accept a less coherent body of principles rather than a more coherent

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180 Ibid, at 285.
182 Ibid, at 286.
183 Ibid.
184 Ibid.
185 Ibid.
186 Ibid.
188 Ibid.
A good example is found in the case of moral theory, as one theory can be the most coherent theory possible, while still being misguided. However, he views this failure of coherence theory as a failure to take due notice of the base to which coherence theory should apply.

Raz then proceeds to show the failure of coherence theory within adjudication. Coherence in adjudication is the most powerful case for coherence, asserting that judges have no alternative but to rely on coherence in deciding cases. He claims that while it is desirable that judicial decisions reflect the most coherent theory, these decisions are to be judged by other criteria as well. Moreover, it is even possible that sometimes coherence needs to be sacrificed for some other good.

The purpose of Raz’s work should not be viewed as a sign that he is against the role of coherence in the law. He is mainly against global coherence accounts which try to impose coherence on the whole of the law. Nevertheless, he speaks in favour of what he calls ‘local coherence’, which is the coherence of doctrine in a specific field. He concludes his work by stating that:

‘Coherence, one might say, is everywhere. But it is local rather than global coherence, and it comes into its own mostly once questions of principle (including questions of resolving conflicts of value where they are resolvable by reason) are resolved on other grounds.’

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189 Ibid, at 293.
190 Ibid.
191 Ibid.
192 Ibid, at 197.
193 Ibid, at 298.
194 Ibid.
196 Ibid, at 310.
197 Ibid, at 310.
198 Ibid, at 314.
The manner in which Raz views coherence and its relevance to law is significant. Although he neither provides a clear definition to what is meant by coherence nor examines the concept, he does manage to draw our attention to other important aspects of coherence. Those aspects are the base and local coherence. The base provides the subject to which coherence applies. Without having such a base, coherence would be self-determined and would be examined in light of how each person views the law. To avoid ending up with a subjective standard of coherence, it is necessary to control the law and how the law is understood. The base controls the law by providing the material to which the coherence applies. In this respect, the base cannot be subjective as well as the law. However, it remains unclear as to how it is possible to limit subjectivity by controlling the way law is understood.

The other aspect is local coherence. It makes more sense to consider coherence locally rather than globally. Such an approach is even more favourable when examining coherence in international law. This is because the law in general is affected by the plurality of inconsistent views on moral, religious, social and political issues in societies.\textsuperscript{199} Pluralism may result in producing legal rules pushing in different directions and therefore lead to conflicting social and economic views. This is when local coherence comes into play. Following a coherent policy in solving the dilemma generated by pluralism would make the legal rules known and their application predictable.

Raz’s theory of coherence will be of benefit in examining coherence within bilateral investment treaties. Both the idea of the base and local coherence will be adopted. The base means that the subject of coherence must be identified. In this case it is the provisions of bilateral investment treaties along with the principles from which these provisions derive, the

\textsuperscript{199} Ibid, at 311.
customary international law in this field and the related non-investment obligations. Additionally, coherence will be examined locally by addressing the degree of coherence in relation to specific treaty provisions.

4.6. Balkin

Balkin highlights the argument that it is unsatisfactory to regard coherence as a property of a legal object independent of the contributions of the legal subject.\textsuperscript{200} His argument is based on the possibility that one may experience the law as coherent because he/she attempts to understand the law in a certain way.\textsuperscript{201} In this respect he finds it necessary to address subjectivity when looking at coherence within the legal system, rather than regarding coherence as a pre-existing feature of the law.\textsuperscript{202}

He starts his theory of coherence and legal understanding by distinguishing between the different types of coherence.\textsuperscript{203} The first type is the coherence of a set of factual beliefs which embodies the question of logical or narrative coherence.\textsuperscript{204} The basic requirement for narrative coherence is logical consistency.\textsuperscript{205} However, a more stringent requirement of narrative coherence is the existence of mutual support between the beliefs.\textsuperscript{206} The second type is the coherence of a normative system such as law.\textsuperscript{207} Normative coherence is concerned with the consistency of principles rather than logic.\textsuperscript{208} Principles are coherent if they entail distinctions and similarities that are principled and reasonable as opposed to being arbitrary and unreasonable.\textsuperscript{209} The third and final type is the coherence of the world around us.\textsuperscript{210} This type of coherence is special and distinctive from the previous types, as it can include

\begin{itemize}
  \item \textsuperscript{200} Balkin, ‘Understanding Legal Understanding’, op. cit..
  \item \textsuperscript{201} Ibid.
  \item \textsuperscript{202} Ibid, at 107.
  \item \textsuperscript{203} Ibid, at 113-115.
  \item \textsuperscript{204} Ibid, at 114.
  \item \textsuperscript{205} Ibid.
  \item \textsuperscript{206} Ibid.
  \item \textsuperscript{207} Ibid.
  \item \textsuperscript{208} Ibid.
  \item \textsuperscript{209} Ibid.
  \item \textsuperscript{210} Ibid, at 115.
\end{itemize}
judgements of logical, narrative and normative coherence. This is because the coherence of the world around us is demanded by our existence as understanding beings and rests on our need to see ourselves as rational and morally sensitive people.

Balkin classifies legal coherence under normative coherence. He argues that legal coherence is a feature not of legislation and existing legal materials, but of the justification afforded to them. The law or part of the law is considered coherent if the principles, policies and purposes justifying it constitute a coherent set in such a way that all conflicts amongst them are decided in a principled, reasonable and non-arbitrary manner. However, the coherence of a set of principles, policies and purposes depends on whether they are consistent or not. In other words, he maintains that the law is coherent if it originates from or can be explained by a set of consistent principles and policies. This should not be seen as a requirement that the principles and policies should stem from a single master principle or policy or that they should be mutually interdependent in a way that if one goes they all go. Rather, they have to be mutually supportive to the extent that they are consistent with each other. Hence, it is believed by Balkin that legal coherence is satisfied by mere consistency and consistency involves the consistent use of principles and policies to justify legal doctrines.

Balkin proceeds to explain how judgements of legal coherence arise when we understand the law in a particular way. He refers to this type of legal understanding as ‘rational
Rational reconstruction is defined as ‘the attempt to see reason in legal materials, to view legal materials as a plausible and sensible scheme of human regulation. The experience of legal coherence is the result of our attempt to understand law through the process of rational reconstruction’. Thus, the question of legal coherence is eventually the question of the conditions of rational reconstruction. He then moves on to explain how judgements of rational reconstruction are produced and how these judgements are affected by the experiences and beliefs of the subject of the legal understanding. Accordingly, he addresses three main features of subjectivity that are likely to contribute to shaping our judgements of rational reconstruction, and these are as follows:

1. The state of moral and political beliefs;
2. The state of our knowledge about the legal system;
3. The state of our efforts at rational reconstruction through considering possible conflicts of value between legal doctrines.

By looking at the effect of moral and political beliefs on rational reconstruction, it is found that coherence or incoherence cannot be wholly separated from our moral and political beliefs. These beliefs strongly contribute to making our judgements. On the other hand, the effect of legal knowledge on rational reconstruction is very significant. This is because it is usually assumed that the subject has complete knowledge of the legal system. However, in reality our knowledge of the law is limited even for those known as legal

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221 Ibid.
222 Ibid.
223 Ibid.
224 Ibid.
225 Ibid, at 137.
226 Ibid, at 137-139.
227 Ibid, at 139-143.
228 Ibid, at 137.
229 Ibid.
230 Ibid, at 137-139.
231 Ibid, at 137.
experts.\textsuperscript{232} Thus, our judgment about legal coherence is limited to our image of the legal system, which is shaped by ignorance as well as knowledge.\textsuperscript{233} Finally, legal coherence results from the interaction between a legal subject and a legal object which is already created by the subject's own views on the legal system.\textsuperscript{234}

The amount of subjectivity affecting legal coherence can be determined by answering the question of whether an individual has an ‘\textit{ontological stake}’ in the coherence of the legal system, or a particular set of legal doctrines, or a particular political or moral theory they believe is embodied in the law.\textsuperscript{235} Such a personal stake comes into existence if a person's moral beliefs are attached to the legal system in such a way that makes any attack on the coherence of that legal system an attack on that person's moral judgements.\textsuperscript{236} However, in order to avoid these issues Balkin introduces the idea of employing an ‘\textit{ideal observer}’ theory of legal coherence.\textsuperscript{237}

In an attempt to further clarify the ‘ideal observer’ theory, Balkin explains how this theory aims at offering a standard of objectivity that departs away from subjectivity.\textsuperscript{238} The attractiveness of this theory results from avoiding the complications which might arise from adopting our own experiences when deciding whether the legal system is coherent or incoherent.\textsuperscript{239} Nonetheless, the ideal observer theory does not address the nature of legal understanding which involves the problem of human understanding of culture in general.\textsuperscript{240} If

\begin{flushleft}
\textsuperscript{232} Ibid, at 138.
\textsuperscript{233} Ibid, at 138-139.
\textsuperscript{234} Ibid, at 139-140.
\textsuperscript{235} Ibid, at 139-140.
\textsuperscript{236} Ibid, at 146.
\textsuperscript{237} Ibid, at 146-147.
\textsuperscript{238} Ibid, at 140.
\textsuperscript{239} Ibid, at 141-143.
\textsuperscript{239} These complications arise from the following facts: 1) Our views of the law are revisable since our minds are likely to change if we were given further information; 2) There are some judgments of the law which are better than others; 3) We believe in general that legal judgments are better if they were made by an individual who has access to more information and who spends a lot of time thinking about the issue involved, ibid, at 141.
\textsuperscript{240} Ibid.
\end{flushleft}
we are to assume that the ideal person is free from any historical or cultural background we will be then imagining a person with no culture, no history and no experiences.\textsuperscript{241} In applying the ideal observer theory there will be no need to be concerned about the contribution of the legal subject to understanding the legal system.\textsuperscript{242} The ideal observer would not have any particular desires, motivations, goals or urges to affect interpretation of the law.\textsuperscript{243} More importantly, there is the question of whether in reality such a theory would be applicable. Finding an ideal observer with unlimited time, knowledge and capabilities is almost impossible to achieve.\textsuperscript{244} Thus, the only option left is to look for an average observer.\textsuperscript{245}

Balkin argues that ‘\textit{much of our subjectivity is intersubjectivity, and this intersubjectivity is a source of objectivity’}.\textsuperscript{246} In other words, sharing similar limitations as much as abilities, ignorance as much as knowledge and partiality as much as neutrality is what helps in creating a standard of objectivity that limits the contribution of subjectivity.\textsuperscript{247} Hence, the imperfections and limitations may be what the average person has most in common with others, which in turn justifies adopting the views of an average person in answering the question of whether the legal system is coherent or incoherent.\textsuperscript{248}

In sum, Balkin’s theory of coherence in legal accounts rests on the assumption that ‘\textit{the coherence of the law is ultimately based upon the coherence of the world and that the coherence of the world is ultimately based upon the coherence of ourselves’}.\textsuperscript{249} This theory differs from the preceding theories of coherence and the law. It does not focus on the concept

\textsuperscript{241} Ibid, at 142.
\textsuperscript{242} Ibid.
\textsuperscript{243} Ibid.
\textsuperscript{244} Ibid, at 142-143.
\textsuperscript{245} Ibid, at 143.
\textsuperscript{246} Ibid.
\textsuperscript{247} Ibid.
\textsuperscript{248} Ibid.
\textsuperscript{249} Ibid, at 169.
of coherence as much as it addresses the role played by the legal subject in understanding the law. As much as this sounds reasonable, Balkin's view can be viewed as somewhat extreme. This is because such subjectivity would mean that the same set of legal doctrines can be considered coherent and incoherent at the same time since coherence depends on the subject's views and beliefs.

This theory shall be taken into consideration when examining the coherence of bilateral investment treaties for the purpose of explaining how subjectivity can be minimised. Taking into account the impossibility of finding an ideal observer, the average observer will be considered instead. In an attempt to define the average observer in accordance with bilateral investment treaties, the key feature is that such an observer does not contribute his own beliefs when trying to examine the coherence of these treaties. Therefore, it can be said that such a person is one who studies coherence in regard to the objectives of these treaties as stated by the treaties' provisions and not as what he believes they are. By adopting such a concept, subjectivity is likely to be minimised as the subject will not have room for his own contribution. Accordingly, for the purposes of this study, coherence in relation to bilateral investment treaties will be examined in the eyes of the average observer.

4.7. Olsson

Olsson’s work in this area attempts to bring together belief, revision and the theory of coherence.\(^{250}\) He approaches coherence within the context of Hansson’s theory of semi-revision.\(^{251}\) The theory of semi-revision provides the means needed for thinking more precisely about coherence and its role in legal justification.\(^{252}\) As coherence theories of legal justification have remained vague about how to reach coherence within a legal system, the


revision theory helps in filling this gap by providing an account of the different coherence-
enhancing operations. More specifically, the belief revision theories differentiate between
two kinds of change: internal and external, as well as their corresponding operations: consolidation and semi-revision. This distinction is crucial for explaining the different mechanisms whereby the alternative hypotheses that are being considered in the course of legal decision-making may be rendered coherent. These hypotheses are divided into two kinds; explanatory hypotheses dealing with the facts under dispute and interpretive hypotheses concerned with what the law requires. Thus, the importance of this theory follows from the fact that it addresses the issue of how legal decision makers reach the most coherent hypothesis when justifying both questions of facts and questions of law.

In his theory, Olsson replaces Hansson's requirement of consistency by coherence. He argues that coherence has two dimensions, which are consistency and stability. Taking the concept of coherence into consideration, Olsson introduces a new approach to the main operations of Hansson's theory, which are consolidation and semi-revision. According to the Hansson, to consolidate is to make a belief coherent in the narrow sense of making it consistent. As for Olsson, he claims that consolidation must be considered as the process of changing one's system of beliefs provided that the change achieves stability in a way that is not limited to consistency. Although introducing the concept of stability is considered a significant step within the process of formalising the concept of coherence, it is noteworthy that Olsson left the meaning of stability undefined. It is not clear how stability should be

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254 Ibid, at 438.
255 Ibid.
256 Ibid.
257 Ibid.
258 See Olsson, 'A Coherence Interpretation of Semi-Revisions', op. cit., at 107-08.
259 Ibid, at 115.
260 Hansson, 'Semi-Revision', op. cit..
understood and how it should be defined. Hence, it can be said that the ambiguity surrounding the notion of coherence is now transferred to the notion of stability.

Moreover, Olsson happens to disagree with Hansson on another issue, which is the process of consolidation.\textsuperscript{262} Olsson maintains that consolidation can be divided into ‘subtractive consolidation’ and ‘additive consolidation’.\textsuperscript{263} While subtractive consolidation amounts to subtracting a belief or more from an incoherent set in order to render it coherent, additive consolidation consists of adding a belief or more to a consistent set of beliefs, thereby rendering it coherent.\textsuperscript{264} An example of subtractive consolidation in reviewing the law in order to enhance coherence would require ruling out as mistaken a statutory provision or a precedent which conflicts with major legal principles. On the other hand, additive consolidation would require adding legal information for the purpose of extending or further strengthening an existing principle or precedent.

The standing question is how we are going to accept or reject beliefs in order to maximise the coherence of a legal system. An interesting approach is developed by Paul Thagard and Karsten Verbeurgt as they provide a general characterisation of coherence as ‘\textit{constraints satisfaction}’.\textsuperscript{265} For them, maximising coherence is all about maximising the satisfaction of a

\begin{itemize}
  \item[Ibid, at 122-123.]
  \item[Ibid, at 123-125.]
  \item[Ibid.]
  \item[See P. Thagard and K. Verbeurgt, 'Coherence as Constraints Satisfaction', \textit{Cognitive Science}, 22/1 (1998), 1-24. They summarise their coherence theory as follows:]
  \begin{enumerate}
    \item 'Elements are representations such as concepts, propositions, parts of images, goals, actions, and so on.'
    \item Elements can cohere (fit together) or incohere (resist fitting together). Coherence relations include explanation, deduction, facilitation, association, and so on. Incoherence relations include inconsistency, incompatibility, and negative association.
    \item If two elements cohere, there is a positive constrain between them. If two elements incohere, there is a negative constrain between them.
    \item Elements are to be divided into ones that are accepted and ones that are rejected.
    \item A positive constrain between two elements can be satisfied either by accepting both of the elements or by rejecting both of the elements.
    \item A negative constrain between two elements can be satisfied only by accepting one element and rejecting the other.
    \item The coherence problem consists of dividing a set of elements into accepted and rejected sets in a way that satisfies the most constrains.' at 3.
  \end{enumerate}
\end{itemize}
set of positive and negative constraints among the elements of a given set. To illustrate, if we take a set of elements (E) and we work on maximising the coherence of it, then the problem that we will face is how we are going to accept and reject elements for that purpose. Thagard and Verbeurgt claim that in order to make (E) as coherent as possible we should consider the coherence and incoherence relations that already exist between pairs of elements of (E). By considering these relations, constraints will be formed as to what can be accepted or what should be rejected. In doing so, (E) should be divided into two disjointed subsets taking into account the local coherence and incoherence relations. The first subset will consist of the accepted elements and will be referred to as (A). The second subset will contain the rejected elements and will be called (R). The problem of coherence is featured in regards to dividing (E) into (A) and (R) in a way that best satisfies the most constraints. More formally, the coherence problem can be defined as:

‘Let E be a finite set of elements and C be a set of constraints on E understood as a set (ei, ej) of pairs of elements of E. C divides into C+, the positive constraints on E, and C-, the negative constraints on E. With each constraint is associated a number w, which is the weight (strength) of the constraints. The problem is to partition E into two sets, A and R, in a way that maximizes compliance with the following two coherence conditions:

1. If (ei, ej) is in C+, then ei is in A if and only if ej is in A.
2. If (ei, ej) is in C-, then ei is in A if and only if ej is in R.’

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266 Ibid.  
267 Ibid.  
268 Ibid.  
269 Ibid.  
270 Ibid.  
271 Ibid.  
272 Ibid.  
273 Ibid.
Based on the above, coherence will then depend on the sum of the weights of the satisfied constraints.\textsuperscript{274} To have a positive constraint between two elements means that both elements should be either accepted or rejected.\textsuperscript{275} A variety of relations may result in having a positive constraint such as a relation of entailment or explanation.\textsuperscript{276} A negative constraint on the other hand means that one element should be accepted while the other is rejected.\textsuperscript{277} A negative constraint may occur if there is, for example, a relation of inconsistency or even for a weaker purpose such as competition between elements.\textsuperscript{278} Consequently coherence is maximised as long as (E) is divided into (A) and (R) in a way that no other partition has greater total weight.\textsuperscript{279}

Thagard and Verbeurgt claim that the above characterisation of coherence is applicable to a wide variety of problems including epistemic justification, mathematics, moral and legal justification and discourse comprehension.\textsuperscript{280} In addition, they mention that there are three sorts of measurements of coherence that are potentially useful, which are the degree of coherence of an entire set of elements, the degree of coherence of a subset of elements and the degree of coherence of a particular element.\textsuperscript{281} They finally conclude that by examining coherence as constraint satisfaction and by properly computing and measuring it, coherence theories can be more fully specified.\textsuperscript{282}

The reason behind mentioning the above belief revision theory and the theory of coherence as constraint satisfaction is that these theories advance the coherence theory of law in different
ways. First, they contribute to forming a precise characterisation of the notion of coherence and clarifying the vagueness associated with it. Second, these theories explain how coherence can be dynamic. Finally, they provide helpful guidance to legal decision-makers as to how coherence can be achieved.

Accordingly, these theories will be helpful in the process of reviewing bilateral investment treaties in terms of coherence. The belief revision theory as provided by Olsson will be followed in looking at how elements related to these treaties can be added or subtracted while taking into consideration the degree of coherence. Coherence in that regard will not be reduced merely to consistency, but will also include stability as it will be clarified in relation to bilateral investment treaties. In applying that, the theory of coherence as constraint satisfaction will come into play. However, it will be implemented in a basic manner. Precisely, it will be featured to the extent that bilateral investment treaties are divided into accepted and rejected subsets according to identified constraints. The accepted provisions are the ones enjoying positive constraints reflected in having relations of coherence and the rejected subset will consist of provisions experiencing negative constraints which are mainly incoherent.

5. Coherence in Relation to Bilateral Investment Treaties: New Concept and Scope

Coherence is considered important for bilateral investment treaties due to a number of factors. First, these treaties should be coherent with the countries’ domestic economic and development policies. The problem of incoherence is likely to arise as a result of the conflicting interests of the countries concluding the treaty. On one hand the availability of a wide range of options for the structure and content of the agreement presents an opportunity

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for countries to seek tailor-made solutions for their individual development needs.\textsuperscript{284} On the other hand, the more complicated these treaties become the more difficult it will be for countries to fully understand them and make the best use of them for achieving certain development goals.\textsuperscript{285} Thus, incoherent treaties may create problems in connection with the development policy of a country.

Second, the negotiators of bilateral investment treaties are facing a difficult task which requires them to avoid as much as possible contradictions and other inconsistencies in the investment agreement network of their countries.\textsuperscript{286} In fact, countries have concluded investment treaties with different provisions dealing with substantial issues such as pre-establishment commitments, national treatment and its exceptions, the coverage of the umbrella clause, performance requirements and investor-state dispute settlement.\textsuperscript{287} In addition to the possibility of treaty incoherence, there is also the likelihood of inconsistency between the treaties and domestic laws which would result in a conflict between domestic and international law.\textsuperscript{288} Therefore, incoherence puts countries in the position of losing organisational knowledge of the specific content of the investment treaties they have concluded.\textsuperscript{289}

Third, coherence is very important in relation to interpretation as it is necessary to avoid further complications due to contradictory awards.\textsuperscript{290} The general and broad wording used in most treaties’ provisions and the apparent need to include exceptions and restrictions may

\textsuperscript{284} Ibid.
\textsuperscript{285} Ibid.
\textsuperscript{286} Ibid.
\textsuperscript{287} Ibid.
\textsuperscript{288} Ibid, at 4.
\textsuperscript{289} Ibid.
\textsuperscript{290} Ibid, at 5.
Such incoherence goes against some core principles that should apply to international investment relations including clarity, stability, transparency and the existence of a common set of ground rules. Accordingly, coherence is crucial to facing the challenge of interpreting provisions and avoiding major discrepancies.

5.1. Concept

As seen in the preceding paragraphs, coherence is generally held to be more than the mere consistency of propositions. That ‘more’ has been addressed by a number of scholars in different ways. For some it means comprehensiveness and completeness at least to a certain extent, while others call for support of varying scope and force or even some kind of connection and mutual justification between the parts of a whole. Clarifying that ‘more’ will be the starting point for explaining the new concept of coherence used in examining bilateral investment treaties.

The first issue to be considered is comprehensiveness. The importance of comprehensiveness arises from its function to prevent achieving consistency by isolating some main elements as they might be inconsistent. Ideally, comprehensiveness reflects having a system of everything and, therefore, in that case only a legal system that includes everything would be considered coherent. When applying that meaning to bilateral investments treaties, bearing in mind their nature, comprehensiveness becomes a complicated issue. It is almost impossible to oppose comprehensiveness in that sense.

291 Ibid.
292 Ibid.
We should accept the fact that we live with 'rational irrationality' because it is almost impossible to achieve 'full rationality'. In other words, we live in a world where all normative systems are incomplete regardless of their degree of coherence. Therefore, if coherence is strictly associated with absolute comprehensiveness, perfect coherence would be impossible for a legal system to oppose. This explains why in some cases a system may be coherent in one respect and not in another.

Moreover, the limitations of comprehensiveness can be explained in reference to the theory of incomplete contracts. In the real world the possibility of drafting a complete contract is unachievable. It is strongly unlikely to have a complete contract whereby all the contingencies affecting the contractual relationship are actually taken into account. There are several reasons for not concluding such contracts. Firstly, the cost of negotiating such a contract would be high. Secondly, it is difficult to collect all the information needed and, therefore, it would not be easy to verify the ex post value of all elements affecting the contract. Thirdly, it is impossible to predict all circumstances which might occur and have them covered under the terms of the contract. Accordingly, contracts usually consider variables which are immediately related to the contractual relation or the ones that are easy to verify, and those are limited.

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295 These points were mentioned as 'limitations follows from coherence' in the work of Alexy and Peczenik, see Alexy and Peczenik, 'The Concept of Coherence and Its Significance for Discursive Rationality', *op. cit.*
297 Ibid.
298 Ibid.
299 Ibid.
300 Ibid.
301 Ibid.
Similarly, bilateral investment treaties as contracts cannot be comprehensive.\textsuperscript{302} Therefore, it is difficult to conclude a treaty that maximises jointly beneficial investments while also being capable of responding appropriately to the occurring changes.\textsuperscript{303} For that reason, comprehensiveness should not be considered as an element of coherence in relation to bilateral investment treaties.

The second issue is the condition of support. For a theory to be coherent there should be a degree of mutual support within its components. It is important that bilateral investment treaties contribute to a supportive structure. However, the mutual support should occur between the provisions and the principles, objectives, customary international law and other related non-investment obligations. The meaning of mutual support will be explained in reference to Olsson’s theory of coherence. As explained earlier, Olsson’s account of coherence is based on two dimensions, namely consistency and stability. Stability is regarded as an essential element of coherence and plays a major role in maintaining the level of coherence within a system as it develops.

In this respect, mutual support derives from the purpose behind stability. In other words, whenever a legal system is examined in terms of coherence it must be considered that these rules are subject to change. Any legal system should be capable of obtaining new legal principles or giving up outdated legal principles as the development of the subject matter of the law requires. Nevertheless, this should be while ensuring that all elements within the system provide mutual support.


5.2. Scope

It is necessary to first identify the base to which coherence will apply. The idea of identifying the base is adopted from Raz’s theory of coherence. In this study each chapter will provide a different base. In this respect each base reflects the legal material to which coherence is applied, and they are as follows:

1. Bilateral investment treaties and the principles of international investment law;
2. Bilateral investment treaties’ objectives and provisions;
3. Bilateral investment treaties and the customary international law in the field of international investment law;
4. Bilateral investment treaties and investment provisions in the free trade agreements (FTAs);
5. Bilateral investment treaties and non-investment obligations.

In applying coherence to each of the above bases, relations of consistency and support will be formed. Consequently, two main subsets will emerge. The first subset will consist of the coherent relations and will be referred to as positive constraints. The other will consist of the incoherent relations and will be referred to as negative constraints. According to these subsets, the bilateral investment treaties’ revision will take place. In other words, the negative and positive constraints will assist in identifying what provisions should be removed and what provisions should be added. The final result would be more coherent bilateral investment treaties.
6. Conclusion

Based on the above, examining the amount of coherence achieved by bilateral investment treaties demands the development of a new set of criteria to reflect on the nature of the evaluated legal system. The legal base to which this concept will apply differs in each of the subsequent chapters. In applying the developed concept of coherence, positive and negative constraints will be identified. The recommendations of reform will reflect on these constraints. Nonetheless, it should be clear that the pursuit of coherence is not capable of providing bilateral investment treaties which are perfectly coherent in a way laws and regulations cannot possess in the real world, but it is rather a correctional device to be used in the continual process of updating and improving these treaties.
Chapter 2

Coherence between Bilateral Investment Treaties and the Principles of International Investment Law

1. Introduction

The evolution of international investment law has been significant over the past few decades. The developments in the legal instruments protecting foreign investment were introduced in response to the changing economic and political situation of the world. During this time, distinct principles started to take shape. These principles were influenced by the traditional developed – developing country tension. The aim of this chapter is to evaluate how coherent bilateral investment treaties are in relation to these principles. The legal base to which coherence will apply consists of the principles of international investment law, the international attempts at regulating foreign investment and bilateral investment treaties. Coherence is examined by dividing the legal base into subsets subject to positive and negative constraints. Positive constraints are formed whenever there is consistency and mutual support between the legal materials within a base. On the other hand, negative constraints prevail whenever there is inconsistency and lack of support. This chapter will start by identifying the fundamental principles of international investment law. It will then deal with the economic theories and political commitments including bilateral investment treaties according to how they cohere with each principle.
2. Principles

It is well known that legal principles play an essential role in supporting judgments about particular legal rights and obligation. Stavros observes that

‘legal rights and duties are determined by the scheme of principles that provides the best justification of certain political practices of a community: a scheme identifiable through an interpretation of the practices that is sensitive both to the facts of the practices and to the values or principles that the practices serve’.  

One of the major tasks of legal philosophy has always been the issue of classifying laws into logically distinct categories.

In an attempt to clarify the meaning of a legal principle, Dworkin distinguishes between principles and rules. He argues that the word principle refers to the different components of law, other than rules including principles, policies and other sorts of standards. His first observation is that there is a logical distinction between rules and principles. Rules tend to apply in all-or-nothing fashion, which is different from the way in which principles operate. Precisely, principles do not generate legal consequences that follow automatically whenever

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304 What is law has always been a very important question. In an attempt to answer the question Bentham states the following:

‘What is a law? What the part of a law? The subject of these questions, is to be observed, is the logical, the ideal, the intellectual whole, not the physical one: the law and not the statute... By the word law then,... is meant that ideal object, of which the part, the whole, or the multiple, or an assemblage of parts, wholes, or multiples mixed together, is exhibited by a statute; not the statute which exhibits them.’ J. Bentham, An Introduction to the Principles of Moral and Legislation (2; London: Printed for W. Pickering, Lincoln's-Inn Fields and E. Wilson, Royal Exchange, 1823) at 267.


308 A policy is different from a principle because it is a standard that sets out a goal to be reached such as an improvement in some economic, political, or social feature of the community, Dworkin, 'The Model of Rules', op. cit., at 23.

309 He explains this further by stating 'If the facts a rule stipulate are given, then either the rule is valid, in which case the answer it stipulates must be accepted, or it is not, in which case it contributes nothing to the decision', ibid, at 25.
certain conditions are met. According to Raz, principles are likely to include broad and flexible terms such as ‘reasonable’ and ‘unjust’, while rules tend to be more specific and certain.

While Raz acknowledges Dworkin’s approach, he does not completely agree with Dworkin’s observations. Raz believes that it is not correct to assume that all laws known as rules are of the same logical type while all laws called principles belong to another uniform type. To the contrary, laws can be norms or non-norms which in turn means that rules and principles can either be characterised as norms or non-norms. Accordingly, principles and rules which are norms are likely to have a similar form, making it difficult to distinguish between them. So, instead of relying on the form, Raz argues that the distinction depends on three elements of a norm which he refers to as the norm subject, the norm act and the conditions of application. By arguing so, Raz objects to Dworkin’s observation of form and claims that the use of generic words like ‘reasonable’ and ‘unjust’ do not on their own mean that we are dealing with a principle. Rather, it is the norm-act which draws the line between a rule and a principle. This is because rules provide relatively specific acts, while principles prescribe...
highly unspecific acts.\textsuperscript{319} Thus, the distinction between rules and principles is one of a degree.\textsuperscript{320} In order to further separate them it is necessary to clarify the role each one of them plays. As norms prescribing highly specific acts require the support of more generic considerations to be justified, principles can be used to justify rules but not vice versa.\textsuperscript{321}

Although both attempts are very reasonable, they do not on their own explain all the differences between principles and rules in the law. Thus, it is difficult to follow one approach and ignore the other. Nevertheless, Dworkin provides a basic definition for principles which might assist in simplifying the process of identifying the principles of international investment law. He states that a principle is ‘a standard that is to be observed, not because it will advance or secure an economic, political, or social situation deemed desirable, but because it is a requirement of justice or fairness or some other dimension of morality’.\textsuperscript{322} Considering that in light of the history of international investment law, one would conclude that fairness and justice were the reasons behind the existence of two distinct and conflicting principles. One is the national treatment standard and the other is the international treatment standard. Moreover, these principles are regarded as the main principles behind shaping the evolution of international investment law.

The period prior to the existence of bilateral investment treaties seemed mainly to reflect the conflict between these principles. The international community was divided into two sides, one supporting the maintenance of a national standard for treating foreign investors, and the other fighting for the implementation of a minimum international standard of treatment. The conflict between these two principles directed the evolution of international investment law.

\textsuperscript{319} In this regard he states that ‘an act is highly unspecific if it can be performed on different occasions by the performance of a great many heterogeneous generic acts on each occasion’, ibid, at 837.
\textsuperscript{320} Ibid, at 838.
\textsuperscript{321} Ibid, at 839.
\textsuperscript{322} Dworkin, 'The Model of Rules', op. cit., at 23.
The international investment rules that used to cohere with one principle were absolutely incoherent with the other. In other words, the international rules on the protection of foreign investment that formed positive constraints with one principle formed negative constraints with the other and vice versa. Below is an analysis of the international investment rules, each under the principle with which it coheres.

3. National Treatment

The human activities of trade and investment can be traced back to the birth of nations. National treatment is the fundamental principle which governs foreigners’ civil status. This principle rests on the notion that foreigners residing and doing business within the national borders of a country are subject to the law of that country. Relying on the doctrine of sovereignty and sovereign equality, foreign investors are subject to the laws of the host state alone and have no protection via any external standards.

At that time foreigners were those who did not believe in Islam or Christianity. According to these civilizations, foreigners who respected the religion and the rules of the State were accorded similar treatment to nationals (believers) with regard to business and the protection of their life and property.

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In this regard, Islamic law treated non-Muslims living under the Islamic sovereignty like Muslims as they agreed to enter into a contract with the Islamic community. The contract allowed non-Muslims to hold to their own beliefs and religion as long as they paid a poll tax called ‘Jizay’, and in return, Muslims would undertake to secure their lives and property. The security granted to non-Muslims was similar to the citizenship which governments grant to an alien who abides by the constitution. As a result, they had the right to freely practice their faith, study, work and access social justice. In the same essence, the position of non-Christians was defined by Innocent IV. He insisted that non-Christians should enjoy their natural rights to posses and govern while upholding the right of the pope to exercise ultimate jurisdiction over them. This explains why both Muslim and Christian civilizations applied the national treatment standard under certain conditions.

Later on the colonial period set the stage for some countries to insist on according foreigners equal treatment with nationals. The European expansion was motivated by political, social and economic reasons. The relation between colonialism and foreign investment is explained through the economic theory of imperialism. It argues that the reason behind countries seeking the acquisition of territories in different areas is to secure sheltered markets for their national investment abroad. For that reason, European nations started to establish

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328 Non-Muslims were known as ‘Ahl Al Dhimma’. In Arabic, Dhimma means safety, security and contract. For that reason they were called Dhimmis as they agreed to enter into a contract with the Islamic community which granted them security, see Siyar, The Islamic Law of Nations, op. cit., at 11-12.
329 Ibid.
330 Ibid.
331 Ibid.
332 Berend, At the Gate of Christendom: Jews, Muslims and ‘Pagans’ in Medieval Hungary, C.1000-C.1300 at 48.
333 Ibid.
colonies and protectorates in Latin America, Africa and Asia in order to enhance safe and stable commercial activities within different parts of the world.

Studies supporting this argument show that investors from the colonial powers were more involved in foreign direct investment in their colonies. Taking Britain and France for example, it was noticed that there were 2.2 times more British investments going to British colonies and 11.9 times more French investments going to French colonies. Scholars did not stop at only considering overseas investment as a reason for colonial expansion. Rather, they went even further in explaining the types of investment and how that played a role in turning certain countries into colonies rather than others.

During the colonial period, foreign investments were made in the following sectors; government loans, transport, primary production, manufacturing, public utilities and trade and services. For example, the British colonial areas received proportionally greater shares of investment in primary production, while British investments presented in independent areas were mainly involved in public utilities, especially railroad projects. John Stopford also notes that “the early manufacturing investments were made without regard to the existence of the Empire, while investments by British manufacturers to control sources of raw materials for their own factories were distinctly biased towards Empire sources”. In addition, 42% of French investment in French West Africa were in primary production.

337 Ibid.
340 Ibid.
341 Railroads projects comprised 42% of all British private sector investments in the developing empire compared to 68.2% outside it. See ibid, at 59-67.
Similarly, the records show that over three quarters of Belgian investment in the Congo were in mines and railways. Finally, Japan’s activities in its colonies including Korea, Kwantung, Taiwan, China and the South Pacific were almost exclusively in agriculture and the production of raw materials.

Colonialism was strongly associated with foreign investment in primary production including mining and oil industries. This justifies the effect cross-border investment had on the behaviour of powerful states towards less powerful states. Having investment largely made in the context of colonial expansion meant that such investment did not require protection. This is because the colonial legal systems were integrated with the legal system of the imperial powers and the latter gave sufficient protection for the investments which went into the colonies. It was only after the end of colonialism that the need for a system of protection of foreign investment arose.

The national investment treatment has always been supported by newly independent countries. The post-colonial period witnessed hostility towards foreign investment resulting in a wave of nationalisations of foreign property. These states were committed politically and economically to the principle of national treatment and that foreign investors should not enjoy better treatment than that accorded to nationals. They adopted an economical theory and introduced legal rules asserting national treatment creating positive constraints. These

positive constraints are based on consistency and strong support between the principle and both the economic theory and legal rules. Below is a detailed explanation of both.

3.1. Positive Economic Constraints
The positive economic constraints are found between the dependence theory and the principle of national treatment. The dependence theory reflects the position of the Latin American States and newly dependent states in relation to foreign investments immediately after the colonial period.\textsuperscript{350} The theory views development in terms of wealth distribution.\textsuperscript{351} According to this theory, foreign investment does not contribute to the economic development of states. It is noticeable that foreign investment is mainly made by multinational corporations which belong to holding companies residing in developed countries. The role of those multinational corporations is to serve the interests of the holding companies and eventually the interests of the developed states. This situation divides states into central economies which are the capital exporting countries and the subservient or peripheral economies which are the capital importing countries.\textsuperscript{352} Thus, economic development becomes impossible as developing states become dependent on the developed states and more under their control.

An economy controlled by foreign interest is likely to grow in a disarticulated manner due to the absence of natural linkages which would normally evolve from locally controlled capital.\textsuperscript{353} In addition, in such situations foreign investments increase income inequality since the elite classes in the developing states form alliances with the owners of the foreign

\textsuperscript{352} Sornarajah, \textit{The International Law on Foreign Investment, op. cit.}, at 57.
As a result, this theory demands developing states to get rid of any foreign investment. This justifies the hostile attitude of newly dependent states immediately after the end of the colonial period.

Having foreign investment under the control of the host state and subject to laws and legal rules as the host states see fit is at the core of this theory. Thus, positive constraints occur for a number of reasons. Firstly, the theory is consistent with the idea that foreign investors should not enjoy any special treatment. Secondly, it strongly supports the position of developing states by providing an economic justification for their principle. Finally, it increases the coherence of the legal rules in favour of national treatment as it adds an economic dimension.

3.2. Positive Political Constraints
At the political level there are a number of legal instruments which cohere with the principle of national treatment. These legal rules affirm the idea of equality between nationals and foreign investors. The level of coherence between these rules and the principle of national treatment is high due to strong positive constraints. These constraints feature consistency and strong support. The analysis below provides an understanding as to how each of these legal instruments coheres with the principle of national treatment.

3.2.1. The Calvo Doctrine
The Latin American countries were the leading group of states to gain independence and they asserted that foreign investors were not entitled to any greater protection than that granted to nationals under national law. At the forefront of the argument in favour of national treatment was Latin American jurist Carlos Calvo, who stated that:

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354 This theoretical argument is supported by the study of C. Chase-Dunn, 'The Effects of International Economic Dependence on Development and Inequality: A Cross-National Study', American Sociological Review, 40 (1975), 720-38.
'It is certain that aliens who establish themselves in a country have the same right to protections as nationals, but they ought not to lay claim to a protection more extended. If they suffer any wrong, they ought to count on the government of the country prosecuting the delinquents, and not claim from the state to which the authors of the violence belong any pecuniary indemnity.'

The Latin American countries incorporated the Calvo doctrine into their constitutions, treaties and investment contracts. The core element of this doctrine is the exhaustion of local remedies. Aliens are required to submit disputes arising in a country to the courts of that country prior to resorting to international arbitration or international adjudication. According to Garcia-Mora the Calvo doctrine is largely based on the following propositions:

1) That equality, sovereignty and independence are paramount rights of the states;
2) That states, being equal, sovereign and independent, have the right to expect non-interference from other states;
3) That aliens have to abide by the local law of the state wherein they reside without invoking diplomatic protection of their governments in the prosecution of claims arising out of contracts, insurrection, civil war or mob violence.

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357 American Treaty on Pacific Settlement (Pact of Bogota, 1948) Art. 7 states 'The High Contracting Parties bind themselves not to make diplomatic representations in order to protect their nationals, or to refer a controversy to a court of international jurisdiction for that purpose, when the said nationals have had available the means to place their case before competent domestic courts of the respective State'.
358 Latin American countries developed the Calvo clause out of the Calvo doctrine which is incorporated in contracts entered with aliens. The clause specifically provides that aliens shall resort to local remedies for the settlement of disputes arising under the contract, and shall further waive the diplomatic intervention of his own government, M.R. Garcia-Mora, 'The Calvo Clause in Latin American Constitutions and International Law', *Marquette Law Review*, 33 (1950), 205-19 at 206.
3.2.2. Draft Convention on the Treatment of Foreigners 1928

The Draft Convention on the Treatment of Foreigners contains twenty-nine far-reaching articles. The articles ensure to nationals of the signatory states the right to conduct commercial transactions of every kind in the territory of any other signatory state on the basis of equality with the nationals of the host state. In this respect the draft convention puts foreigners on an equal footing with nationals when it comes to the freedom to travel and establish business, the freedom of fiscal matters, the freedom to carry on business and engage in all permitted occupations and the ability to exercise civil, judicial and succession rights. Thus, the general principle observed by the drafters of this convention has been the principle of national treatment.

3.2.3. The Convention on Rights and Duties of States 1933

Article 9 of the Convention on Rights and Duties of States provides that:

‘The jurisdiction of States within the limits of national territory applies to all the inhabitants. Nationals and foreigners are under the same protection of the law and the national authorities and the foreigners may not claim rights other or more extensive than those of the nationals.’

It is contended that this article made the equality of rights the maximum that could be claimed by any alien.

361 During the World Economic Conference in Geneva in 1927, the International Chamber of Commerce (ICC) had submitted a report on the treatment of foreigners. The report recommended that the Council of the League hold a diplomatic conference. Consequently, the Council delegated the Economic Committee of the League of Nations to prepare a draft convention to be used as a basis for discussion at the conference. See A.K. Kuhn, ‘The International Conference on the Treatment of Foreigners’, American Journal of International Law 24 (1930), 570-73.


3.2.4. The Commission on Permanent Sovereignty over Natural Resources 1958

In accordance with the Calvo doctrine, land and other national resources belong to the host state by virtue of sovereignty and foreigners cannot permanently own land in the host state.\textsuperscript{367} The Latin American countries introduced the doctrine of permanent sovereignty over natural resources and the concept of economic self-determination to the UN agenda. Initially the General Assembly Resolution 626\textsuperscript{368} came to be shortly followed by the establishment of the Commission on Permanent Sovereignty over Natural Resources.\textsuperscript{369} The Commission’s efforts crystallised in the General Assembly Resolution 1803 which asserts the principle of national treatment by stating that:

‘1. The right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their national development and of the well-being of the people of the state concerned;

2. The exploration, development and disposition of such resources, as well as the import of the foreign capital required for these purposes, should be in conformity with the rules and conditions which the peoples and nations freely consider to be necessary or desired with regard to the authorization, restriction or prohibition of such activities;

3. (Omitted);

4. Nationalization, expropriation or requisition shall be based on grounds or reasons of public utility, security, or the national interest which are recognized as overriding purely individual or private interests, both domestic and foreign. In such cases the owner shall be paid appropriate

\textsuperscript{367} N. Schrijver, Sovereignty over Natural Resources: Balancing Rights and Duties (Cambridge: Cambridge University Press, 1997).

\textsuperscript{368} General Assembly resolution 626 (VII) of 21 December 1952.

\textsuperscript{369} The Commission on Permanent Sovereignty Over Natural Resources was established by the General Assembly resolution 1314 (XIII) of 12 December 1958.
compensation, in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law. In any case where the question of compensation gives rise to a controversy, the international jurisdiction of the State taking such measure shall be exhausted. However, upon agreement by sovereign states and other parties concerned, settlement of dispute should be made through arbitration or international adjudication.370

3.2.5. The New International Economic Order (NIEO) 1974

The international attempts in affirming national treatment as the main principle in regulating foreign investment experienced an increased demand after the oil crisis in the early seventies. Due to that crisis the developing countries came together to introduce the NIEO within the UN.371 The countries behind the NIEO were aiming at enhancing the control of developing countries in order to prevent the rising corporate powers from interfering in the internal affairs of developing countries.372 The basic principles on which the NIEO rests include permanent sovereignty over natural resources as well as expropriation and nationalisation.373 In this regard, Article 4 of the declaration recognises ‘full permanent sovereignty of every state over its natural resources and all economic activities’ as it states that:

‘In order to safeguard these resources, each State is entitled to exercise effective control over them and their exploitation with means suitable to its own situation, including the right to nationalization or transfer of ownership to its nationals, this right being an expression of the full permanent sovereignty of the State. No state may be subjected to economic,

370 General Assembly resolution 1803 (XVII) of 14 December 1962.
373 Resolution adopted by the General Assembly 3201 (S-VI). Declaration on the Establishment of a New International Economic Order and a programme of Action on the Implementation of the Declaration through resolution 3202 (S-VI).
political or any other type of coercion to prevent the free full exercise of this inalienable right.'

3.2.6. The Charter of Economic Rights and Duties 1974

Based on the principles of the NIEO, in 1974 the UN General Assembly adopted the Charter of Economic Rights and Duties of States. More stringent regulation of multinational corporations and enterprises was one of the clear objectives of the NIEO Declaration and the Charter. Article 2 of the charter reflects the provisions of the NIEO. It clearly asserts the Calvo doctrine and emphasises the application of national law on issues concerning foreign investment and expropriation or nationalisation. It is worth mentioning that the Charter is considered the only UN General Assembly resolution which identifies the fundamentals of international economic relations in a consolidated fashion. The first chapter of the Charter

374 General Assembly Resolution 3281 (XXIX) of 12 December 1974. The Resolution was adopted by a vote of 120 in favour and six against, with ten abstentions. The countries which voted against were Belgium, Denmark, German Federal Republic, Luxembourg, United Kingdom and United States. The abstained countries were Austria, Canada, France, Ireland, Israel, Italy, Japan, the Netherlands, Norway and Spain, see B.H. Weston, 'The Charter of Economic Rights and Duties of States and the Deprivation of Foreign-Owned Wealth', American Journal of International Law 75 (1981), 437-75 note 7
376 Article 2 states: ‘Every State has and shall freely exercise full permanent sovereignty, including possession, use and disposal, over all its wealth, natural resources and economic activities.
Each state has the right:

\[ a) \]
To regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities. No state shall compelled to grant preferential treatment to foreign investment;

\[ b) \]
To regulate and supervise the activities of transnational corporations within its national jurisdiction and take measures to ensure that such activities comply with its laws, rules and regulations and conform with its economic and social policies. Transnational corporations shall not intervene in the internal affairs of a host State. Every State should, with full regard for its sovereignty rights, co-operate with other States in the exercise of the right set forth in this sub-paragraph;

To nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the state adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State consider pertinent. In case where the question of compensation give rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely and mutually agreed by the States concerned that other peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principle of free choice of means.’
comprehensively enshrines sovereign equality of all states, non-intervention and sovereignty, territorial integrity and political independence of states.\textsuperscript{378}

3.2.7. Organisation for Economic Co-operation and Development (OECD) Declaration on International Investment and Multinational Enterprises 1976

In 1976 the OECD member states responded to the NIEO Declaration and Charter by producing the 1976 OECD Declaration on International Investment and Multinational Enterprises.\textsuperscript{379} While highlighting the importance of international investment to economic development, the Declaration imposes national treatment of foreign enterprises.\textsuperscript{380} In this regard the Declaration states that:

\textquote{adhering governments should, consistent with their needs to maintain public order, to protect their essential security and to fulfil commitments relating to international peace and security, accord to enterprises operating in their territories and owned or controlled directly or indirectly by nationals of another adhering government (hereinafter referred to as ‘Foreign-Controlled Enterprises’) treatment under their laws, regulating and administrative practices, consistent with international law and no less favourable that that accorded in like situations to domestic enterprises.}\textsuperscript{381}

Based on the above definition, national treatment rests on four central elements.\textsuperscript{382} Firstly, it prohibits discrimination between foreigners and nationals.\textsuperscript{383} Secondly, the applicable

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\textsuperscript{378} Ibid, at 680.
\textsuperscript{380} See ibid, Chapter 4.
\textsuperscript{383} Ibid.
subjects should be in like situations. Thirdly, whenever foreign enterprises are found in a like situation to a domestic enterprise, the former must receive no less favourable treatment than the latter. Finally, national treatment obligations are not absolute, and therefore, legitimate, non-protectionist rationales may justify differential treatment.

The Declaration also includes the OECD Guidelines on Multinational Enterprises. According to the Declaration it is recommended that multinational enterprises observe the Guidelines which provide principles and standards for responsible business conduct and encourage enterprises to make positive contributions towards economic and social progress. Additionally, the Guidelines assert that states have the right to regulate multinational corporations in accordance with international law standards without elaboration on the content of those standards.

To sum up, the positive constraints between the above rules and the principle of national treatment are visibly presented. Whether it is a doctrine, convention or a declaration it explicitly included the term ‘national treatment’. Consistency is featured as they set out national treatment as their fundamental principle. They add to the coherence of the principle by introducing further legal doctrines dependent on the principle. Last but not least, they provide strong support to the principle at international level as well as domestically.

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384 Ibid.
385 Ibid.
386 Ibid.
388 Para 2, ibid at 969.
389 The Guidelines stipulate this requirement as follows: ‘Having regard to the foregoing considerations, the Member countries set forth the following guidelines for multinational enterprises with the understanding that Member countries will fulfil their responsibilities to treat enterprises equitably and in accordance with international law agreements, as well as contractual obligations to which they have subscribed.’, ibid, at 971.
4. International Minimum Standard

The minimum standard of treatment derives from the ancient doctrine of denial of justice which goes back as far as ancient Greece.390 The beginning of the modern era witnessed legal scholars arguing that international law protected the rights of aliens to travel and trade.391 Francisco de Vitoria claimed that international law acknowledges the right of foreigners to travel, live and trade in foreign lands.392 As for Hugo Grotius, he dealt with the status of foreigners and asserted a norm of non-discrimination in the treatment of foreigners.393 Nonetheless, the first modern scholar to address the status of foreigners in detail was Emmerich de Vattel. In his book the Law of Nations, Vattel recognises the state’s right to control the entry of foreigners, and once admitted, foreigners become subject to national laws while the state becomes responsible for their protection in the same manner as its own subjects.394 However, on the other hand, foreigners maintain their membership in their own state and therefore are not obliged to submit, like nationals, to all the commands of the state.395 In his view, foreigners’ membership of their home state extends to their property which remains part of the wealth of their home nation.396 Thus, the mistreatment of foreigners or their property by a state is an injury to the foreigners’ home state.397

392 For a critical assessment of Vitoria’s work concerning the colonial origins of international law and the Spanish conquest of the Americans, see A. Anghie, Imperialism, Sovereignty, and the Making of International Law (Cambridge: Cambridge University Press, 2005).
393 This is found under the category ‘Of Things That Belong to Men In Common’, see H. Grotius, (1648-1815), the Rights of War and Peace, in Three Books. Wherein Are Explained, the Law of Nature and Nations, and the Principal Points Relating to Government. Written in Latin by the Learned Hugo Grotius, and Translated into English. To Which Are Added, All the Large Notes of Mr. Barbevus, Professor of Law at Groningen, and Member of the Royal Academy of Sciences (Berlin, London: Printed W. Innys and R. Manby, J. And P. Knapton, D. Brown, T. Osborn, and E. Wicksteed, MDCCXXXVLL, 1738) at 142-58.
396 Ibid, at 270.
397 Vattel argues that whoever ill-treats a foreign citizen has indirectly offended the state which ought to protect this citizen, ibid, at 251.
Basically, this view is motivated by the concern that the standards of treatment accorded to nationals in a host state are unsatisfactory due to the host state being uncivilised, arbitrary, or unable to ensure the rule of law.\textsuperscript{398} Developed states are at the forefront of the argument in favour of a minimum international standard of treatment. These countries introduced a set of legal remedies and adopted an economic theory to support their position. Coherence is viewed in the economic and political positive constraints which are formed as per the following.

\textbf{4.1. Positive Economic Constraints}

The economic theory that coheres with the minimum standard of treatment for foreign investment is the classical or neo-classical economy.\textsuperscript{399} It argues that foreign investment is wholly beneficial to the host state.\textsuperscript{400} The classical economy is mainly concerned with the efficient allocation of resources and their optimal growth over time.\textsuperscript{401} It claims that the economic development of a country depends on the market.\textsuperscript{402} In such a market economy, economic benefits flow to participants, whether countries or individuals.\textsuperscript{403} Applying that to foreign investment, the theory regards foreign investment as capital flow adding up to the amount of capital in the host country and as a result boosting its economy.\textsuperscript{404} This theory rests on several factors. First of all is the presumption that by attracting foreign capital the host country would be more capable of directing the available domestic capital to other uses of public benefit.\textsuperscript{405} Secondly, foreign investment is a great way for transferring technology;


\textsuperscript{400} This theory is based on the early work of a number of scholars, mainly Adam Smith and those who came after him such as David Ricardo, John Elliot Cairnes and Karl Marx. For more information about the development of the Classical School visit \url{http://homepage.newschool.edu/het/schools/ricardian.htm}.


\textsuperscript{402} Ibid.

\textsuperscript{403} Ibid.

\textsuperscript{404} R. Jenkins, \textit{Transnational Corporations and Uneven Development: The Internationalization of Capital and the Third World} (London: Methuen, 1987) at 18.

\textsuperscript{405} Somarajah, \textit{The International Law on Foreign Investment}, op. cit.,at 48-52.
hence, the new technology brought by the foreign investment will enrich the diffusion of technology within the host state’s economy.\textsuperscript{406} Thirdly, foreign investment helps in decreasing the unemployment rates by creating new employment opportunities.\textsuperscript{407}

Within the same context, foreign direct investment is important for supplementing domestic savings and providing additional foreign exchange necessary for economic growth.\textsuperscript{408} In addition, foreign investment also stimulates domestic investments.\textsuperscript{409} All of these elements explain the three main assumptions underlying the classical theory in favour of foreign investments which are as follows:

1. The supplement assumption which establishes a link between foreign direct investment and local investments due to the fact that foreign investments stimulate domestic production. Therefore in the absence of the former, the latter would fail to exist;

2. The competitive assumption which basically relies on the role of the market. Free markets provide a perfectly competitive model in which profits are not excessive. Therefore, if market deficiencies are to arise they would largely be the result of misconceived government policies;

3. The resource generation assumption which views foreign direct investment not only as a tool for supplementing existing local resources, but also as the generator of additional resources.\textsuperscript{410}

\textsuperscript{406} Ibid.
\textsuperscript{407} Ibid.
\textsuperscript{408} Jenkins, Transnational Corporations and Uneven Development: The Internationalization of Capital and the Third World, op. cit., at 18.
\textsuperscript{410} Jenkins, Transnational Corporations and Uneven Development: The Internationalization of Capital and the Third World, op. cit., at 19.
A number of empirical studies adopted this theory and concluded that foreign direct investment generates considerable benefits for the host countries.\textsuperscript{411} For that reason the classical theory argument for foreign investment serves as a good justification for why foreign investment must be granted a high standard of international protection.\textsuperscript{412} Thus, if a country is experiencing economic growth the government will then be required to respond to that by removing any barriers restricting foreign investment.\textsuperscript{413} Requiring countries to adopt international standards is at the heart of this theory. A strong positive constraint is created by linking foreign investment to states’ economic development. The positive constraints include three main elements. Firstly, the theory is consistent with the principle of minimum standard of protection. It adopts the idea that economic development requires foreign investment and foreign investment needs treatment in accordance with international standards. Secondly, the theory provides significant support to the principle at the economic level. Finally, it makes the principle more supported by adding an economic justification to it.

\textbf{4.2. Positive Political Constraints}

Developed countries supported and introduced a number of legal instruments which cohere with the minimum international standard of treatment for foreign investment. These legal rules assert that foreign investors should be treated in accordance with international standards. The level of coherence between these rules and the minimum international standard is high due to strong positive constraints. These constraints feature consistency and strong support. The analysis below provides an understanding about how they cohere with each other.

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\textsuperscript{413} See Contreras, ‘Competing Theories of Economic Development’, \textit{op. cit.}
4.2.1. Diplomatic Protection

The entwining of foreign investors’ interests with those of their home states is rooted in history.\(^{414}\) The notion of an international minimum standard derives from the doctrine of state responsibility which asserts protection against injury to aliens and alien property.\(^{415}\) As a result the notion of diplomatic protection was created.\(^{416}\) Diplomatic protection allows the home state to invoke the law to provide protection for its citizens abroad and sought remedy for them.\(^{417}\) In other words, through the exercise of diplomatic protection the home state is capable of making a claim against the host state in case of an injury to the home state’s national.\(^{418}\) However, the exercise of diplomatic protection is subject to a set of rules.\(^{419}\) First, the claim must comply with the rules relating to international claims, including the nationality of claims.\(^{420}\) Second, it is not possible to invoke state responsibility for injury of foreign nationals if ‘the rule of exhaustion of local remedies applies and any available and effective
local remedy has not been exhausted’. Finally, the home state has the right to decide on whether to exercise diplomatic protection or not.\textsuperscript{422}

Historical facts prove that during the nineteenth and early twentieth century, the exercise of diplomatic protection was often accompanied by ‘gun boat-diplomacy’.\textsuperscript{423} At that time, international law did not prohibit the use of force in exercising diplomatic protection.\textsuperscript{424} On numerous occasions both the United States and European countries used force and threats of force to enforce claims of diplomatic protection.\textsuperscript{425} For example, between the years 1820 and 1914, Great Britain used force against Latin America at least 40 times to back up claims regarding injuries to its nationals and to reinstate order and protect property.\textsuperscript{426}

During the same period, international trade and investment witnessed great expansion, which required increased attention to the legal status of foreign nationals abroad and to the protection of their interests.\textsuperscript{427} By the early twentieth century, a general agreement emerged amongst international European and American lawyers that there existed a minimum standard of treatment of foreigners.\textsuperscript{428} This minimum standard reflected standards of justice and


\textsuperscript{422}In the case of Barcelona Traction, Light and Power Company Limited the court stated that ’The State must be viewed as the sole judge to decide whether its protection will be granted, to what extent it will be granted, and when it will cease. It retains in this respect a discretionary power the exercise of which may be determined by considerations of a political or other nature, unrelated to the case’, Barcelona Traction, Light and Power Company Limited (Belgium v. Spain) [1970] ICJ Rep 4 at para 9.


\textsuperscript{426}C. Lipson, Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries (Berkeley: University of California Press, 1985) at 54.


treatment accepted by civilised states. In the 1920s a number of decisions adopted the view of capital exporting states and reaffirmed the existence of such a standard.

4.2.2. The Hull Rule

It is difficult to identify the content of the international minimum standard. It has been claimed that the position taken by the United States in its conflict with Latin American States represented this standard. The conflict occurred due to the expropriation of American-held oil interests by Mexico. In 1938, Cordell Hull, American Secretary of State, asserted that:

‘The Government of the United States merely adverts to a self-evident fact when it notes that the applicable precedents and recognized authorities on international law support its declaration that, under every rule of law and equity, no government is entitled to expropriate private property, for whatever purpose, without provision for prompt, adequate, and effective payment thereof.’

The requirement of prompt, adequate and effective compensation articulated what has been recognised as the Hull Rule. This rule was advocated by developed countries in general and

429 J. Westlake, *International Law* (Cambridge: Cambridge University Press, 1904) at 313. J. In this respect Root states that ‘Each Country is bound to give to nationals of another country in its territory the benefit of the same laws, same administration, the same protection, and the same redress for injury which gives to its own citizen’s, and neither more nor less: provided the protection which the country gives to its own citizens conforms to the established standard of civilization.’ Root, ‘Basis of Protection for Citizens Residing Abroad’, *op. cit.*, at 521.


431 Sornarajah, *The International Law on Foreign Investment*, *op. cit.*, at 128.

432 Ibid, at 127.

433 Between 1915 and 1940, the Mexican government expropriated various oil properties, see J.L. Kunz, ‘The Mexican Expropriations’, *New York University Law Quarterly Review*, 17 (1940), 327-45.

the United States in particular. In addition to the standard of compensation, the supporters of the minimum standard argued that an international tribunal must settle issues relating to expropriation. This view was justified on the suspicion that national courts would not provide objective justice to the foreign investors.

4.2.3. The Draft Statutes of the Arbitral Tribunal for Foreign Investment and the Foreign Court 1948
The next attempt was the Draft Statutes of the Arbitral Tribunal for Foreign Investment and the Foreign Court by the International Law Association (ILA). From the articles it is understood that the whole purpose behind the proposed tribunal was to provide an impartial forum for the settlement of foreign investment disputes instead of establishing a specific standard of treatment for foreign investment. The Statute was never adopted.

4.2.4. The International Code of Fair Treatment of Foreign Investment 1949
There have been attempts to displace the Hull rule and the rule relating to the settlement of expropriation issues through a tribunal that sits outside the host state. In 1949, the International Chamber of Commerce (ICC) proposed an International Code of Fair Treatment for Foreign Investment. The code came to reflect high standards of treatment for foreign investment by ensuring fair compensation according to international law in case of

435 The Hull standard was strongly opposed by developing states. Their position can be described in reference to the response of the Mexican Foreign Minister as he rejected Hull’s assertion of immediate compensation by stating that ‘there was in international law no rule universally accepted in theory nor carried out in practice, which makes obligatory the payment of immediate compensation nor even of deferred compensation, for expropriation of a general and impersonal character like those which Mexico has carried out for the purpose of redistribution of the land’, Mexican Minister of Foreign Affairs to Us Ambassador 1 Sept. 1938, ‘Mexico-United States: Expropriation by Mexico of Agrarian Properties Owned by American Citizens’, American Journal of International Law Supplement, 33 (1939), 201-07..
436 Sornarajah, The International Law on Foreign Investment, op. cit., at 129.
437 Ibid.
439 Ibid.
expropriation, as well as by providing binding state-to-state dispute resolution before the ICC International Court of Arbitration. However, the ICC Code was never adopted.

**4.2.5 Draft Convention on Investment Abroad (Abs-Shawcross Draft Convention) 1959**

In 1959 the Draft Convention on Investment Abroad, known as Abs-Shawcross Draft Convention, was introduced. The Draft Convention provided for a minimum standard of treatment (defined as ‘fair and equitable treatment’), protection against unreasonable or discriminatory measures and just and effective compensation for expropriation. Most importantly, the Abs-Shawcross was the first instrument to expressly provide for direct investor-state arbitration.

**4.2.6. Draft Convention on International Responsibility 1961**

Following the Abs-Shawcross Draft Convention by two years, the 1961 Draft Convention on the International Responsibility of State for Injuries to Aliens (1961 Harvard Draft) was introduced. Several cases had cited the draft as an authoritative statement of the minimum standard of treatment.

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441 Article 11, ibid, at 277.
442 Article 13, ibid at 278.
445 Article I, ibid.
446 Ibid.
447 Article III, ibid, at 396.
448 Article VII, ibid.
449 The Draft Convention on International Responsibility was prepared by Louis Sohn and Richard Baxter upon the request of the UN Secretariat in an attempt to codify the international law relating to states’ responsibilities. See L.B. Sohn and R. R. Baxter, ‘Responsibility of States for Injuries to the Economic Interests of Aliens’, American Journal of International Law, 55 (1961), 545-84.
4.2.7. Draft Convention on the Protection of Foreign Property 1962

In 1961 the twenty Member States of the OECD liberalised investment and capital transfers in major service industries through codes on the liberalisation of capital movement and current invisible operations.\(^\text{451}\) A year later the OECD released the Draft Convention on the Protection of Foreign Property.\(^\text{452}\) The Draft was later revised and approved by the OECD in 1967.\(^\text{453}\) It is not surprising that the approved Draft mainly reflects the views of the major capital exporting states on the minimum standard of treatment and it sets out the standard 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 territories 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 then that provided for in this Convention not be regarded as discriminatory against nationals of the Party by reason only of the fact that such treatment is not accorded to the latter.’\(^\text{454}\)

In regard to compensation, the Convention adopted the Hull Rule requirement for prompt, adequate and effective compensation by stating that taking of property was to be:

‘...accompanied by provision for the payment of just compensation. Such compensation shall represent the genuine value of the property affected,

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\(^{451}\) These codes are legally binding on OECD Member States under the Convention on the Organisation for Economic Co-operation and Development (14 Dec. 1960), 88 UNTS 179 (entered into force 30 Sep. 1961).


\(^{453}\) OECD, Draft Convention on the Protection of Foreign Property, 7 International Legal Materials 1968, at 117-143.

\(^{454}\) Article 1(a), ibid, at 119.
shall be paid without undue delay, and shall be transferable to the extent necessary to make it effective for the national entitled thereto''.

4.2.8. The International Centre for the Settlement of Investment Disputes (ICSID) 1965
As explained earlier, the standard related to dispute resolution is the other aspect of international minimum standard in addition to the standard of compensation. Thus, states supporting the principle of an international minimum standard undertook several attempts to displace the rule of external settlement through treaties. In 1965 ICSID was established under the auspices of the World Bank. The establishment of ICSID is considered a very important step in the creation of an international legal framework for foreign investment protection through providing a neutral forum for the settlement of investment disputes.

5. The Principles and Bilateral Investment Treaties
Despite the fact that capital exporting countries were keen on obtaining better market access commitments from capital importing states, their efforts to create an international framework for foreign investment and to adopt a high standard of investment protection did not succeed. The consistent disagreement between capital exporting and capital importing states about standards of treatment for foreign investors overturned these efforts. As a result, capital exporting states began to obtain high standards of investment protection bilaterally. Although not formally called Bilateral Investment Treaties, Treaties of Friendship, Commerce and Navigation (FCN) essentially served the same purpose.

455 Article 3, ibid.
456 Somarajah, The International Law on Foreign Investment, at 129.
457 Ibid.
FCNs have been in existence from early times. They traditionally focused on promoting trade and commercial relationships, however, post-Second World War they became more investment-specific. These treaties were mainly designed to facilitate post-war reconstruction in Europe by providing a high level of protection for investment. FCN treaties contained provisions on free entry and establishment as well as reference to international law in connection with protection of foreigners and their property. While a number of countries including The United States, United Kingdom and Japan concluded FCN treaties, other European powers were signing bilateral investment treaties (BITs).

The first BIT was signed between Germany and Pakistan in 1959. Shortly afterwards, a number of capital exporting states followed Germany’s efforts to conclude BITs including Switzerland, The Netherlands, Italy, Sweden, Norway, France, The United Kingdom, Austria and Japan. In this period, BITs were based on the 1962 and 1967

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OECD Draft Conventions focusing on core protections such as a general minimum standard of treatment, compensation for expropriation and rights to transfer capital and returns.\textsuperscript{477}

The bilateral investment treaties were created to reflect one side of international investment law. Developed states were seeking to conclude these treaties in order to assert forms of international investment law that reflected their interests. As a result, a high degree of coherence exists between these treaties and the principle of a minimum international standard of protection for foreign investment. The positive constraints are formed between the minimum international standard and the stringent investor protection guarantees and standards included in these treaties. These include full protection and security, most-favoured-nation treatment, prompt, adequate and effective compensation on expropriation (Hull Rule)\textsuperscript{478} and dispute resolution through arbitration in a neutral forum.\textsuperscript{479}

On the other hand, bilateral investment treaties also refer to the national treatment principle.\textsuperscript{480} However, the reference does not create a positive constraint between these treaties and the principle. That is because unlike in the past, national treatment may now confer advantages on aliens as states reserve many of their economic sectors and privileges to their nationals.\textsuperscript{481} The inclusion of national treatment prevents discrimination between


\textsuperscript{477}OECD argues that two model BITs have emerged, the first is the ‘European Model’ based on the Abs-Shawcross Draft Convention model endorsed by OECD Ministers in 1962 and the second is a ‘North American model’ developed in the early 1980s, OECD, ‘Relationships between International Investment Agreements’, \textit{Working Papers on International Investment} (2004b) at 4.

\textsuperscript{478}These standards will be examined in more detail in subsequent chapters, however, for an overview see Newcombe and L. Paradell (eds.), \textit{Law and Practice of Investment Treaties: Standards of Treatment}, op. cit..

\textsuperscript{479}Until 1968, bilateral investment treaties provided for state-state dispute resolution through submission of the dispute to the ICJ or the establishment of an arbitral tribunal; see for example Article 11 (2) of Germany Pakistan BIT (1959). The first bilateral investment treaty to incorporate provisions for investor-state arbitration is Indonesia-Netherlands (1968); see Article 11, Newcombe and L. Paradell (eds.), \textit{Law and Practice of Investment Treaties: Standards of Treatment}, op. cit., at 44.


\textsuperscript{481}Somarajah, \textit{The International Law on Foreign Investment}, op. cit., at 202.
nationals and foreign investors, and grants foreigners the same privileges enjoyed by nationals. Moreover, it is not possible to extend harsh measures taken against nationals to foreign investors on the basis of national treatment because such conduct is not allowed under other standards of treatment in the treaty. Accordingly, it can be said that foreign investors are granted the best of both worlds: the privileges of national treatment and the high standards of protection.

The proliferation of bilateral investment treaties is consistent and strongly linked to the general policies of capital exporting countries. They are exclusively coherent with the principle of a minimum international standard as they impose no obligations or responsibilities on foreign investors whatsoever. Rather, they do not respond to the needs of local communities affected by the activities of foreign investors. Their sole focus is investor protection without much attention to states’ sovereignty. Their disregard of host states’ sovereignty puts them in a position of incoherence with the principle of national sovereignty. They even take this incoherence to a higher level, as in some cases states may end up sacrificing their sovereignty for credibility.482

Despite the fact that bilateral investment treaties are significantly incoherent with the principle of national treatment, developing states decided to enter into these treaties.483 By the end of 2011, the number of bilateral investment treaties concluded reached 2,833 treaties.484

In the beginning, capital importing states had little interest in concluding bilateral investment

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treaties. By the early 1980s the external debt of developing states significantly increased and many states were not able to service their debt level and therefore defaulted. At that time developing countries realised that there were no other alternatives to foreign direct investment. In response, a number of changes in these countries’ political and economical policies have been adopted. The incoherence of states’ attitude towards foreign investment can be summarised in two major reasons:

5.1. Political Reason
Significant shift in the international economic sphere took place when the ideology of Communism receded. Communism adopted norms hostile to the notions of property on which investment strongly depends. After the fall of this ideology, states started to introduce more liberal policies on foreign investment, not only because the world was moving towards economic liberalization, but also because states were competing in attracting foreign investments. Investment treaties in general were regarded as instruments aiding the flow of investment required for development. The positive role of investment treaties was reinforced by the Washington Consensus.

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485 Between 1970 and 1979 only about 100 treaties were concluded; see Unctad, ‘Bilateral Investment Treaties 1959-1999’.
488 Ibid.
of the consensus were fiscal austerity, privatisation and market liberalisation including the promotion of foreign direct investment and enforcement of property rights.\footnote{492 ibid.}

At that time, governments in both developed and developing states had increased their political commitment to economic liberalism and the free international flow of goods. New regional arrangements started to take place. The establishment of the European Union imposed commitment to internal flows of investment within its member states.\footnote{493 The full liberalisation of capital movement in the EU was agreed in 1988 see (Directive 88/361/EEC) available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31988L0361:EN:NOT.} At the same time, Chapter 11 of the North American Free Trade Agreement (NAFTA) came to adopt the U.S. model of foreign investment protection.\footnote{494 Chapter 11 from the NAFTA includes the following: ‘Article 1110 (1): No part may directly or indirectly nationalize or expropriate an investment of an investor of another party in its territories or take a measure tantamount to nationalisation or expropriation of such investment (‘expropriation’) except:
(a) for a public purpose;
(b) on a non-discriminatory basis;
(c) in accordance with due process of law and Article 1105 (1);
(d) on payment of compensation in accordance with paragraph 2 through 6.


As the importance and benefits of foreign direct investment were emphasised affecting the policy for and legal framework governing foreign investment, the OECD resumed its efforts to uniform the international legal rules on foreign investment. In 1995 the OECD attempted
to draft a multilateral agreement on foreign investment with an aim to ‘set high standards for the treatment and protection of investment’ and ‘go beyond the existing commitments to achieve a high standard of liberalization’. Additionally, in the same year the World Trade Organisation was established. Although its main interest is trade and the free movement of goods, it includes instruments affecting investment.

5.2. Economic Reason

The idea that multinational corporations should enjoy free movement around the world to enhance global integration and globalisation emerged. This approach to economic liberalisation was adopted mainly by international economic institutions such as the World Bank and the International Monetary Fund. These institutions introduced privatisation, liberalisation and macro-stability programs to attract foreign investment as a means for development. At the same time a new mood of strong competition among the developing countries came into place, especially after the dissolution of the communist states. The collapse of the Soviet Union gave birth to new states which adopted the free market ideology and worked hard to attract foreign investment. Therefore, the level of competition between

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497 Committee on International Investment and Multinational Enterprise (Cime) and Committee on Capital Movements and Invisible Transactions (CMIT), 'Multilateral Agreement on Investment (MAI)', (OECD, 1995) at 2. See also S. Canner, 'The Multilateral Agreement on Investment', Cornell Journal of International Law, 31 (1998), 657-82.
499 See Sornarajah, The International Law on Foreign Investment, op. cit. at 262-63.
developing countries increased. As a result, developing countries changed their policies in support of national treatment and started to look into bilateral investment treaties.

Although developing countries used to oppose the international attempts aimed at protecting foreign investment, the dissolution of communism along with the new ideology of liberalization and free market shifted countries away from the theories which are hostile to foreign investment.\textsuperscript{505} The fact that foreign investment promotes economic development has been strongly used by developed states and international organisations to impose greater levels of international protection for foreign investment. On the other hand, developing countries were left with no other alternative than to comply with these international standards, although these standards do not cohere with their legal principles and policies. In other words, coherence was sacrificed for the sake of foreign investment and economic development.

To conclude, bilateral investment treaties form positive constraints with the principle of minimum international standard. They follow the approach of capital exporting countries in regards to the protection of foreign investment. Firstly, they are consistent with the principle of minimum international standard as they explicitly refer to it in their provisions. Secondly, these treaties form a strong supportive relationship with this principle since they legally oblige member parties to respect the existence of a minimum international standard. Finally, they contribute to increasing the coherence of the principle by having a large number of treaties concluded.

\textsuperscript{505} In opposing the proposal for adopting of a multinational agreement on foreign investment, developing states argued that the agreement does not address the environment and human rights affected by the activities of foreign investment. See Somarajah, \textit{The International Law on Foreign Investment, op. cit.}, at 57.
6. Conclusion

The national treatment and minimum international standard are the two main principles underlying the rules of international investment law. The tension between these principles was evident in the long-lasting conflict between developed and developing states. While developed states were supporting the principle of minimum international standard, developing countries were putting a fair amount of effort in asserting the principle of national treatment. However, coherence between these principles and the network of bilateral investment treaty is crystal clear. The treaties exclusively cohere with one principle and completely ignore the other. The positive constraints exist between bilateral investment treaties and the principle of minimum international standard. The treaties were drafted with an eye on the protection of foreign investment which made them consistent and strongly supportive to the principle of minimum international standard. This left developing countries with no other option than to sign these treaties and adopt policies that were incoherent with their original views.
Chapter 3

Coherence between Bilateral Investment Treaties and the Objective of Investment Promotion

1. Introduction

The objective of investment promotion is reflected in the titles of virtually all bilateral investment treaties, which typically contain the words: “A Treaty Concerning the Encouragement and Protection of Investments”. It is also evident in the treaties’ preambular language. Promoting foreign investment is the most common explanation of bilateral investment treaties. Basically, bilateral investment treaties are viewed as tools for reducing risks that foreign investors would otherwise face and that a reduction of risk encourages investment. The aim of this chapter is to apply coherence to the legal base which consists of treaties’ provisions and investment promotion as an investment obligation. In doing so, this chapter will look at whether the provisions of these treaties are drafted in accordance with this objective. In this respect, an analysis of the different types of constraints formed between each treaty provision and the objective of investment promotion will be provided. The positive constraints reflect a coherent relationship formed on the grounds of consistency and support. On the contrary, negative constraints exist whenever a provision fails to contribute to increasing coherence between the treaty and its objective. To conclude,

507 Generally, these treaties’ preambles consist of the following:
   a. The general desire of the parties to intensify and to develop their economic relations;
   b. More specifically, the need to create conditions which are favourable for investments of nationals of either State in the territory of the other State;
   c. The conviction that the protection of such investment will lead to the stimulation of private initiative and to the promotion of the prosperity of both States concerned.
this chapter will provide an understanding as to how coherence between bilateral investment treaties and investment promotion can be increased.

2. Promotion in Return of Protection

Bilateral investment treaties are considered as vital risk-mitigating tools providing foreign investors with credible commitments. These treaties create a secure legal environment which favours foreign investments.  

It is argued that bilateral investment treaties promote foreign investment by reducing the risk associated with investing abroad. The amount of risk is reduced by providing clear and enforceable rules that protect foreign investment and create a favourable investment climate. In other words, the value of these treaties depends on the amount of risk reduced and the level of stability.  

Based on the above, coherence requires treaty provisions to accord protection to foreign investors. In other words, the more these treaties protect foreign investors, the more coherent they are in terms of their objective. Accordingly, the provisions which fall under this equation would then be categorised as coherent provisions. On the other hand, the provisions which limit investors’ protection or increase investors’ risk would create negative constraints and therefore fall under the incoherent category. Accordingly, treaty provisions are examined as follows;

3. Positive Constraints

The positive constraints are found in the definition clause, standards of treatment, protection against expropriation and compensation for losses and dispute settlement. Each clause is addressed respectively.

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511 Ibid.


513 Ibid.
3.1. Definition

Virtually all bilateral investment treaties include a definition clause. These treaties seem to follow a unified broad definition of investment.\(^{514}\) The clause is broadly drafted to cover as much investment as possible and also to reflect the changing nature of investment.\(^{515}\) A standard definition clause includes:

1. 'Movable and immovable property and property rights such as mortgages, liens and pledges.
2. Shares, stocks and debenture in companies and other interests in companies.
3. Claims to money or to any other performance under contracts having a financial value.
4. Intellectual property rights and goodwill.
5. Business concessions including concessions relating to natural resources.\(^{516}\)

A broader definition is typically provided by United States bilateral investment treaties which include 'license and permits issued pursuant to law, including those issued for manufacture and sale of products' and 'any right conferred by law or contract, including rights to search for or utilise natural resources, and rights to manufacture, use and sell products'.\(^{517}\) The United States justifies adding these elements by claiming that they correspond to the administrative rights of foreign investors granted permission to conduct certain activities in the host state.\(^{518}\) Thus, protecting these rights is within the task of bilateral investment treaties.\(^{519}\)

\(^{514}\) Sornarajah, *The International Law on Foreign Investment*, op. cit., at 220.
\(^{515}\) Ibid, at 220-221.
\(^{516}\) See Article 1 of the U.K.-Singapore BIT (1975), Dolzer and Stevens, *Bilateral Investment Treaties*, op. cit., at 27.
\(^{518}\) Sornarajah, *The International Law on Foreign Investment*, op. cit., at 222.
\(^{519}\) Ibid, at 222-223.
Adopting a broad definition increases the level of protection to foreign investors. It reduces the risk of having certain activities fall outside the scope of the treaty. Extending the meaning of investment to cover almost all categories of assets contributes to achieving more consistent and strongly supported provisions and objectives. For that reason, this broad formula establishes a positive constraint between the treaty and the objective of investment promotion.

3.2. Standards of Treatment

Despite the differences in emphasis and style, there are common standards of treatment introduced in the vast majority of bilateral investment treaties. These standards mainly include fair and equitable treatment, full protection and security, non-discrimination, national treatment and most-favoured-nation treatment.

3.2.1. Fair and Equitable Treatment

Bilateral investment treaties refer to ‘fair and equitable treatment’ to be accorded to foreign investment. However, there is no general agreement on what the term precisely means. It is debatable whether the term 'fair and equitable' should be read in reference to the minimum standard of treatment required by international law, or whether it should be considered as a separate independent concept. The vagueness of the term has implications on the strength of the positive constraint.

By considering that the standard of ‘fair and equitable treatment’ is equal to the minimum standard of international law, the positive constraint between the former standard and the...
objective of investment promotion will be weaker. This is because there is no clear understanding as to what constitutes a minimum international standard. Thus, attaching the standard of ‘fair and equitable treatment’ to a vaguer and more complicated standard affects treaties’ objective of promoting foreign investment, since such a link works against reducing risk and increasing credibility between the host state and foreign investor.

On the other hand, the strength of the positive constraint is likely to increase if the standard of ‘fair and equitable treatment’ is regarded as an expressed obligation independent of the international minimum standard. In such a case, treaties will offer a higher amount of credibility. However, this raises the question of scope. The standard’s scope has been expanded to include notions of transparency and legitimate expectations of foreign investors. The expansive view allows future tribunals to regard foreign investors as protected against unfair treatment whatsoever.

Despite the strength of the positive constraint, the standard of ‘fair and equitable treatment’ coheres with the objective of promoting foreign investment. It ensures better treatment and protection for foreign investment. The obligation this standard imposes on the host state is equal to if not higher than the minimum international standard.

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525 This was explained in the preceding chapter.
526 For a detailed discussion on this matter see Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment*.
528 Mann spoke of the standard as involving ‘overriding obligations’ which exceed discriminatory measures to embrace other offensive measures, Mann, ‘British Treaties for the Promotion and Protection of Investments’, op. cit., at 244.
529 In the case of Genin v. Estonia, the tribunal stated that ‘while the exact content of this standard is not clear, the Tribunal understands it to require an ‘international minimum standard’ that is separate from domestic law, but that is indeed, a minimum standard. Acts that would violate this minimum standard would include acts showing a wilful neglect of duty, an insufficiency of action falling far below international standards or even subjective bad faith’, Alex Genin and others v. Republic of Estonia, ICSID Case No. ARB/99/2, Decision dated 25 June 2001, para 50.
3.2.2. Full Protection and Security

Bilateral investment treaties include the requirement that foreign investment should be accorded ‘full protection and security’.\(^{530}\) However, it is noteworthy to highlight that this standard is presented in different forms.\(^{531}\) Some treaties have followed the OECD Draft Convention by combining it with the principle of ‘fair and equitable treatment’.\(^{532}\) On the other end, some treaties add that it should be granted ‘*in a manner consistent with international law*’.\(^{533}\)

This standard has a firm basis in customary international law as developed by the United States.\(^{534}\) A number of awards recognised that the failure to provide protection to an alien who is threatened with violence creates responsibility in the host state.\(^{535}\) At treaty level, the standard was first included in the FCN treaties.\(^{536}\) It was then adopted by most bilateral investment treaties. The wording of the standard suggests that the host state is obliged to take active measures to protect foreign investment from adverse effects.\(^{537}\)

In an attempt to further clarify the meaning of the standard under the bilateral investment treaties, the ICSID held that it does not render the host state responsible for all injuries caused to investments.\(^{538}\) The host state is not required to act as a guarantor, but would remain liable in cases where it fails to show due diligence in protecting the investor from any injuries.\(^{539}\)


\(^{531}\) Dolzer and Stevens, *Bilateral Investment Treaties*, op. cit., at 60-61.

\(^{532}\) For example see Article 2(3) of the U.S.-Turkey BIT (1985), Article 2 of the U.K.-Sri Lanka BIT (1980) and Article 3(2) of The Netherlands-Philippines BIT (1984).

\(^{533}\) See Article II(3) of the U.S.-Morocco BIT (1985).

\(^{534}\) M. Sornarajah, ‘The International Law on Foreign Investment’, op. cit., at 359.


\(^{536}\) The standard formula of the FCNs concluded by the US usually provided that nationals of each state party to the agreement would receive ‘the most constant protection and security’ provided that this ‘would be in no case less than that required under international law.’ Dolzer and Stevens, *Bilateral Investment Treaties*, op. cit., at 60-61.


\(^{538}\) See Asian Agriculture Products, Ltd. v. The Republic of Sri Lanka (ICSID Case No. ARB/87/3).

\(^{539}\) In that regard, Vasciannie explains that there is a general obligation imposed on the host state under which it is required to exercise due diligence in the protection of foreign investment, but that does not mean that the standard creates a ‘strict liability’ which renders the host state in breach of its obligation in case of any destruction even if caused by a third party. See
Regarding the meaning of due diligence, the ICSID tribunal in the case of *Asian Agriculture Products, Ltd. v. The Republic of Sri Lanka* defined it as ‘reasonable measures of prevention which a well administered government could be expected to exercise under similar circumstances’.  

A positive constraint is created by including such provision. This standard contributes to achieving the objective of promoting foreign investment. Imposing such an obligation on the host state enhances the protection of foreign investment. It reduces the amount of risk a foreign investor may face and increases the amount of credibility. Consequently, including the ‘full protection and security’ standard coheres with the objective of promoting foreign investment.

### 3.2.3. Protection against Arbitrary or Discriminatory Measures

This standard is common in investment treaties. It requires states to refrain from conducting arbitrary or discriminatory acts against foreigners. The precise wording of such a clause varies between ‘arbitrary or discriminatory’, ‘unjustified or discriminatory’ and ‘unreasonable or discriminatory’. The standard is twofold: 1) protection against arbitrary measures and 2) protection against discriminatory measures.

For the meaning of ‘arbitrary’, a number of tribunals have consulted Black’s Law Dictionary, according to which, the word means ‘depending on individual discretion’ or an action


Schreuer, ‘Protection against Arbitrary or Discriminatory Measures’, *op. cit.*, at 184.
‘founded on prejudice or preference rather than on reason of fact’. On the other hand, an act is discriminatory if it results in actual injury to the foreigner and the state intended to cause that harm. Unless these conditions are met, a host state will not be held liable merely because it accords more favourable treatment to its nationals.

Given the nature of the concept of arbitrariness, it has been argued that any arbitrary action will violate the standard of fair and equitable treatment. The same applies to non-discriminatory measures and the standards of national and most-favoured-nation. In other treaties, such as the ones concluded by the United States and the United Kingdom, the principle of non-discrimination is combined with the ‘fair and equitable treatment’ clause. In this regard, Vasciannie explains the interrelationship of these standards as follows:

‘If there is discrimination on arbitrary grounds, or if the investment has been subject to arbitrary or capricious treatment by the host State, then the fair and equitable treatment standard has been violated. This follows from the idea that fair and equitable treatment inherently precludes arbitrary and capricious actions against investors.’

545 Lauder v Czech Republic, Award, 3 September 2001, 9 ICSID Reports 66 para 221; Occidental v Ecuador, Award, 1 July 2004, 12 ICSID Reports 59, para 162; CMS v Argentina, Award, 12 May 2005, reprinted in International Legal Materials 44 (2005), 1205-1263 para 291 and Siemens v Argentina, Award, 6 February 2007, para 318.
546 Dolzer and Stevens, Bilateral Investment Treaties, op. cit., at 62.
548 Vasciannie, ‘The Fair and Equitable Standard of International Investment Law and Practice’, op. cit., at 133. In the application of bilateral investment treaties, the tendency to merge the two concepts can be found in CMS v Argentina, Award, 12 May 2005, at para 290; Impregilo S.p.A. v Islamic Republic of Pakistan, ICSID Case No ARB/03/3, Decision on Jurisdiction of 22 April 2005, at para 264; MTD v Chile, Award, 25 May 2004, at para 196; Noble Ventures v Romania, Award, 12 October 2005, at para 182; Saluka Investments BV (The Netherlands) v The Czech Republic, Partial Award, 17 March 2006, at para 460 and PSEG v Turkey, Award, 19 January 2007, at para 261.
549 Dolzer and Stevens, Bilateral Investment Treaties, op. cit., at 62.
550 In that regard, Lauder v. Czech Republic, Award of 3 September 2001, para 220, explains that a discriminatory measure is that which fails to provide national treatment.
551 Ibid.
552 Vasciannie, ‘The Fair and Equitable Standard of International Investment Law and Practice’, op. cit., at 133. On the same matter Muchlinski argues that ‘the concept of fair and equitable treatment is not precisely defined. It offers a general point of departure in formulating an argument that the foreign investor has not been well treated by reason of discriminatory or other unfair measures being taken against its interest. It is, therefore, a concept that depends on the interpretation of specific facts for its content. At most it can be said that the concept connotes the principle of non-discrimination and proportionality.
There is no doubt that there may be considerable overlap and the same set of facts may violate both the standard against arbitrary and discriminatory measures and the fair and equitable treatment clause. However, their separate treatment in arbitral awards indicates that tribunals regard them as two distinct standards.\textsuperscript{552} This means that this standard provides additional protection for foreign investors. This protection creates a positive constraint by promoting foreign investment and increasing the level of coherence.

### 3.2.4. National Treatment

Although drafted in different forms, the standard of national treatment exists in almost all bilateral investment treaties.\textsuperscript{553} Typically, such a clause states that foreign investors are accorded treatment no less favourable than that accorded to nationals by the host state.\textsuperscript{554} This standard is based on the Calvo doctrine originally supported by Latin American countries.\textsuperscript{555} In the past, national treatment as a standard of treatment was rejected altogether because such a treatment in some cases was lower than the minimum standard accepted by capital exporting countries.\textsuperscript{556} More recently, advantages have come with granting such a treatment as many states reserve economic sectors and privileges to their nationals.\textsuperscript{557} This is recognised in most bilateral investment treaties by using the words: ‘no less favourable than that which the state accords to its own investors’.\textsuperscript{558}

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\textsuperscript{552} See for example Occidental Exploration and Production Co. v. Ecuador, Award, 1 July 2004, 12 ICSID Reports 59, paras 159-166; Ronald S. Lauder v The Czech Republic, Award, 3 September 2001, 9 ICSID Reports 66, paras 214-288; Genin, Eastern Credit Ltd. Inc. And AS Baloit v Republic of Estonia, Award, 25 June 2001, 6 ICSID Reports 241, paras 368-371; Noble Ventures v Romania, Award, 11 October 2005, paras 175-180; Azurix Corp. v. The Argentina Republic, Award, 14 July 2006, paras 385-393 and Siemens v. Argentina, Award, 6 February 2007, paras 310-321.

\textsuperscript{553} Dolzer and Stevens, Bilateral Investment Treaties, op. cit., at 63-65.


\textsuperscript{555} See previous chapter for more details.

\textsuperscript{556} Somarajah, The International Law on Foreign Investment, op. cit., at 202.

\textsuperscript{557} Ibid.

\textsuperscript{558} Dolzer and Schreuer, Principles of International Investment Law, op. cit., at 178.
The standard applies once an investment is established. The standard rests on two major components. Firstly, to determine whether both foreign and national investors are placed in a comparable setting. Secondly, to determine whether the treatment accorded to the national investor is more favourable than that accorded to the foreign investor. For those to be determined a number of issues should be answered including the basis of comparison, the existence of a differentiation, a justification for the differentiation and the relevance of discriminatory treatment.

The incorporation of the standard aims at reducing the extent to which foreign investors can be put at a comparative disadvantage in comparison with national investors. Therefore, it reduces the risk of foreign investors being treated less favourably. This justifies the existence of a positive constraint between such a standard and the objective of promoting foreign investment. The inclusion of national treatment is consistent with and supportive to the objective and thus contributes to the coherence between treaty provisions and objectives.

3.2.5. Most-Favoured-Nation Treatment

For centuries, the most-favoured-nation (MFN) has formed part of the international economic treaties. The MFN treatment can be traced back to even before the spread of FCNs. The Draft articles on MFN defined MFN treatment as the:

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559 A different approach is followed by United States and Canada whereby the right of admission is also based on a national treatment clause, see ibid at 81.
560 In referring to this issue bilateral investment treaties use different terminologies such as ‘same circumstances’ or ‘like situations’ as well as ‘identical’ and ‘similar’. Dolzer and Stevens, Bilateral Investment Treaties, op. cit., at 63.
561 Dolzer and Schreuer, Principles of International Investment Law, op. cit., at 179.
‘... treatment accorded by the granting State to the beneficiary State, or to persons or things in a determined relationship with that State, not less favourable than treatment extended by the granting State to third State or to persons or things in the same relationship with that third State.’

Further, the MFN clause is defined as ‘... a treaty provision whereby a State undertakes an obligation towards another State to accord most-favoured treatment in an agreed sphere of relations.’

Virtually all bilateral investment treaties refer to this standard. In the context of investment, MFN treatment ensures that the foreign investor from a party to an agreement is treated, with respect to a given subject matter, in a manner at least as favourable as any other investor from any third country. It is meant to guarantee an equality of competitive opportunities between foreign investors of different nationalities seeking to establish an investment in a host state.

The MFN treatment clause is a treaty-based obligation. Although the inclusion of this clause became general practice in numerous investment treaties, the drafting of it is quite diverse. While some clauses are narrow, others are more general. In addition, many MFN clauses enclose specific exceptions and restrictions as to exclude certain areas including economic integration and matters of taxation from their application. More specifically, the scope of application of the MFN clause is determined by whether the treatment covers

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566 Article 5, ibid.
567 Article 4, ibid.
569 OECD, 'Most-Favoured-Nation Treatment in International Investment Law', op. cit..
571 Some cover post establishment phase and others cover both establishment and post establishment phases, see ibid, at 3-5.
572 Ibid, at 5.
investors and/or their investment, post-establishment phase or both pre- and post-establishment phases and whether it includes generic and/or country-specific exceptions.\textsuperscript{573}

The MFN clause contributes to the promotion objective of bilateral investment treaties. A positive constraint is established as it ensures a level playing field amongst foreign investors and prevents competition between foreign investors from being distorted by discrimination on the grounds of nationality. It means that all foreign investors are subject to the same rules and operation and transactions costs as well as the same market access and operational conditions and opportunities. Therefore, the purpose of the MFN clause strongly coheres with promoting foreign investment.

\textbf{3.3. The Protection against Expropriation}

The rules governing the expropriation of alien property have long been of central concern to foreign investors. Expropriation is the most severe act of interference with property. It is defined as an action by the host state that deprives investors of the ownership, control and economic benefit of their investment.\textsuperscript{574} Consistent with the notion of territorial sovereignty, international law recognises the host state’s right to expropriate alien property in principle.\textsuperscript{575}

Typically, treaty law addresses only the conditions and consequences of an expropriation, while leaving the right to expropriate unaffected.\textsuperscript{576}

\textsuperscript{573} Ibid, at 18-21.
\textsuperscript{575} In this respect the preamble of the Resolution No. 1803 of the General Assembly of the United Nations on the ‘Permanent Sovereignty over Natural Resources’ of December 1962 states that ‘Bearing in mind its resolution 1515 (XI) of 15 December 1960, in which it recommended that the sovereign right of every State to dispose of its wealth and its natural resources should be respected, considering that any measures in this respect must be based on the recognition of the inalienable right of all States freely to dispose of their natural wealth and resources in accordance with their national interests, and on respect for the economic independence of State,’ General Assembly Resolution on the ‘Permanent Sovereignty over Natural Resources’, UN Doc A/Res/1803 (14 December 1962).
\textsuperscript{576} Dolzer and Schreuer, \textit{Principles of International Investment Law}, op. cit. at 89. 89.
The most common terms amongst the measures of forced dispossession referred to in bilateral investment treaties are 'expropriation' and 'nationalisation'. 577 Nevertheless, some treaties refer to wider terms such as 'dispossession', 'taking', 'deprivation' or 'privation'. 578 Generally, bilateral investment treaties do not define expropriation or any of the other terms used to describe similar measures of forced dispossession. The reluctance to include a definition of expropriation in these treaties can be justified by the possibility that host states may take measures which have similar effect to expropriation or nationalisation without constituting an act of expropriation per se. 579 Such acts are generally termed ‘indirect’, ‘creeping’ or ‘de facto’ expropriation. 580

Bilateral investment treaty practice demonstrates that expropriation clauses are broad enough to include indirect measures and accord them all the same legal treatment. 581 In other words, these treaties are more concerned with the effect of the measure under consideration rather than the measure itself. 582 In this context the decision of Starrett Housing v. Islamic Republic of Iran can be recalled as the Tribunal found that:

‘it is recognised in international law that measures taken by a State can interfere with property rights to such an extent that these rights are

rendered so useless that they must be deemed to have been expropriated, even though the State does not purport to have been expropriated them and the legal title to the property formally remains with the original owner.  

The legality of expropriation is conditioned on expropriation being for public purpose, non-discriminatory, in accordance with the principles of due process and accompanied by prompt, adequate and effective compensation. In relation to public purpose there seems to be no agreed-upon definition. To a considerable extent, the notion of what constitutes public purpose rests with the concerned state. Virtually all bilateral investment treaties include references to public purpose; however, some variations may occur in the language. To a large extent, these variations reflect the different terminology used in the domestic law of each state.

A further stipulation in bilateral investment treaties requires that the expropriation should be non-discriminatory. To illustrate, the act of expropriation must apply to all properties in a

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584 Dolzer and Schreuer, Principles of International Investment Law, op. cit., at 91. Article 3 of the OECD Draft Convention 1967 on the Protection of Foreign Property, expressly states:

No Party shall take any measures depriving, directly or indirectly, of his property a national of another Party unless the following conditions are complied with:

(i) The measures are taken in the public interest and under due process of law;
(ii) The measures are not discriminatory or contrary to any undertaking which the former party may have given; and
(iii) The measures are accompanied by provisions 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.

585 Dolzer and Stevens, Bilateral Investment Treaties, op. cit., at 104.
588 Dolzer and Stevens, Bilateral Investment Treaties, op. cit., at 105.
589 See the expropriation clause in the U.S.-Bahrain BIT (2001) which states:

‘Neither Party shall expropriate or nationalize a covered investment either directly or indirectly through measures tantamount to expropriation or nationalization (‘expropriation’) except for a public purpose; in a non-discriminatory manner’.
similar position and must not discriminate against aliens or any particular group of aliens.\textsuperscript{590} In the context of bilateral investment treaties, unlike customary international law, the concept of non-discrimination has wider connotations.\textsuperscript{591} In its wider sense, the concept encompasses national treatment as well as MFN.\textsuperscript{592}

Nevertheless, there is no such absolute principle of alien non-discrimination.\textsuperscript{593} Accordingly, a certain act may be regarded as discriminatory if it results in aliens being treated differently than nationals or other aliens without any reasonable justification for such a treatment.\textsuperscript{594} To that effect, differential treatment is accepted as long as it is based on justifiable or reasonable grounds.\textsuperscript{595} This in particular has been explained by the European Court of Justice in the \textit{Italian Government v. E.E.C. Commission}, where the court held that:

\begin{quote}
\textit{The different treatment of non-comparable situations does not lead automatically to the conclusion that there is discrimination. An appearance of discrimination in form may therefore correspond in fact to an absence of discrimination in substance. Discrimination in substance would consist of treating either similar situations differently or different situations identically.}\textsuperscript{596}
\end{quote}


\textsuperscript{593} M. Sornarajah, \textit{The Pursuit of Nationalized Property} (Dordrecht: Nijhoff, 1986) at 185.

\textsuperscript{594} That view is adopted by the American Law Institute Restatement; see Restatement (Third) of Foreign Relations Law of the United States for the year (1986) secssion 711.

\textsuperscript{595} Professor Schachter stated that ‘since the time of Plato, it has been suggested that ‘equality among unequals’ may be inequitable and that differential treatment may be essential for ‘real equality.’’ O.Schachter, ‘Sharing the World ‘S Resources’, in R.A. Falk, F.V. Kratochwil, and S.H. Mendlovitz (eds.), \textit{International Law: A Contempory Perspective} (Boulder: Westview Press, 1985) at 528.

The third condition is a requirement which refers to the procedure that surrounds the expropriation and that it should be conducted in accordance with due process. Some treaties specify that the use of due process is identical to that stated in national law, while others particularly refer to domestic laws rather than due process. Generally, due process suggests that foreign investors are offered the right of advanced notification and fair hearing before the expropriation takes place, provided that the decision is made by an unbiased official and within reasonable time. Such a right can be breached in different forms including the failure to provide notice or fair hearing or means for legal redress.

Nevertheless, it is unclear whether the condition of due process imposes an obligation of conduct or result. Considering it as an obligation of conduct would then render any defect in process, regardless of it being reviewable or correctable, as breach. For example, in such a case, failing to notify the investor about the expropriation would put the host state in a position of breach even if the investor knew about the expropriation through other means.

The UNCTAD Taking of Property report argues that bilateral investment treaties seem to adopt the requirement of due process in regard to what should follow an expropriation.

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597 Some bilateral investment treaties, such as those based on the United Kingdom Treaty Model, do not require that expropriation be effectuated under due process of law, see for example Article 5 (1) of Bosnia and Herzegovina-United Kingdom BIT 2002 and Article 5 (1) of United Kingdom Vietnam BIT 2002. Newcombe and L. Paradell (eds.), Law and Practice of Investment Treaties: Standards of Treatment, op. cit., at 375.

598 This is done by incorporating a special statement for that purpose such as ‘under due process of national law, see for example Article 4(1) of the China-Poland BIT 1998.


600 This is clearly stated in the case of ADC Affiliate Limited and ADC &ADMC Management Limited v. Republic of Hungary where the tribunal stipulated that due process of law requires ‘Some basic legal mechanisms, such as reasonable advance notice, a fair hearing and an unbiased and impartial adjudicator to assess the actions in dispute, are expected to be readily available and accessible to the investor to make such legal procedure meaningful. In general, the legal procedure must be of a nature to grant an affected investor reasonable chance within a reasonable time to claim its legitimate rights and have its claims heard. If no legal procedure of such nature exists at all, the argument that ‘the actions are taken under due process of law’ rings hollow.’ ADC Affiliate Limited and ADC &ADMC Management Limited v. Republic of Hungary, ICSID Case No. ARB/03/16, Award, 2 October 2006, para 435.


602 Ibid.

Relating due process to the post expropriation phase, the requirement offers a review of whether proper compensation standards were used in assessing the compensation.604

Finally, expropriation must be followed by compensation.605 The measure of compensation is by far the most controversial requirement for lawful compensation.606 A traditional issue that has been at the centre of the debate on expropriation for many years concerns the amount of expropriation.607 On one side, the developed countries have maintained that a minimum international standard exists and that compensation must be ‘prompt, adequate and effective’ (Hull Rule).608 On the other, developing countries asserted that the issue of compensation should be determined in accordance with domestic law.609 This long lasting disagreement lent particular importance to treaties’ provisions on the standard of expropriation. In this regard, many bilateral investment treaties followed the Western formula of ‘prompt, adequate and effective’ compensation.610 Other treaties incorporated more general terms, such as ‘just’, 611 ‘full’, 612 ‘reasonable’613 or ‘fair and equitable’,614 to describe the required compensation.615

604 Ibid.
606 Ibid.
609 Article 2 (2) of the Charter of Economic Rights and Duties of States recorded the vote of more than 100 developing countries in its favour. It provides that ‘Each state has the right to nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the state adopting such measure, taking into account its relevant laws and regulations and all circumstances that the state consider pertinent.’
611 Mann, ‘British Treaties for the Promotion and Protection of Investments’, op. cit., at 246-47.
612 Sornarajah, The International Law on Foreign Investment, at 417.
613 Article 4 of the Hong Kong Model Bilateral Investment Treaty, Dolzer and Stevens, Bilateral Investment Treaties, op. cit., at 204.
As for the value of compensation, many bilateral investment treaties refer to ‘fair market value’. Other treaties use different terminologies such as ‘genuine value’, ‘market value’, ‘full and genuine value’ and much vaguer terms. However, virtually no bilateral investment treaty makes reference to what method should be used in determining the fair market value or market value. Additionally, these treaties generally require compensation to be fully realisable, freely transferred and made in convertible currency. In addition, most treaties highlight the importance of making compensation ‘without delay’.

In conclusion, it may be noted that virtually all modern bilateral investment treaties include mandatory conditions for expropriation. In this respect it may generally be suggested that these treaties now reflect a strong trend towards protecting the property of foreign investors. Most treaties cover a range of other measures which indirectly have a similar effect to expropriation. Moreover, treaties’ provisions adopt the views of developed countries and impose a high compensation standard. By strengthening the position of the foreign investor, these provisions significantly contribute to achieving the objective of promoting foreign direct investment. A positive constraint is formed due to these provisions eliminating the risk of foreign investors losing their property illegitimately.

616 ‘Compensation will be deemed “adequate” if it is based on the fair market value of the taken asset’, ibid. See also M. Houde, ‘Novel Features in Recent Oecd Bilateral Investment Treaties’, International Investment Perspectives (OECD, 2006) at 161-62.

617 See Article 5 (1) of the United Kingdom bilateral investment treaties with Argentina and Bahrain (1991).


620 See for example Article 4 (2) of Germany-Swaziland BIT 1990 whereby it states that compensation ‘shall be equivalent to the value of the expropriated investment immediately before the date on which the actual or threatened expropriation ... has become publicly known’.

621 See S. Ripinsky and K. Williams, Damages in International Law (London: British Institute of International and Comparative Law, 2008) at 79.

622 Dolzer and Stevens, Bilateral Investment Treaties, op. cit., at 112.

623 This is normally compared to the time needed for the completion of transfer formalities, see ibid.
3.4. Dispute Settlement

Prior to the existence of bilateral investment treaties, foreign investors did not have access to international remedies to pursue claims against host states for violation of their rights.\textsuperscript{624} The only resort was diplomatic protection by their home states.\textsuperscript{625} However, bilateral investment treaties came to provide for two types of dispute settlement.\textsuperscript{626} The first provision offers arbitration between an investor and the host state as it obliges the host state, upon the request of the investor, to submit investment disputes to binding third party arbitration.\textsuperscript{627} The second arbitration clause obliges contracting parties, upon the request of either party, to submit to arbitration any disputes involving interpretation or application.\textsuperscript{628}

From the investors’ perspective, these provisions are very important. Access to international arbitration avoids foreign investors all the pressure and delay that may accompany the adjudication of investment disputes in national courts.\textsuperscript{629} In addition it reduces their fear of lack of impartiality from the courts of the host state.\textsuperscript{630} Thus, including such arbitration clauses in a treaty is considered a major protection to foreign investors.

The dispute settlement provisions contribute to increasing coherence between treaty provisions and the objective of investment promotion. A positive constraint exists as the risk of exhausting local remedies is removed.

\textsuperscript{626} Dolzer and Schreuer, Principles of International Investment Law, op. cit., at 213.
\textsuperscript{628} ibid, at 509.
\textsuperscript{630} Dolzer and Schreuer, Principles of International Investment Law, op. cit., at 214.
4. Negative Constraints

The objective of promoting foreign investment and encouraging the flow of foreign investment from one state party to a bilateral investment treaty to the other party’s territory appears almost self evident. However, a number of issues within the bilateral investment treaties are incoherent with this objective. Firstly, these treaties impose no obligation whatsoever on the home state of investors in order to encourage or facilitate outward investment. Having these treaties begin with a declaration as to the reciprocal encouragement and protection of investment does not create a positive duty on the part of the capital exporting states to encourage investment flows. If these treaties provide a separate article for the purpose of encouraging flows of foreign investment by the home state, the duty may then be stronger.

It would be logical to ask home states to liberalise their own regimes or adopt enhanced programs for investment insurance if promoting investment flow is indeed an objective of such a treaty. A number of measures can be adopted in this regard, for example: incorporating a provision according to which home states are committed to subsidising regulatory risk insurance for those investments covered by the treaty. Instead, bilateral investment treaties only refer to subrogation rights of political risk insurance or guarantee programs.

Secondly, bilateral investment treaties apply to already existing investment. There are no provisions dedicated to new investment or re-investment by existing investors. These treaties

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632 Sornarajah, *The International Law on Foreign Investment*, op. cit., at 188-89.
633 Ibid, at 189.
635 Ibid.

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would be more coherent with their objective of investment promotion if they stipulated provisions granting incentives to such investment, such as facilitating establishment procedures or granting tax incentives. In this regard it is worthwhile to recall the conflicting evidence as to whether bilateral investment treaties actually promote foreign investment.

Most empirical research finds very little connection between the conclusion of these treaties and the increase of foreign direct investment. These studies include analysing bilateral investment treaties by the UNCTAD where it concluded that these treaties have a ‘minor and secondary role in influencing FDI flows’.637 A similar conclusion was reached by Hallward-Dreimeier as he found a ‘significant negative finding on the impact of ratifying a BIT’638 According to Tobin and Rose-Ackerman, bilateral investment treaties have ‘little impact’ on attracting foreign direct investment.639

On the other hand, Salacuse and Sullivan found that bilateral investment treaties entered into with the United States have a positive effect on foreign direct investment greater than that of treaties signed with other OECD countries.640 Neumayer and Spess concluded that the greater the number of bilateral investment treaties signed with capital exporting countries, the greater the flow of foreign direct investment.641 In applying Neumayer and Spess’ model,

638 M. Hallward-Dreimeier, ‘Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit... And They Could Bite’, op. cit., at 19.
639 They also found that ‘signing a BIT with the United States does not correspond to increased FDI flows’. J. Tobin and S. Rose-Ackerman, Foreign Direct Investment and Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties, Center for Law, Economic and Policy Research Paper (Yale Law School, 2004) at 19, 31.
641 They claim to provide the ‘first hard evidence that there is a payoff to a developing country’s willingness to incur the costs of negotiating BITs and to succumb to the restrictions on sovereignty’, E. Neumayer and L. Spess, ‘Do Bilateral Investment Treaties Increase Foreign Direct Investment in Developing Countries?’, World Development, 33/10 (2005), 1567-85 at 1571.
Yackee found a marginal and much smaller relationship between bilateral investment treaties and foreign investment flows.\textsuperscript{642}

5. Conclusion

As discussed, promoting foreign investment requires the provision of high standards of protection. Dedicating provisions to that purpose guarantees better coherence. However, as seen in the preceding paragraphs, coherence between treaties’ provisions and the objective of investment promotion should not be limited to investment protection. There are other issues these treaties must address in order to enhance and increase the level of coherence. In revising these treaties to be more coherent in this respect, it is found that additive consolidation must be undertaken. Bilateral investment treaties should add a provision for the purpose of imposing an obligation on the host state to encourage and facilitate outward investment. In addition, these treaties should also address new and re-investment from existing investors by granting them some incentives. Such provisions may help bilateral investment treaties in promoting foreign investment and thus increase their overall coherence.

\textsuperscript{642} He explains that the findings of Neumayer and Spess ‘rest on quite unstable ground’ and ‘are far less robust’, see Yackee, ‘Sacrificing Sovereignty: Bilateral Investment Treaties, International Arbitration, and the Quest for Capital’, op. cit., at 51.
Chapter 4

Coherence between Bilateral Investment Treaties and the Objective of Investment Liberalisation

1. Introduction

Investment liberalisation is spreading across the world. The need to attract capital in the form of foreign investment and the reduced availability of loans as a result of the third world economic crisis have pushed states towards liberalisation. One element of the process of liberalisation is the conclusion of bilateral investment treaties. Usually these treaties advertise themselves as tools for liberalisation. Investment liberalisation differs from investment promotion in the way that each is achieved. As explained earlier, investment promotion is achieved by reducing the risks that foreign investors would otherwise face. It is that reduction in risk which encourages and promotes investment. On the other hand, countries’ efforts to liberalise their economies through bilateral investment treaties are fulfilled by facilitating the entry of a treaty member’s investment and offering conditions which favour their operations.

The aim of this chapter is to apply coherence to treaties’ provisions and the objective of investment liberalisation. In doing so, it will answer the question of whether bilateral investment treaties are tools for liberalisation or not. This chapter will look at the type of

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647 Ibid.
constraints formed between each provision and this objective. The positive constraints reflect a coherent relationship based on consistency and support. On the contrary, negative constraints exist whenever a provision fails to contribute to increasing coherence between the treaty and its objective. This chapter will conclude by recommending consolidation to enhance and strengthen coherence between bilateral investment treaties and investment liberalisation.

2. Investment and Market Liberalisation

Investment liberalisation is concerned with facilitating the entry and operation of foreign investment in the host state.\(^\text{648}\) The fundamental premise of liberal economic theory is that free markets ensure the most efficient use of resources and thus the greatest productivity.\(^\text{649}\)

For this to happen it is necessary to base the relationship between the state and its market on three main principles.\(^\text{650}\)

Firstly, states have to intervene in civil society in order to establish and protect private rights of contract and property.\(^\text{651}\) In this respect, each state is responsible for implementing a strong legal framework to secure the rights of the parties and enforce the exchange of such rights.\(^\text{652}\)

Secondly, states should refrain from interfering in the market’s allocation of resources.\(^\text{653}\)

Having created the legal system for the market, the state must then let the market guide the

\(^{648}\) Investment liberalization differs from investment protection. Investment protection refers to protecting the investment once it has entered the host country and such protection is mainly against any act that would interfere with the functioning of the investment in general especially the investor's property rights. On the other hand, investment liberalisation refers to facilitating the investment process throughout all its phases. This distinction was made in the launching negotiations for a Multilateral Agreement on Investment in September 1995, as the OECD called for ‘a broad multilateral framework for international investment with high standards of liberalisation of investment regimes and investment protection’ (CIME) and (CMIT), ‘Multilateral Agreement on Investment (MAI)’. available at http://www1.oecd.org/daf/mai/txt/cmitcime95.htm


\(^{653}\) Ibid, at 505.
allocation of resources within the society. Thirdly, states are required to intervene in the market whenever it is necessary to correct market failures. In other words, the state should defer to the market as long as the market is functioning properly; however, once the market fails, the state may intervene to remedy the failure.

Based on the above, the relation between the state and the market must reflect the following. First is the principle of investment security, which holds states responsible for protecting investment against public and private interference. Second is the principle of investment neutrality, which requires states to allow the market to determine the nature and direction of investment flows. Finally, there is the principle of market facilitation, according to which the state must ensure that the market is functioning properly and intervene to remedy market failure.

Assessing the coherence between bilateral investment treaties and the objective of liberalisation reveals the extent to which these treaties contribute to advancing these principles. Thus, each of these principles will be addressed in reference to the provisions of these treaties. In doing so, a thorough explanation of the positive and negative constraints will be provided.

654 Ibid.
657 Ibid, at 506.
658 Ibid.
659 Ibid.
3. Investment Protection for Liberalisation

As noted above, having a liberal investment regime requires protecting the investment from both public and private intervention. In this regard, the following positive and negative constraints are found.

3.1. Positive Constraints

The positive constraints exist between bilateral investment treaties and the protection from public intervention. As explained in the preceding chapter, these treaties protect foreign investment from being expropriated by the host state. The strict conditions and the high standard of compensation ensure that states are incapable of intervening in the property rights of foreign investment whenever they wish. The provisions on expropriation and compensation are consistent with the objective of liberalisation. For that reason, bilateral investment treaties limit states’ intervention and therefore contribute to the objective of liberalisation and the overall coherence of such treaties.

3.2. Negative Constraints

Unlike public intervention, bilateral investment treaties are silent regarding private intervention. It is understood that treaties’ obligations apply to states that are parties to the treaty. They limit and control the conduct of those states’ parties, not private parties. Additionally, these treaties protect foreign investment against some forms of damage by private parties under the ‘full protection and security’ and ‘fair and equitable treatment’ provisions.\(^{660}\) However, they do not provide substantive protection against private intervention, such as addressing anti-competitive practices\(^{661}\) or the pirating of intellectual


property. Consequently, such a gap in bilateral investment treaties decreases the level of coherence between their provisions and the objective of liberalisation.

4. Investment Neutrality for Liberalisation

The implications of investment neutrality are found at both pre- and post-establishment phases of the investment. It is concerned with the free movement of investment across borders as well as provisions prohibiting host states from discriminating among investment on the basis of nationality. In looking at these issues, the following positive and negative constraints are found.

4.1. Positive Constraints

As mentioned earlier, these treaties contain provisions protecting foreign investment against discrimination based on nationality. Bilateral investment treaties guarantee that foreign investment will receive national treatment and that the host state will not discriminate among foreign and national investment. Moreover, foreign investors are guaranteed to be accorded MFN treatment.

Another positive constraint is found in the provisions regulating the movement of capital. For investors, the right to make capital transfers is essential to the feasibility, implementation and profitability of the investment. On the other hand, the host state is more concerned with foreign exchange availability and general balance of payment. Put differently, while investors seek unrestricted transfers, host states are determined to control such rights, which makes it difficult to strike the right balance.

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663 Ibid, at 510-11.
664 Dolzer and Stevens, *Bilateral Investment Treaties*, *op. cit.*, at 85.
665 Ibid.
Although transfer clauses in bilateral investment treaties are drafted in different ways, they generally address three fundamental issues: 1) the types of payment which are covered by the right to make transfer, 2) convertibility and exchange rates and 3) limitations on transfers.\textsuperscript{666}

In this regard a typical transfer clause states:

\textit{Recognizing the principle of freedom of transfer each Contracting Party shall authorize, in conformity with the relevant most favourable rules the transfer, without undue restriction and delay, to the country of the other Contracting Party and in the currency of that country or any other freely convertible currency of payments resulting from the investment activities and in particular of the following items:}

a) Net profits, interests, dividends and other current income;

b) Funds necessary
   i) for the acquisition of raw or auxiliary materials, semifabricated or finished products, or
   ii) to replace capital assets in order to safeguard the continuity of an investment;

c) additional funds necessary for the development of an investment;

d) earnings of natural persons;

e) the proceeds of liquidation of capital;

f) funds in the repayment of loans;

g) management fees;

h) loyalties.\textsuperscript{667}

However, the principle of free transfer is subject to limitations.\textsuperscript{668} The limitation provisions correspond to the World Bank Guidelines which provide that in certain circumstances

\begin{footnotesize}
\textsuperscript{666} Ibid, \textit{op. cit.}, at 86.

\textsuperscript{667} See Article IV of the Netherlands-Malta BIT (1984). Also similar drafting was followed by Switzerland and the United Kingdom, \textit{ibid}, at 86-87.
\end{footnotesize}
transfers ‘may as an exception be made in instalments within a period which will be as short as possible and will not in any case exceed five years from the date of liquidation or sale, subject to interest as provided in Section 6(3) of the Guidelines’. 669

In practice, bilateral investment treaties followed different routes when dealing with transfers. According to Kolo and Walde, these routes can broadly be summarised into four approaches. 670 The first approach is mainly to provide free transfer unrestricted by domestic or economic circumstances of the host state. 671 The second is to subject the free transfer to the host state exchange law and regulations. 672 The third is to provide for exceptions through certain measures applicable during periods of balance of payment difficulties, conditioned on such measures being necessary, temporary and consistent with the IMF or WTO Agreement and imposed in a non-discriminatory manner. 673 Finally, the fourth approach combines the second and third but in addition it insulates such measures from third party scrutiny. 674

In conclusion, bilateral investment treaties allow member states to impose exchange restrictions only when a state faces balance of payment problems or an economic

668 In the protocol to the treaty between Germany and Swaziland it is stipulated that:
   (a) A transfer shall be deemed to have been made “without delay” within the meaning of Article 7(1) if effected within such period as is normally required for the completion of transfer formalities. The said period shall commence on the day on which the relevant request has been submitted and may on no account exceed two months.
   (b) If and insofar as necessitated by extreme balance of payments difficulties, either Contracting Party may, on decision of the competent organ, restrict for a limited period transfers of the proceeds of liquidation in the event of the sale of the whole or any part of the investment. In any case an annual minimum transfer of twenty per cent (20%) of the proceeds of liquidation shall be guaranteed. The transfer shall be carried out at a rate of exchange no less favourable than the rate of exchange on the date on which the application for transfer is made.

669 This is normally the case whenever a state suffers from foreign exchange difficulties, Guidelines III 6 (1) (d), World Bank, Report to the Development Committee and Guidelines on the Treatment of Foreign Direct Investment, reprinted in International Legal Materials, 31 (1992), 1366-1378, at 1374.


671 Ibid, at 161.

672 Ibid, at 162.

673 Ibid.

674 Ibid, at 163.
emergency. Virtually all bilateral investment treaties’ provisions on free movement of capital form positive constraints with the objective of liberalisation. In principle, these treaties explicitly recognise the investors’ right to make free transfers, but the strength of such constraint varies depending on the approach a treaty follows. The treaties that follow the first approach provide for what seem to be absolute free transfer provisions. Such provisions do not allow states to restrict transfers even when faced with balance of payment problems. Thus, they achieve a higher level of coherence than the other treaties. The more such provisions provide for restrictions, the weaker the constraint gets.

4.2. Negative Constraints

The first negative constraint is found in the admission clauses. Generally, bilateral investment treaties acknowledge that foreign investors have no absolute right to entry. On the contrary, admission provisions allow host states to regulate the conditions for admission and only properly admitted investment can benefit from the provisions of the treaty. In other words, the conclusion of a bilateral investment treaty is by no means a guarantee for the admission of foreign investment into the territory of either of the member states.

Generally admission clauses, excluding those incorporated in treaties concluded by the United States, reflect a general pattern. A standard provision would usually provide that each contracting party should ‘admit investment in accordance with its legislation’. Accordingly, to ascertain the obligations that must be complied with in respect of a certain entry requires an analysis of the host state’s legislation. As for the treaties concluded by The


677 Bilateral investment treaties practice reflect that investment is admitted in conformity with the laws of the host state, see Newcombe and L. Paradell (eds.), Law and Practice of Investment Treaties: Standards of Treatment, op. cit., at 134.

678 Dolzer and Stevens, Bilateral Investment Treaties, op. cit., at 50.

679 Article 2 (1) of Germany-Guyana BIT (1989), Dolzer and Stevens, Bilateral Investment Treaties, op. cit., at 52.
United States, the host state is expected to accord the better of either national or MFN treatment to investment during the establishment phase. In this respect, an admission clause in such a treaty is likely to state that

‘Each party shall maintain favourable conditions for investment in its territory by nationals and companies the other Party. Each Party shall permit and treat such investment, and activities associated therewith, on a basis no less favourable than that accorded in like situations to investment or associated activities of its own nationals or companies, or of nationals or companies of any third country, which is more favourable...’

The United States’ practice follows the theories of free market and liberalisation. However, they raise a number of concerns. To begin with, the application of national treatment is limited to ‘like’ or ‘similar’ situations. Further, in light of national treatment and MFN, the host state maintains its right to derogate from their application in respect of certain sectors of the economy. Thus, although at first the above provisions seem more liberal, their limited application forms negative constraint with the objective of liberalisation.

Admission clauses are important because they determine the amount of control a host state has over the entry of foreign investment. By linking admission to domestic laws and legislations foreign investment would fall under the discretion of the host state instead of leaving the investment direction and allocation to the market power. Thus, it is reasonable to

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681 See Article II (1) of United States – Panama BIT (1982), Dolzer and Stevens, *Bilateral Investment Treaties, op. cit.*, at 57.
684 Dolzer and Stevens, *Bilateral Investment Treaties, op. cit.*, at 57.
conclude that admission clauses are not that effective in attaining the objective of investment liberalisation.\textsuperscript{685}

Another negative constraint is found in the relation between bilateral investment treaties and performance requirements. Performance requirements are ‘\textit{stipulations imposed on investors requiring them to meet certain specific goals with respect to their operations in the host state}’.\textsuperscript{686} Host states sometimes impose such requirements on foreign investment in an attempt to shape the economic consequences of the investment. For example, in order to ensure that foreign investment generates employment or has a favourable impact on the balance of payment, the host state may oblige the investor to hire local employees, purchase their inputs from the local market or at least arrange the export of some percentage of their product.\textsuperscript{687} Performance requirements can be imposed at the point of entry, or for subsequent expansion or as a condition for receiving certain advantages and incentives.\textsuperscript{688} An example of such a performance requirement is found in obliging foreign investors to export a certain percentage of their production, buy local products or services, or employ local labour.\textsuperscript{689} Therefore, including such provisions is against the principles of free market.\textsuperscript{690}

The position regarding performance requirements differs between developing and developed countries. For developing countries, such requirements are considered an important policy

\textsuperscript{686} The UNCTAD report on performance requirements explain that performance requirements can be divided into three main categories: 1) performance requirements explicitly prohibited by the WTO agreement on Trade-Related Investment Measures (TRIMs) as they are inconsistent with Articles III and XI of GATT/1994, 2) performance requirements clearly prohibited, conditioned or discouraged by agreements including interregional, regional or bilateral but not multilateral agreements and 3) performance requirements that are not subject to control by any international investment agreement. See UNCTAD, ‘Foreign Direct Investment and Performance Requirements: New Evidence from Selected Countries’, (New York, Geneva: United Nations, 2003b) at 2-3. available at http://unctad.org/en/docs/iteia20037_en.pdf
\textsuperscript{688} Ibid, at 2.
\textsuperscript{689} Sornarajah, \textit{The International Law on Foreign Investment, op. cit.}, at 237.
tool which can be used to enhance the benefits of foreign investment. In preserving their right to impose performance requirements, they argue that they should be entitled to the same tools which were available to developed countries when they were industrialising their economies. On the contrary, developed countries relate such requirements to the interventionist strategies of the past and question their effectiveness. Hence, they hold that investment liberalisation demands the elimination of such provisions.

Generally, bilateral investment treaties are silent on this issue. However, some treaties expressly regulate the use of performance requirements. These include treaties between the Dominican Republic and Ecuador (1998), Bolivia and Mexico (1995) and El Salvador and Peru (1996). In other treaties performance requirements fall within the obligations that must be complied with upon entry. The only treaties that expressly prohibit imposing such requirements are the ones concluded by the United States and Canada.

Being silent on performance requirements means that bilateral investment treaties are not totally against them. Following such practice forms a negative constraint with the objective of

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691 Sornarajah, *The International Law on Foreign Investment, op. cit.*, at 237.
692 Ibid.
693 Ibid.
694 Ibid.
695 Dolzer and Stevens, *Bilateral Investment Treaties, op. cit.*, at 79-80; and UNCTAD, *Foreign Direct Investment and Performance Requirements: New Evidence from Selected Countries*.
696 Ibid.
697 Vandevelde, *The Political Economy of a Bilateral Investment Treaty*, at 630. According to Cavas' findings over half of the surveyed foreign investors were subject to some type of performance requirements involving either export targets or domestic content, R. Caves, *Multinational Enterprises and Economic Analysis* (2 edn.; Cambridge: Cambridge University Press, 1996) at 222.
698 US-Cambon BIT (1986) which states:

‘Neither Party shall impose performance requirements as a condition of establishment, expansion or maintenance of investments owned by nationals or companies of the other Party, which require or enforce commitments to export goods produced, or which specify that goods or services must be purchased locally, or which impose any other similar requirements’

Dolzer and Stevens, *Bilateral Investment Treaties, op. cit.*, at 80.
liberalisation. This is because through performance requirements host states maintain power and control over the activities of foreign investment.

The third constraint is found in how bilateral investment treaties deal with the movement of labour. In practice, very few treaties expressly oblige member parties to allow the entry and sojourn of all persons associated with covered investment. Other treaties include a non-obligatory statement which requires the member states to give favourable consideration to requests for entry by persons associated with an investment. Other treaties affirm that entry of foreign nationals remains subject to states’ legislation and provide that each contracting state shall give ‘sympathetic consideration’ or ‘shall provide assistance’ to applications for entry or work permits.

Based on the above, it seems that bilateral investment treaties do not address labour movement often, and whenever they do, they use declaratory language. Other than being non-legally binding, the application of such clauses is limited. Firstly, the obligation to allow entry is subject to the law and regulations of the host state. Secondly, they seem more concerned with top managerial staff rather than the movement of labour in general. Thus,

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701 J.W. Salacuse, The Law of Investment Treaties (Oxford: Oxford University Press, 2010) at 334. See for example Article II(5) of Estonia–United States BIT (1994) which provides that: Companies which are legally constituted under the applicable laws or regulations of one Party, and which are investments, shall be permitted to engage top managerial personnel of their choice, regardless of nationality. Also see Newcombe and L. Paradell (eds.), Law and Practice of Investment Treaties: Standards of Treatment, op. cit., at 144.
703 Ibid.
704 Ibid.
within the text of bilateral investment treaties a negative constraint is created due to improperly addressing the movement of labour.

5. Investment Facilitation for Liberalisation

There are no positive constraints whatsoever between bilateral investment treaties and market facilitation. Market facilitation requires such treaties to contain a set of provisions dedicated to ensure that a properly functioning market is in place. A typical bilateral investment treaty does not provide any provisions for that purpose. Nevertheless, a few treaties include provisions related to one form of market failure, namely lack of information. Other than that, bilateral investment treaties do very little, if anything at all, to remedy or ameliorate market failure.

Although the liberal model suggests that the market will guide and direct the flow of investment to find its most efficient use, bilateral investment treaties do nothing to facilitate this or ensure it will happen. The negative approach towards market failure is that these treaties follow creates a massive gap between them and liberalisation. In this respect, it is found that these treaties lack coherence.

Before concluding on whether bilateral investment treaties are of any use for liberalisation, it is noteworthy to refer to Salacuse and Sullivan’s view of liberalisation. They maintain that

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there are two approaches to liberalisation. First is the ‘absolutist approach,’ which focuses on whether all legal and regulatory limitations facing foreign investment are removed or not. The other is the ‘relativist approach’ which is more concerned with the extent to which a country has shifted from being interventionist to being more liberal.

When evaluating bilateral investment treaties in light of the absolutist approach, a likely result will be that such treaties are very limited tools for liberalisation. Despite the fact that such treaties support and adopt liberal policies, they are not properly drafted to ensure that a liberal investment regime is in place. As discussed earlier, admission is subject to local legislation. The standards of treatment are high, but only applicable post-establishment. No security is afforded against private intervention. In addition to that, there are a number of other issues which make these treaties incoherent with the objective of liberalisation.

On the other hand, bilateral investment treaties appear to be more coherent when looked at in reference to the relativist approach. The economies of most countries became more liberalised after they entered into bilateral investment treaties. Countries started to adopt liberal policies in drafting laws and regulations governing foreign investment. However, these are more of an indirect effect that does not increase the degree of coherence between the provisions and the objective of liberalisation.

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711 Ibid, at 91-92.
712 Ibid.
713 Ibid, at 92.
714 Vendevelde strongly supports this outcome, see Vandevelde, ‘Investment Liberalisation and Economic Development: The Role of Bilateral Investment Treaties’, op. cit., at 514.
717 See UNCTAD, ‘World Investment Report: FDI Policies for Development: National and International Perspectives’, op. cit., at 20. As this study finds that during the period between 1991 and 2002 almost 95% (1551 out of 1641) changes introduced by 165 countries in their FDI laws were in the direction of greater liberalization.
6. Conclusion

In conclusion, bilateral investment treaties are limited tools for liberalisation. Bilateral investment treaties do not entail strong host state investment liberalisation since the amount of negative constraints outnumbers the positive constraints. In light of the above circumstances, investment liberalisation would be achieved at a national level in accordance with national investment laws and regulations depending on the host countries’ policy. However, to enhance coherence between these treaties and investment liberalisation, additive consolidation should take place in relation to a number of issues. Firstly, bilateral investment treaties must prevent private intervention through, for example, addressing anti-competitive practices and the pirating of intellectual property. Secondly, these treaties should expressly prevent performance requirements in order to limit host states’ power and control over the activities of foreign investment. Thirdly, bilateral investment treaties must oblige member parties to allow the entry and sojourn of all persons associated with covered investment. Finally, these treaties must contain a set of provisions dedicated to ensure that a properly functioning market is in place. In doing so, the coherence between bilateral investment treaties and the objective liberalisation will be enhanced and strengthened.
Chapter 5

Coherence within the Bilateral Investment Treaties Network

1. Introduction

While the emergence of multilateral institutions is evident in some areas of international economic law, in particular international trade and international monetary law, the development of international investment law is based on bilateral practice. Bilateralism puts the interest, sovereignty and consent of a state first and pays very little attention, if any, to interests outside or beyond the two states’ realm. By contrast, multilateralism aspires towards an international community and assumes the existence and legitimacy of universal interests beyond the interests of states. Being based on bilateralism, international investment law suggests divergence in structure. The divergence and fragmentation in bilateral investment treaties renders constituting a coherent system of law governing international investment relations more difficult.

It is important to achieve coherence within bilateral investment treaties because it provides states, policy makers and foreign investors with higher predictability vis-a-vis the scope of their commitments and benefits. To illustrate, it provides negotiators with informed options regarding the obligations they are undertaking when concluding such treaties. Moreover, it allows states to make informed decisions, administer their international commitments and be fully aware of the arguments that may succeed or fail in the context of arbitration. The aim of this chapter is to assess the potential for coherence within the network of bilateral investment treaties. This will be done by addressing the contribution of the MFN clause and the investor-state dispute settlement mechanism to reduce and/or increase overall coherence. However,
the study will be limited to the impact of these provisions on coherence without going into depth regarding the role of each one, as this could be a subject of a separate thesis.

2. Coherence through the Application of MFN Clause

Despite some variations, the MFN clauses in bilateral investment treaties are reciprocal, unconditional and indeterminate.\(^{718}\) These clauses oblige member states to treat investments and investors in regard to a given subject matter ‘no less favourably’ than an investor or investment from any third party.\(^{719}\) Accordingly, an investor covered by a bilateral investment treaty that includes an MFN clause (referred to as a basic treaty) can invoke more favourable provisions provided for a third-party national by another bilateral investment treaty to which the host state is party. As promising as this may sound, the amount of coherence in this respect relies heavily on the possibility to import from third parties’ allegedly benefits and accordingly derogate from or modify the basic treaty. The analysis below will provide an understating as to when the application of an MFN clause provides positive constraints as well as negative constraints.

2.1. Positive Constraints

The positive constraints include cases whereby the MFN clause has succeeded to increase coherence between bilateral investment treaties. This is featured in arbitral awards, according to which the tribunal treated bilateral investment treaties signed by the same host state in a consistent manner. The following are examples of such scenarios.

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\(^{719}\) The ILC has provided a definition for an MFN clause as a ‘treatment accorded by the granting State to the beneficiary State, or to persons or things in a determined relationship with that State, not less favourable than treatment extended by the granting State or to a third State or to persons or things in the same relationship with that third State’, Article 5 of the Draft Articles on Most-Favoured-Nation Clauses, in *Yearbook of the International Law Commission*, 1978, Vol. II, Part Two, at 21. See also OECD, 'Most-Favoured-Nation Treatment in International Investment Law', *op. cit.*
2.1.1. Importing ‘More Favourable’ Substantive Protection Standards

Using the MFN clause to import more favourable substantive provisions from third party bilateral investment treaties is firmly accepted. In the first known claim under a bilateral investment treaty, the tribunal in *Asian Agricultural Products v. Sri Lanka* did not rule out the general proposition that an investor covered by the basic treaty could rely on more favourable substantive provisions granted in another bilateral investment treaty to which the host state is party. Later on, the extension of substantive rights by means of an MFN clause was largely uncontested in *Pope & Talbot v. Canada*, *MTD v. Chile*, *Rumeli Telekom v. Kazakhstan* and *ADF v. United States*.

Moreover, some awards have referred to provisions in third party treaties to clarify the meaning of words used in the basic treaty. A good example is found in the *CME v. Czech Republic* case whereby the tribunal interpreted the phrase ‘just compensation’ used in the expropriation clause in the Czech Republic and Netherlands bilateral investment treaty to mean the same as the ‘fair market value’ referred to in the Czech Republic and United States of America bilateral investment treaty.

The MFN clause can also be used to import more favourable substantive protections which are not present in the basic treaty. This was applied by the tribunal in *Bayindir v. Pakistan* which decided that the obligation to afford ‘fair and equitable treatment’ could be read into the basic treaty, the Pakistan-Turkey BIT (1995), despite such a clause being absent from this

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724 *ADF Group Inc. v. The United States of America*, Award, 9 January 2003.
725 UNCTAD, ‘Most-Favoured-Nation Treatment’, at 59.
726 See *CME Czech Republic B.V. v. The Czech Republic*, UNCITRAL, Final Award, 14 March 2003.
727 UNCTAD, ‘Most-Favoured-Nation Treatment’, *op. cit.*, at 60.
treaty. In this case, Pakistan did not dispute the claimant’s assertion that it had signed several bilateral investment treaties with other countries including an ‘explicit fair and equitable treatment clause’ and therefore the tribunal concluded that under the circumstances and for the purpose of assessing jurisdiction ‘prima facie, Pakistan was bound to treat investments of Turkish nationals fairly and equitably’. Thus, in this respect the MFN clause contributes to enhancing coherence within bilateral investment treaties and harmonises the protection of foreign investment in a specific host state.

2.1.2. Importing Procedural Provisions Concerning Admissibility

The application of the MFN clause is not limited to the substantive rights of investors. In some cases the claimants have invoked the MFN clause to encompass more favourable conditions related to the dispute settlement mechanism under bilateral investment treaties. In, for example, Maffezini v. Spain the tribunal held that, by means of the MFN clause, the claimant could rely on more favourable conditions in Spain’s third party bilateral investment treaties. This allowed the initiation of investor-state arbitration more quickly and therefore the claimant was not bound by the longer waiting period contained in the basic treaty. The same issue arose in a number of cases against The Argentine Republic due to it signing bilateral investment treaties with a mandatory waiting period of 18 months before claims can be brought to international arbitration and others which do not include such a provision. Hence, extending MFN clauses to questions of admissibility of investor-state claims has been accepted in most arbitral jurisprudence.

728 See Bayindir Insaat Turizm Ticaret Ve Sanayi AS v. Islamic Republic of Pakistan, ICSID Case No. ARB/03/29, Decision on Jurisdiction, 14 November 2005, paras. 227-235.
729 Ibid, para. 232.
731 Emilio Agustin Maffezini v. The Kingdom of Spain, Decision of the Tribunal on Objections to Jurisdiction of January 25, 2000, para. 38.
2.2. Negative Constraints

The negative constraints are characterised as cases whereby the application failed to be broad enough to contribute to coherence. Moreover, these constraints also include awards that have not provided clear guidance vis-a-vis the application of MFN clauses. Rather, they have generated contradictory decisions and different conceptual understating on how the MFN treatment operates.

2.2.1. Applying MFN to Eliminate Provisions of the Basic Treaty

In some cases claimants have tried to eliminate non-beneficial provisions included in the basic treaty by arguing that these provisions are not contained in a third-party treaty. In the case of CMS v. Argentina, the claimant sought to avoid the application of the emergency exception clause contained in the basic treaty between the United States of America and The Argentine Republic. However, the tribunal concluded:

‘Thus, had other Article XI type clauses envisioned in those treaties a treatment more favourable to the investor, the argument about operation of the MFNC might have been made. However, the mere absence of such provision in other treaties does not lend support to this argument, which would in any event fail under the ejusdem generis rule, as rightly argued by the Respondent’.  

2.2.2. Treatment Subject to ‘Like Circumstance’ or ‘Like Situations’

The application of the MFN clause is limited to treating foreign investors equally as long as they are in ‘like circumstances’ or ‘like situations’. In other words, this clause does not mean that foreign investors should be treated equally irrespective of their activities or
circumstances, but rather, different treatment is justified if they were in different objective situations. In this respect, there are few arbitration cases dealing with the actual comparison between the treatment granted to two foreign investors in the same host state in given circumstances. However, two recent arbitral awards have considered this matter.

In the case of *Parkerings v. Lithuania*, the tribunal held that it is necessary to establish a comparison between two investors in like circumstances. The tribunal then proceed to use the test of the ‘same economic or business sector’ and further assessed any policy or purpose behind the measure that could amount to a violation of the MFN clause. Although the relevant comparators in this case were engaged in similar activities, the tribunal concluded that they were in different circumstances due to the different characteristics reflected in their offers and proposed projects. Thus, the tribunal established that the similarity and hence the comparability between two foreign investors should not stop at being in the same economic sector, but must also include the characteristics of their respective project proposals.

Similarly, in *Bayindir v. Pakistan*, the tribunal examined the comparability between the foreign investors at the level of the contractual terms and circumstances. Nevertheless, the tribunal found itself in no position to proceed to a meaningful comparison given the lack of

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739 The tribunal held that ‘The essential condition of the violation of a MFN clause is the existence of a different treatment accorded to another foreign investor in a similar situation. Therefore, a comparison is necessary with an investor in like circumstances.’ *Parkerings-Compagniet AS v. Republic of Lithuania*, ICSID Case No. ARB/05/8, Award, 11 September 2007, paras. 368-369.
740 Ibid, para. 371.
741 In this respect the tribunal states that ‘despite similarities in objective and venue, the Tribunal has concluded, on balance, that the differences of size of Pinus Proprius and BP’s projects, as well as the significant extension of the latter into the Old Town near the Cathedral area, are important enough to determine that the two investors were not in like circumstances... Thus the City of Vilnius did have legitimate grounds to distinguish between the two projects. Indeed, the refusal by the Municipality of Vilnius to authorize BP’s project in Gedimino was justified by various concerns, especially in terms of historical and archaeological preservations and environmental protection’, ibid, para. 369.
data on the terms and performance of the contracts involved.\textsuperscript{743} Thus, it concluded that no sufficient arguments were evident to substantiate a violation of the MFN clause.\textsuperscript{744}

In practice, the comparison test seems to have worked differently depending on what claimants were seeking to achieve from implementing the MFN clause.\textsuperscript{745} To illustrate, when claimants were asking for better material or effective treatment, such as within the aforementioned claims, tribunals were satisfied in comparing two investors in identical circumstances.\textsuperscript{746} On the other hand, when claimants have referred to the MFN clause to import benefits from third treaties, tribunals have looked at the mere fact that the claimant qualifies as an ‘investor’ according to the basic treaty and were not concerned with actually comparing investors with another foreign investor from a third country.\textsuperscript{747} Therefore, arbitral awards provide little guidance on how the comparison should be made. As a result, coherence is negatively affected by the uncertainty surrounding this area of MFN clauses, which also leaves both states and foreign investors unaware of the arguments that may fail or succeed.

2.2.3. Importing Procedural Provisions Concerning Jurisdiction

Under this category, a number of cases have rejected extending the MFN clause to cover the jurisdictional requirements of bilateral investment treaties.\textsuperscript{748} In this respect it was doubted that the contracting states have intended to import the arbitration provisions of a third party

\textsuperscript{741} In this respect the tribunal states its findings as follows:

\textit{The Tribunal is in no position to proceed to any meaningful comparison between the different situations at issue. To do so it would have needed sufficiently specific data on the terms and the performance of the different contracts involved.}

\textsuperscript{743} Ibid, para. 417.
\textsuperscript{744} Ibid, para. 418.
\textsuperscript{745} UNCTAD, \textit{Most-Favoured-Nation Treatment}, \textit{op. cit.}, at 63.
\textsuperscript{746} Ibid.
\textsuperscript{747} UNCTAD, \textit{Most-Favoured-Nation Treatment}, \textit{op. cit.}, at 64.
agreement without explicitly referring to such an intention.\textsuperscript{749} For example, the case of \textit{Palama v. Bulgaria} concerned an arbitration clause in the basic treaty which only provided for ad hoc arbitration in relation to the amount of compensation, while other host state bilateral investment treaties provided for more comprehensive investor-state arbitration.\textsuperscript{750} The tribunal concluded that in order to benefit from broader dispute settlement provisions in subsequent bilateral investment treaties, the MFN clause needed to encompass investor-state dispute settlement explicitly.\textsuperscript{751}

Nonetheless, it is noteworthy that this matter generated contradictory arbitral awards. The establishment of jurisdiction by incorporation by reference through an MFN clause was accepted by the tribunal in \textit{RosInvestCo v. Russian Federation}.\textsuperscript{752} In this case the tribunal agreed to extend the scope of jurisdiction through an MFN clause and stated that this ‘\textit{was a normal result of the application of the MFN clause}’.\textsuperscript{753} More recently, in \textit{Renta v. Russian Federation}, the tribunal addressed the same issue and held that

‘it is not convincing for a State to argue in general terms that it accepted a particular system of arbitration with respect to national of one country but did not so consent with respect to nationals of another. The extension of commitments is the very nature of the MFN clause. Drafters wishing to do so would have little difficulty in defining restrictions that would go further than the \textit{ejusdem generis} constraint...’\textsuperscript{754}

\textsuperscript{749} UNCTAD, ‘Most-Favoured-Nation Treatment’, \textit{op. cit.}, at 73.

\textsuperscript{750} See \textit{Plama Consortium Limited v. Republic of Bulgaria}, ICSID Case No. ARB/03/04, Decision on Jurisdiction, 8 February 2005.

\textsuperscript{751} The tribunal emphasised that ‘the reference must be such that the parties’ intention to import the arbitration provision of the other agreement is clear and unambiguous’, ibid, para. 200.


\textsuperscript{753} Ibid, para. 131.

The existence of contradictory awards goes against the potential of achieving coherence through the application of MFN clause. This raises uncertainty amongst states and investors as a result of inconsistency and lack of support between arbitral awards addressing the same issue. The lack of understanding on the how the MFN treatment operates is a major hurdle to increasing coherence within bilateral investment treaties.

In conclusion, MFN clauses have a significant effect in increasing coherence between bilateral investment treaties. They contribute to providing a level playing field for relations between the host state and various home states with whom the bilateral investment treaties are concluded and, therefore, they also push bilateral investment treaties towards coherence. They form an essential part of the process of increasing coherence by reducing leeway for specialities that may occur in bilateral investment treaties. However, unless arbitral awards provide more guidance and fewer contradictory decisions in relation to the application of the MFN clauses, the MFN provisions will not reach their full potential of ensuring coherence and countering fragmentation in bilateral investment treaties.

3. Coherence in Investor-State Dispute Resolution

Traditionally, international law allowed states, via their bargaining powers, to negotiate the consequences of breaches vis-a-vis their international obligations including those they had toward foreign investors in their territories.\textsuperscript{755} By contrast, the dispute settlement mechanism available in bilateral investment treaties ensures the ability of foreign investors to enforce the provisions of these treaties against host states independently of their home state’s relative power.\textsuperscript{756} This contributes to coherence within bilateral investment treaties by ensuring that


the general and uniform principles of these treaties are enforced and by removing the power of states to negotiate the possibility of departing from their treaty obligations.

Additionally, most bilateral investment treaty disputes are governed by the ICSID Convention which constitutes a multilateral convention. This adds to the coherence of these treaties by subjecting investor-state disputes to the same procedural rules and guaranteeing equality amongst investors from different home states. Moreover, it provides for the international recognition of arbitral awards as final and binding in all of the Member States of the ICSID Convention. However, incoherence is evident due to the fact that arbitral awards feature high levels of conflicting and inconsistent views. The incoherence of these decisions can be explained in light of the following aspects.

3.1. Multiplicity of Sources and Proceedings
The incoherence in the decisions in investment treaty arbitration can result from the multiplicity of sources as well as proceedings in respect to bilateral investment treaties. To illustrate, the large number of bilateral investment treaties may lead to the same state measure being assessed differently under two existing investment treaties. In addition, due to the broad definition of ‘investor’ and ‘investment’, multiple proceedings concerning identical sets of facts may arise from independent claims at different levels. This, for example, resulted in having conflicting decisions made by two tribunals in CME v. Czech Republic and Lauder v. Czech Republic. In this case some measures adopted by the Czech Republic against a locally incorporated media company ended in proceedings before two investment

757 225 disputes of the 357 known disputes are filed with the ICSID or under the ICSID Additional Facility, UNCTAD, ‘Latest Developments in Investor-State Dispute Settlement’, (New York, Geneva: United Nations, 2010a) at 2.
758 See Article 54 of the ICSID Convention.
tribunals under two different bilateral investment treaties.\textsuperscript{762} One claim was initiated by CME, who is the direct shareholder of the locally incorporated company, and the other by Mr. Lauder who is the controlling shareholder of CME. The tribunals reached two different decisions. The tribunal in CME found that the government’s measures amounted to a violation of several provisions of the Dutch-Czech bilateral investment treaty and ordered the Czech Republic to pay damages,\textsuperscript{763} whereas the tribunal in Lauder found a minor breach of the United States-Czech BIT and decided not to order damages due to remoteness.\textsuperscript{764}

3.2. The Dispute Settlement Mechanism

The institutional design of dispute settlement in bilateral investment treaties is based on \textit{ad hoc} arbitration.\textsuperscript{765} This in itself is a threat to coherence within bilateral investment treaties as arbitral tribunals coexist without hierarchy, along with not being subject to appeal or any form of external control by a supervisory body.\textsuperscript{766} Additionally, the principle of arbitral precedent is not followed in investment treaty arbitration.\textsuperscript{767} Rather, tribunals are free to adopt rulings that significantly depart from prior decisions by other tribunals.

Incoherence in investment treaty arbitration is likely to occur when different tribunals reach different assessments of law and facts. Two tribunals may, for example, agree on the meaning of the fair and equitable treatment standard in international investment law, but disagree on whether the prevailing circumstances actually qualify as a breach of such a standard. Thus, tribunals may disagree on the interpretation of the same provision in the same bilateral investment treaty. For example, the tribunals in \textit{CME v. Argentina} and \textit{LG&E v. Argentina} reached different conclusions in applying the element of necessity as stated in the United

\begin{footnotes}
\item[763] \textit{CME Czech Republic B.V. v. The Czech Republic}, Final Award of March 14, 2003.
\item[764] \textit{Lauder v. Czech Republic}, Final Award of September 3, 2001, para. 235.
\item[765] See Dolzer and Schreuer, \textit{Principles of International Investment Law}, op. cit..
\end{footnotes}
States-Argentina bilateral investment treaty, because they assumed a different legal relationship between necessity under customary international law and a specific emergency clause in the relevant treaty.\footnote{S. Schill, ‘International Investment Law and the Host State's Power to Handle Economic Crises’, Journal of International Arbitration, 24/3 (2007), 256-86.}

Moreover, incoherence may result from tribunals adopting conflicting views regarding the construction of comparable treaty provisions in different treaties. That was in the case in \textit{SGS v. Philippines},\footnote{\textit{SGS Societe Generale de Surveillance S.A. v. Republic of Philippines,} ICSID Case No. ARB/02/6, Decision on Jurisdiction, 29 January 2004.} whereby the tribunal concluded that a provision in the Swiss-Philippine bilateral investment treaty constituted an umbrella clause and allowed the investor to bring contractual claims under the relevant treaty. However, the tribunal in \textit{SGS v. Pakistan}\footnote{\textit{SGS Societe Generale de Surveillance S.A. v. Islamic Republic of Pakistan,} ICSID Case No. ARB/01/13, Decision on Jurisdiction, 6 August 2003.} rejected such an effect to a similar provision included in the Swiss-Pakistani bilateral investment treaty.

In sum, the institutional structure of investor-state dispute settlements needs to undergo major reform in order to overcome the persistent potential for continuous fragmentation and lack of coherence. Unless some sort of internal and/or external control mechanisms are introduced to ensure hierarchy and consistency among investment tribunals, the coherence of jurisprudence in the realm of bilateral investment treaties will remain threatened.

\textbf{4. Conclusion}

Bilateral investment treaties create mutual obligations and rights and govern state behaviour on a bilateral basis. This makes achieving coherence more challenging. However, there is potential for coherence within these treaties through the MFN clause and investor-state dispute settlement procedure. The impact of MFN clauses on the overall coherence of
bilateral investment treaties is divided into positive and negative constraints. The positive constraints include importing ‘more favourable’ substantial protection procedures along with importing procedural provisions concerning admissibility. These positive constraints ensure better coherence within the network of such treaties. On the contrary, the negative constraints embodied in applying MFN clauses to eliminate provisions of the basic treaty, limiting the application of such clauses to ‘like circumstances’ or ‘like situations’ and importing procedural provisions concerning jurisdiction hinder achieving coherence through such clauses.

As for coherence through investor-state dispute resolution, more negative constraints rather than positive constraints are found. Although the rules for investment arbitration contribute to treaties’ coherence by creating a level playing field for the settlement of investment disputes and the enforcement of substantive investment protection, a number of issues stand between these provisions and attaining better coherence. These include the multiplicity of sources and proceedings as well as the institutional design of the dispute settlement mechanism. Thus, unless the negative constraints are overcome, coherence through dispute resolution will remain minimal.
Chapter 6

Coherence between Bilateral Investment Treaties and Customary International Law

1. Introduction

A controversial debate always accompanied the question of whether legal protection for foreign investors under customary international law had ever existed. No international consensus emerged on the protection of foreign investors due to the traditional clash between developed and developing countries. It is evident that the evolution of customary international law on foreign investment did not reflect the expansion and growth of foreign investment activities. Due to the uncertainty of the customary rules available to foreign investors, states resorted to concluding ad hoc bilateral investment treaties. During that time, uncertainty surrounded the legal protection available for foreign investors under custom.

Bilateral investment treaties are viewed as tools which influence and enhance customary rules related to foreign investment. Others argue that the sweeping practice of these treaties puts them in the category of customary international law. The aim of this chapter is to apply the test of coherence to the relationship between bilateral investment treaties and customary international law. In doing so, it will answer the question of whether the expansion of

772 Ibid.
773 'Considering the important developments of the last half-century, the growth of foreign investments and the expansion of international activities of corporations, in particular of holding companies, which are often multinational, and considering the way in which the economic interests of states have proliferated, it may at first sight appear surprising that the evolution of the law has not gone further and that no generally accepted rules in the matter have crystallized on the international plane', Barcelona Traction, Light and Power Co., Ltd. (Belgium v. Spain), I.C.J., (5 February 1970), para 89.
775 See Congyan, 'International Investment Treaties and the Formation, Application and Transformation of Customary International Law Rules', op. cit...
bilateral investment treaties is sufficient to consider their provisions as customary international law. In this respect it will look at how each argument fits with the coherence of bilateral investment treaties.

The chapter starts first by briefly discussing customary international law in the field of foreign investment and how it relates to bilateral investment treaties. The next section surveys the coherence of the view that the customary rules correspond to the total sum of bilateral investment treaties. It then proceeds to provide an analysis as to how coherent it is to say that these treaties enhance customary international rules for foreign investment protection.

2. Customary International Law

Despite the early lack of consensus, it is undeniable that some principles of customary international law on foreign investment have been established. For example, the obligation imposed on host states to provide foreign investors with a 'minimum standard of treatment' is a customary norm.\textsuperscript{777} Another example is the set of conditions for lawful expropriation.\textsuperscript{778}

The existence of an international minimum standard for the treatment of foreign investment including its meaning and scope has been frequently challenged.\textsuperscript{779} The international minimum standard is a norm of international law concerned with the treatment of foreign investors.\textsuperscript{780} For developed countries, the establishment of an international standard was


\textsuperscript{778} Generation Ukraine, Inc v. Ukraine, ICSID Award (Sept. 16, 2003), para 11.3, as the tribunal states that 'it is plain that several of the BIT standards, and the prohibition against expropriation in particular, are simply a conventional codification of standards that have long existed in customary international law'. See also OECD, "Indirect Expropriation" and the "Right to Regulate" in International Investment Law', op. cit., at 3. And C. Maclachlan, L. Shore, and M. Weiniger, \textit{International Investment Arbitration: Substantive Principles} (Oxford: Oxford University Press, 2007) at 16.


\textsuperscript{780} 'The International Minimum standard is a norm of customary international law which governs the treatment of aliens, by providing for a minimum set of principles which states, regardless of their domestic legislation and practices, must respect when dealing with foreign national and their property', OECD, 'Fair and Equitable Treatment Standard in International Investment Law', op. cit., at 8.
necessary in order to provide their citizens who invest abroad with satisfactory protection.\textsuperscript{781} The standard serves to set out principles which states should respect when dealing with foreign nationals and their property.\textsuperscript{782} These principles include a number of basic rights derived from international law which states must grant to foreigners regardless of their domestic legislation.\textsuperscript{783} In case of violation, the host state would face international responsibility and the foreigners' rights may be enforced by diplomatic protection.\textsuperscript{784}

In relation to the meaning of the minimum standard of treatment, Roth defines it as ‘\textit{nothing else than a set of rules, correlated to each other and deriving from one particular norm of general international law, namely that the treatment of aliens is regulated by the law of nations}’.\textsuperscript{785} Other scholars define the minimum standard of treatment in terms of comparison between it and national treatment.\textsuperscript{786} In this regard, Brownlie explains that the international minimum standard is a moral standard for civilised countries as opposed to the principle of national treatment.\textsuperscript{787}

The international minimum standard imposes a general obligation on host states to exercise due diligence when protecting foreign investors, rather than creating a 'strict liability' on states.\textsuperscript{788} According to case law, the standard's application includes the notion of denial of justice and the administration of justice in cases where foreign nationals are involved.\textsuperscript{789} In

\textsuperscript{781} Ibid.
\textsuperscript{782} Ibid.
\textsuperscript{783} \textquoteleft While the principle of national treatment foresees that aliens can only expect equality of treatment with national, the international minimum standard sets a number of basic rights established by international law that States must grant to aliens, independent of the treatment accorded to their own citizens', ibid.
\textsuperscript{784} \textquoteleft Violation of this norm engenders the international responsibility of the host State and may open the way for international action on behalf of the injured alien provided that the alien has exhausted local remedies', ibid.
\textsuperscript{785} Roth, \textit{The Minimum Standard of International Law Applied to Aliens}, op. cit., at 127.
\textsuperscript{786} Tudor, \textit{The Fair and Equitable Treatment Standard in The International Law of Foreign Investment}, op. cit., at 61.
\textsuperscript{788} Strict liability would render a host state liable for any damages caused to foreign investors even if caused by persons whose acts could not be attributed to the state. See Dolzer and Stevens, \textit{Bilateral Investment Treaties}, at Chapter 2.
\textsuperscript{789} See USA (Janes) v United Mexican States, Award rendered in 1926, IV RIAA 82.
In this respect it also governs the treatment of foreigners under detention.\textsuperscript{790} This treatment should be based on providing full protection and security which requires host states to adopt all reasonable measures to physically protect foreigners and their property.\textsuperscript{791}

In order to better understand the concept of the minimum standard of treatment, reference is made to some cases where the standard has been thoroughly analysed. First, there is the Neer case which became the landmark case for the international minimum standard.\textsuperscript{792} Although the case did not concern an investment dispute but the murder of an American citizen, the Commission explained the concept of the standard as follows:

\textit{`The propriety of government acts should be put to the test of international standards ... the treatment of an alien, in order to constitute an international delinquency should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency. Whether the insufficiency proceeds from the deficient execution of a reasonable law or from the fact that the laws of the country do not empower the authorities to measure up to international standards is immaterial.'}\textsuperscript{793}

From the above, it is clear that the Commission has established a very high threshold for the violation of the international minimum standard. The same evaluation, whereby every reasonable and impartial man would readily recognise outrage, was applied in Roberts’

\textsuperscript{790} See USA (Harry Roberts) v. United Mexican States, The Mexican–United States General Claims Commission, Award rendered in 1926, IV RIAA 77 (1927).
\textsuperscript{791} During the early years the idea of minimum standard was linked to the protection of the life and liberty of foreigners, later it evolved to cover their property and investment. A. Mussi, 'International Minimum Standard of Treatment', at 3, available at \url{http://asadip.files.wordpress.com/2008/09/mst.pdf}.
\textsuperscript{792} See USA (LF Neer) v United Mexican States, The Mexican–United States General Claims Commission, Award rendered on 15 October 1926, reprinted in \textit{American Journal of International Law}, 21 (1927), 555.
\textsuperscript{793} Ibid.
As an illustration for the application of the international minimum standard, the Commission emphasised that the standard does not provide for equality of treatment of foreigners with nationals, but treatment of foreigners ‘in accordance with ordinary standards of civilization’. 795

Accordingly, national treatment was not an option for the capital exporting countries which were not satisfied with the political and legal system of the uncivilized countries. 796 Capital exporting countries and investors were calling for a minimum standard under which international law and diplomatic protection would come to their defence. As a result of the persisting differences of approaches between developed and developing countries there was no broad international consensus on the existence of customary protection for foreign investors. 797 The lack of consensus prevented the development and crystallisation of rules of customary international investment law. The International Court of Justice drew the same conclusion in the well known Barcelona Traction case by stating the following:

‘Considering the important developments of the last half-century, the growth of foreign investment and the expansion of international activities of corporations, in particular of holding companies, which are often multinational, and considering the way in which the economic interests of states have proliferated, it may at first sight appear surprising that the evolution of the law has not gone further and that no generally accepted rules in the matter have crystallized on the international plane.’ 798

794 USA (Harry Roberts) v United Mexican States, The Mexican-United States General Claims Commission, Award rendered in 1926, IV RIAA 77 (1927).
795 Ibid, at 104-105.
796 The distinction between civilized and uncivilized countries was fundamental to the positivist international law project of the European sovereign states in the 19th Century. See A. Angie, ‘Finding the Peripheries: Sovereignty and Colonialism in the Nineteenth-Century International Law’, Harvard International Law Journal, 40/1 (1999a), 1-71 at 22-34.
The dispute over the recognition and importance of an international customary law which demands a minimum standard of treatment for foreign investors evolved with the emergence of Friendship, Commerce and Navigation treaties and later the appearance of bilateral investment treaties.\(^{799}\) As a result, an overlap between customary and conventional law emerged. Customary international law continues to play an important role due to a number of reasons. First, bilateral investment treaties are not global; although the number of these treaties has increased rapidly they cover only certain bilateral relations within the international sphere.\(^{800}\) Second, customary international law is important not only because it can be used as a legal basis of investment claims, but also as applicable law to disputes over claims stemming from other legal sources.\(^{801}\) Finally, customary international law frequently interacts with bilateral investment rules. However, such relationship is not limited to the interaction between treaties and customary law, but also includes the influence exercised by these treaties on customary international law. By dividing this relationship into interaction and influence, the following analysis will address the level of coherence in regard to both.

3. The Influence of Bilateral Investment Treaties on Customary International Law

As argued by Dolzer and Schreuer, during the nineties ‘the tide had turned’ and capital importing countries were no longer opposed to the application of custom, but instead by concluding bilateral investment treaties they granted ‘more protection to foreign investment than traditional customary law did, now on the basis of treaties negotiated to attract additional foreign investment’.\(^{802}\) The controversial issue currently being debated amongst academics and arbitrators concerns the impact that bilateral investment treaties have on the

\(^{801}\) Article 31(3)(c) of the Vienna Convention on the Law of Treaties recognises that international treaties must be interpreted while taking into account ‘any relevant rules of international law applicable in the relations between the parties’. Accordingly customary international law is part of the applicable law.
\(^{802}\) Dolzer and Schreuer, Principles of International Investment Law, op. cit., at 16.
existence and the content of custom. More specifically, the question is whether these treaties represent the 'new' custom in this field. In this respect, coherence can be considered as a useful tool to determine whether bilateral investment treaties should be regarded as the new customary rules governing international investment law or not. To do so, the following analysis will address both the positive and negative constraints to evaluate which argument prevails.

3.1. Positive Constraints
The positive constraints embody the arguments which are consistent with and supportive to the idea that bilateral investment treaties formulate the new customary rules. The position of Judge Schwebel is a good starting point to examine this view. He claims that 'customary international law governing the treatment of foreign investment has been reshaped to embody the principles of law found in more than two thousand concordant bilateral investment treaties'. The same approach was adopted by the CME Tribunal, in which Schwebel acted as an arbitrator, as they concluded that bilateral investment treaties 'reshaped the body of customary international law'. In support of the same view the Mondev tribunal also decided that the content of current international investment law was 'reshaped by the conclusion of more than two thousand bilateral investment treaties and many treaties of friendship and commerce'.

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806 Mondev International Ltd. v. United States, ICSID Case No ARB(AF)/99/2 2002, at para 125.
The same position was adopted by some authors. Larid argues that the development of international investment law has reached a point where we are seriously required to consider bilateral investment treaties as reflective of the development of what he called 'new' customary international law.\(^{807}\) Apparently, the 'new' custom consists of the more than 2,800 bilateral investment treaties concluded by states.\(^{808}\) This view has been further explained by Lowenfeld as he believes that ‘taken together, the [bilateral investment treaties] are now evidence of customary international law, applicable even when a given situation or controversy is not explicitly governed by a treaty’.\(^{809}\) In this respect they assert that the provisions of bilateral investment treaties are the customary international rules governing foreign investment.\(^{810}\)

### 3.2. Negative Constraints

The aforementioned view is strongly opposed by a number of arguments which suggest that customary international investment law does not correspond to bilateral investment treaties. These arguments constitute the negative constraints and they are as follows.

#### 3.2.1. Quantity is Irrelevant

Identifying customary rules of international investment law is a complicated exercise.\(^{811}\) However, what is clear about it is that the identification cannot be a ‘mechanical exercise based on mere quantitative considerations’\(^{812}\). Thus, the existence of numerous treaties on one subject matter does not indicate that much and deciding whether new customary rules are

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\(^{807}\) Larid, 'A Community of Destiny: The Barcelona Traction Case and the Development of Shareholder Rights to Bring Investment Claims', *op. cit.*.


\(^{810}\) As explained by Schwebel ‘when BITs prescribe treating the foreign investor in accordance with customary international law, they should be understood to mean the standard of international law embodied in the terms of some two thousand concordant BITs’. Schwebel, 'Investor-State Disputes and the Development of International Law: The Influence of Bilateral Investment Treaties on Customary International Law', *op. cit.*, at 29-30.

\(^{811}\) Mondev tribunal states that ‘it is often difficult in international practice to establish at what point obligations accepted in treaties, multilateral or bilateral, come to condition the content of a rule of customary international law binding on States not party to those treaties’, Mondev International Ltd. v. United States, ICSID Case No ARB(AF)/99/2 2002, at para 111.

created cannot be done by simply adding up the number of treaties.\textsuperscript{813} The same conclusion was reached by the ADF tribunal whereby they decided that ‘we are convinced that the Investor has shown existence, in current customary international law, of a general and autonomous requirement (autonomous, that is, from specific rules addressing particular, limited contexts) to accord fair and equitable treatment and full protection and security to foreign investment. The Investor, for instance, has shown that such a requirement has been brought into the corpus of present day customary international law by the many hundreds of bilateral investment treaties now extant’.\textsuperscript{814}

In addition, the total sum of bilateral investment treaties cannot be assessed globally as a single instrument. That is because these treaties to a great extent vary in form. For example, the bilateral investment treaty entered into by Canada with Poland and Hungary which consists of 10 pages cannot be compared to the bilateral investment treaty that Canada concluded 15 years later with Peru which consists of a much more comprehensive 104 pages.\textsuperscript{815} The same can be said about recent bilateral investment treaties entered into by Germany as they cannot be compared to the earlier ones which used to provide only for State-to-State dispute resolution.\textsuperscript{816}

Accordingly, the proposition that customary international law is embodied in the bilateral investment treaties is circular. As explained by Schwebel, whenever an investment treaty states that foreign investors should be treated in accordance with customary international law,

\textsuperscript{813} Faruque, 'Creating Customary International Law through Bilateral Investment Treaties: A Critical Appraisal', \textit{op. cit.}, at 300. Also as further explained by McLachlan ‘the mere prevalence of similarly worded treaty language, however numerous, will not, without more, give rise to a binding obligation in custom’, McLachlan, Shore, and Weiniger, \textit{International Investment Arbitration: Substantive Principles}, \textit{op. cit.}, at 400.

\textsuperscript{814} ADF Group Inc. V. United States, ICSID Case No ARB(AF)/00/1 2003, at para 183.


\textsuperscript{816} An example is the bilateral investment treaty entered into with Malaysia in 1960.
this means that the standard of international law rests in the terms of some two thousand bilateral investment treaties.\footnote{Schwebel, ‘Investor-State Disputes and the Development of International Law: The Influence of Bilateral Investment Treaties on Customary International Law’, op. cit., at 29-30.} Under this interpretation, finding out the exact meaning of a customary rule as referred to in an investment treaty requires taking into consideration all bilateral investment treaties. For that reason, determining the content of custom does not sound practical or helpful. In turn this may be considered a reasonable ground for regarding such a view as incoherent.

3.2.2. The Absence of two Necessary Elements of Custom

The main negative constraint in regarding bilateral investment treaties as equivalent to any such new custom is the failure to meet the definition of customary international law. For a rule to constitute custom, two fundamental elements should be met: 1) a ‘constant and uniform’ practice of States in their international relation and 2) to believe that such practice is required by law.\footnote{This double requirement is a well established principle of international law, see International Law Association (ILA), ‘Statement of Principles Applicable to the Formation of General Customary International Law’, Final Report (2000). It can also be found in the context of investor-state arbitration, see for example the UPS Tribunal which states that ‘to establish a rule of customary international law, two requirements must be met: consistent state practice and an understanding that the practice is required by law’, United Parcel Service v. Canada, Dec. Jurisdiction, UNCTRAL of Nov. 22 2002, at para 84. It is also noteworthy to highlight that the same requirements are expressly referred to in bilateral investment treaties based on the United States Model BIT, such as the U.S.-Uruguay BIT (2005) and the U.S.-Rwanda BIT (2008). The U.S. Model BIT 2004 expressly stipulates that ‘The Parties confirm their shared understanding that `customary international law’ generally and as specifically referenced in Article 5 [Minimum Standard of Treatment] and Annex B [Expropriation] results from a general and consistent practice of States that they follow from a sense of legal obligation’.
} The recent work of the International Law Association (ILA) on customary international law explains how there is no such presumption that concluding similar treaty provisions should give rise to a new customary rule with the same content.\footnote{Principle no. 25 adopted by the International Law Association (ILA), ‘Statement of Principles Applicable to the Formation of General Customary International Law’, Final Report (2000) at 47.}

Moreover, the ILA specifically addresses the question of the impact of bilateral investment treaties on custom and concludes the following:

“The question of the legal effect of a succession of similar or treaty provisions arises particularly in relation to bilateral treaties, such as those dealing with extradition or investment protection... There seems to be no
reason of principle why these agreements however numerous, should be presumed to give rise to new rules of customary international law or to constitute the State practice necessary for their emergence... some have argued that provisions of bilateral investment protection treaties (especially the arrangements about compensation or damages for expropriation) are declaratory of, or have come to constitute, customary law. But ... there seems to be no special reason to assume that this is the case, unless it can be shown that these provisions demonstrate a widespread acceptance of the rules set out in these treaties outside the treaty framework."  

In the context of bilateral investment treaties, it is true that they are rapidly increasing. However, this increase does not satisfy the first basic requirement of custom which is consistent state practice as such treaties are very diverse in their content and scope.  

Certainly, these treaties are not consistent enough to constitute the basis for any customary international rule. The lack of consistent state practice can be found in relation to the following issues: the definition of investment, foreign investment admission rules, national treatment and most-favoured-nation treatment, compensation as a result of expropriation and dispute settlement mechanisms.

821 As explained by the ICJ in the North Sea Continental Shelf Case state practice must be ‘both extensive and virtually uniform’ for a rule of customary international law to emerge, see North Sea Continental Shelf Cases (Germany v. Denmark) 1969 ICJ at para 75.
822 This position is adopted by Canada in NAFTA arbitration proceedings which shows that ‘Even amongst the BITs, no consistent practice can be found. The variation in terms, and specifically the differences in the scope and nature of access to international arbitration makes it impossible to find a consistent practice. Without such a consistent practice there can be no customary norm’.
In addition, it is obvious that bilateral investment treaties lack any *opinio juris*. The repetition of common clauses in these treaties does not reflect that the rules in these clauses are considered obligatory. In fact, studies suggest that states base their decisions to enter into bilateral investment treaties solely on their economic interest. It is somehow agreed that investment treaties offer greater protection to foreign investors than that under custom and, therefore, states enter into such treaties to have an advantage while competing for foreign investment. In this regard Guzman convincingly concludes that it is "simply not possible to explain the paradoxical behaviour of [less developed countries] toward foreign investment based on a view that BITs reflect *opinio juris*" because these treaties "do not reflect a sense of legal obligation but are rather the result of countries using the international tools at their disposal to pursue their economic interest".

3.3. Conclusion

From addressing the positive and negative constraints related to the presumption that bilateral investment treaties represent the new customary international law in international investment law, the negative constraints strongly show that such assumption is incoherent. In other words, the more coherent and prevailing view in doctrine is that the thousands of bilateral

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829 As explained by Schachter, "the repetition of common clauses in bilateral treaties does not create or support an inference that those clauses express customary law" that is because "to sustain such a claim of custom one would have to show that apart from the treaty itself, the rules in the clauses are considered obligatory", Schachter, 'Compensation for Expropriation', *op. cit.*, at 126. See also UPS case in which the Tribunal stated that 'while BITs are large in number, their coverage is limited ... and in terms of opinio juris there is no indication that they reflect a general sense of obligation', United Parcel Service v. Canada, Dec. Jurisdiction, at para 97 UNCITRAL of Nov. 22, 2002.


832 Ibid.
investment treaties and the content of custom are simply not the same. Thus, in terms of coherence, it makes more sense to conclude that these treaties create lex specialis rules that are solely applicable between countries that are party to these treaties.

4. The Interaction between Bilateral Investment Treaties and Customary International Law

Generally, treaty rules and customary international rules may co-exist and be applied independently. However, there is no hierarchy between them. Instead, treaty rules are considered as lex specialis and this is particularly evident in bilateral treaties. For that reason an intense and continuous interaction occurs in different forms between bilateral investment treaties and customary rules. In some cases the interaction is based on positive constraints creating a coherent relation between them both. On the other hand, treaty and customary rules may develop negative constraints due to certain contradictions. Below an analysis of the different forms is provided.

4.1. Positive Constraints

A key form of interaction between customary law and treaties is that the former defines and completes treaty rules. In other words, customary international law is important for the purpose of interpreting and completing treaty provisions. While interpreting treaties the

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837 This view has been maintained by the ICSID Tribunal in ADC and ADC & ADMC v. Hungary case whereby it states that ‘there is general authority for the view that a BIT can be considered as a lex specialis whose provisions will prevail over rules of customary international law’, ADC and ADC & ADMC v. Hungary, ICSID/ARB/03/16, Award, 2 October 2006 at para 481.
839 Ibid. See also Amoco v. Iran where the Tribunal held that ‘the rules of customary law may be useful in order to fill in possible lacunae of the treaty, to ascertain the meaning of undefined terms in its text or, more generally, to aid the interpretation and implementation of its provisions’, Amoco International Finance Corp. v. Islamic Republic of Iran et al., Iran-U.S.C.T., 14 July 1987, 83 International Law Review (1990) 500, at para 112.
relevant rules of international law including customary international law should be taken into consideration. This rule of interpretation reflects a "principle of integration" as well as the "unity of international law". The role of interpretation in terms of coherence is mainly reflected in the element of consistency. Using one rule to interpret another can only be possible if both rules are consistent. The relationship between consistency and the role of interpretation shall be examined through the intense interaction between the standard of fair and equitable treatment contained in virtually all bilateral investment treaties on the one hand, and the international minimum standard imposed by customary law on the other hand.

Normally, multilateral treaties stipulate fair and equitable treatment provisions without referring to the minimum international standard and that is possibly in order to give it a direct content. As for bilateral investment treaties, there seems to be no general agreement on the meaning of this standard. Thus, the content of such a provision must be clarified through interpretation in accordance with Article 31 (3) (c) of the Vienna Convention of the Law of Treaties. In Siemens v. Argentina the Tribunal held that it is 'bound to find the meaning of these terms under international law bearing in mind their ordinary meaning, the evolution of international law and the specific context in which they are used'.

However, different views have been adopted as to the relationship between fair and equitable treatment and the international minimum standard. One view regards both standards as

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840 See Article 31 (3) (c) of the Vienna Convention on the Law of Treaties.
841 See C. Yannaca-Small, 'Fair and Equitable Treatment Standard in International Investment Law', OECD Working papers on International Investment (OECD, 2004) at 40. See also Dolzer and Stevens, Bilateral Investment Treaties, op. cit., at 58.
843 For more information see Yannaca-Small, 'Fair and Equitable Treatment Standard in International Investment Law', op. cit.
equivalent to each other.\footnote{OECD Council Resolution of 12 October 1967 on the Draft Convention on the Protection of Foreign Property, reprinted in International Legal Materials, 7 (1968), 117-143;} It argues that the fair and equitable treatment corresponds to the 'minimum standard' as part of customary international law, or introduces a 'substantive legal standard referring to general principles of customary international law'.\footnote{Ibid, at 120} This view seems to be more preferred,\footnote{See Vasciannie, 'The Fair and Equitable Standard of International Investment Law and Practice', op. cit.} a claim confirmed by the fact that a number of bilateral investment treaties stipulate that the fair and equitable treatment must be 'no less than that required by international law',\footnote{See for example Article II.3 (a) of the United States-Mozambique BIT (1998); Article II.2 (a) of the United States-Argentina BIT (1991); Article II.3 (a) of the United States-Estonia BIT (1997).} 'consistent with international law',\footnote{See for example Article II.3 of the United States-Morocco BIT (1985).} 'not inconsistent with the norms and principles of international law',\footnote{See for example, Article 3 of France-Romania BIT (1995); Article 3 of France-Peru BIT (1993); Article II.2 of Canada-Egypt BIT (1996); Article II.2 of Canada-Thailand BIT (1997).} or 'in accordance with the principles of international law'.\footnote{Occidental Exploration and Production Company v. Ecuador, UNCITRAL, Final Award, 1 July 2004, at para 188.}

By virtue of the above references, it is clear that the standard established by international law has a direct impact on the content of the fair and equitable treatment standard since it ensures that 'at a minimum fair and equitable treatment must be equated with the treatment required under international law'.\footnote{In Lauder v. Czech Republic, Final Award, 3 September 2001, at para 292, and in reference to Unctad, 'Bilateral Investment Treaties in the Mid-1990s', at 53. the Tribunal held that 'in the context of bilateral investment treaties, the 'fair and equitable' standard is subjective and depends heavily on a factual context'.} Nonetheless, the obligation to provide fair and equitable treatment to foreign investors must be established on a case-by-case basis.\footnote{See for example, Enron Corp. Ponderosa Assets L.P. v. Argentina, ICSID ARB/01/3, Award, 22 May 2007, at para 258} Accordingly, they may either coincide with one another or the fair and equitable treatment may be more stringent than the international minimum standard.\footnote{See for example, Enron Corp. Ponderosa Assets L.P. v. Argentina, ICSID ARB/01/3, Award, 22 May 2007, at para 258} In both cases, such an interaction verifies a high degree of consistency which in turn ensures better coherence.
On the other hand, customary rules play the additional important role of filling the gaps within treaty rules. A number of tribunals have resorted to customary international law when confronted with incomplete treaty provisions. Thus, whenever an investment treaty is silent regarding a particular legal issue, the answer will be found in customary international law. By doing so another element of coherence comes along and that is comprehensiveness. By completing treaty rules and filling their gaps, customary rules are used to increase comprehensiveness within such treaties. To illustrate, typically bilateral investment treaties are silent on the rules of attribution of conduct to a state, therefore tribunals frequently refer to the International Law Commission’s Articles on State Responsibility as a codification of customary law on the matter.

A clear implementation of such an interaction is found in the case of *Sempra Energy International v. Argentina*, where the tribunal was faced with a treaty that did not mention the legal elements necessary for the legitimate invocation of a state of necessity, and hence it observed that the ‘rule governing such questions will thus be found under customary law’. In addition, The ADC Tribunal adopted a similar approach as it held that since the bilateral investment treaty between Cyprus and Hungary did not ‘contain any lex specialis rules’ regulating ‘the issue of the standard for assessing damages in the case of an unlawful expropriation’, it was ‘required to apply the default standard contained in customary international law in the present case’. Based on that, the content of customary

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857 See for example Loewen Group v. United Sate where the Tribunal held that ‘there is no language in those articles, or anywhere in the treaty, which deals with the questions of whether nationality must continue to the time of the resolution of the claim. It is that silence in the Treaty that requires the application of customary law to resolve the question of the need for continuous national identity’, Loewen v. United States, ICSID ARB (AF)/98/3, of June 26, 2003, at para 226.
858 See Noble Ventures, Inc. v. Romania, ICSID Case No. ARB/01/11, of October 12, 2005, at para 69: ‘while those Draft Articles are not binding, they are widely regarded as a codification of customary international law’.
international law remains of fundamental importance to bilateral investment treaty for the purpose of comprehensiveness.

4.2. Negative Constraints
A strong form of negative constraint is found in treaty provisions derogating from customary rules. In some cases treaties may deviate from general rules of international law. In order to achieve such a result, the treaty rules must be clearly formulated for that purpose.\(^{861}\) A common derogation is that related to the requirement of exhausting local remedies before pursuing international arbitration.\(^{862}\) According to Article 26 of the ICSID Convention a case can be brought directly before an ICSID Tribunal, unless the involved contracting States request the prior exhaustion of local remedies.\(^{863}\) For example, in *CME v. Czech Republic* and *Yaung Chi Oo v. Myanmar* the tribunals held, despite the fact that the concerned treaties were silent in regards to exhausting local remedies, that the claimants were not obliged to exhaust local remedies before initiating arbitration proceedings.\(^{864}\) It may be concluded that although the prior exhaustion of local remedies is required by customary law, conventional derogations are quite common.

Another interesting example of derogation is found in the protection of shareholders' rights. The main reference in this regard is the Barcelona Traction case where the International Court of Justice held that:

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\text{‘the mere fact that damage is sustained by both the company and shareholder does not imply that both are entitled to claim compensation [...]}
\]

\(^{861}\) In Loewen v. United States, the Tribunal held that ‘an important principle of international law should not be held to have been tacitly dispensed with by international agreement, in the absence of words making clear an intention to do so (Elettronica Sicula SpA (ELSI) United States v. Italy (1989) ICJ 15 at 42). Such an intention may be exhibited by express provisions which are at variance with the continued operation of the relevant principle of international law’. Loewen v. United States, ICSID ARB (AF)/98/3 of June 26, 2003, at para 160.
\(^{863}\) For Schreuer, this provision ‘a rule of interpretation, that is, a presumption that arbitration was intended to be the sole remedy’; ibid, at 389.
\(^{864}\) *CME Czech Republic B. V. V. Czech Republic, UNCETRAL, Partial Award, 13 September 2001, at para 411; Yaung Chi Oo Trading PTE Ltd. v. Government of the Union of Myanmar, ASEAN ARB/01/1, Final Award, 31 March 2003, at paras 40-41.*
Thus whenever a shareholder's interests are harmed by an act done to the company, it is the latter that he must look to institute appropriate action' for although two separate entities may have suffered the same wrong, it is only one entity whose rights have been infringed. 865

Based on the above, it is understood that shareholders may be entitled to bring an action only when the alleged international wrongful act directly harms their interest. However, the court provides two possible exceptions: 1) if the company ceases to exist; and 2) if the company's national state lacks the capacity to take an action on its behalf.866 On the other hand, bilateral investment treaties have departed from customary international law. The extent of such a departure heavily depends on the definition of investors as stipulated in the relevant investment treaty. Some treaties only acknowledge majority shareholders as investors while others take a step further and include minority shareholders.867

In this regard the tribunal in CMS v. Argentina adopted the following view:

‘No bar in current international law to the concept of allowing claims by shareholders independently from those of the corporation concerned, nor even if those shareholders are minority of non-controlling shareholders. Although it is true, as argued by the Republic of Argentina, that this is mostly the result of lex specialis and specific treaty arrangements that have so allowed, the fact is that lex specialis is so prevalent that it can now be

866 Ibid, at para 64.
considered the general rule, certainly in respect of foreign investments and increasingly in respect of other matters.\textsuperscript{868}

Although the above shows that in some situations bilateral investment treaties and customary rules may contradict each other in a way that weakens the degree of coherence between them, it is necessary to clarify that it is not that much of an issue. This is because in the event of a conflict, treaty rules normally prevail over customary rules.\textsuperscript{869} As \textit{lex specialis}, treaty provisions must be strictly followed even if they deviate from general rules of international law.\textsuperscript{870} Thus, whenever a treaty rule is clear, there is no need to examine customary law as courts and international tribunals usually begin their analysis with treaty rules.\textsuperscript{871} Moreover, derogation further emphasises the importance of bilateral investment treaties since states entered into these treaties to provide a higher level of protection to foreign investors due to the lack of development of relevant customary rules in the field of international investment law.

\textbf{4.3. Conclusion}

Based on the above, a coherent interaction between bilateral investment treaties and customary international law is in place. They both intensely interact and constantly affect each other. The positive constraints reflect characteristics of consistency and strong support between both rules which elevate the level of coherence. Customary rules perform a fundamental function in interpreting as well as complementing treaty provisions. On the other hand, some negative constraints are formed due to elements of derogation. However, derogation is the result of drafting treaty provisions which aim at providing better protection

\textsuperscript{869} ADC and ADC & ADMC v. Hungary, ICSID/ARB/03/16 of October 2 2006, at para 481.
\textsuperscript{871} In regards to nationality it has recently been held that ‘as the matter [...] is settled unambiguously by the [ICSID] Convention and the BIT, there is no scope for consideration for customary law principles of nationality’, \textit{ibid}, at para 72.
to foreign investors than that accorded under customary rules. In so doing, treaty provisions may end up sacrificing coherence whenever they depart from certain customary rules in order to achieve a wider perspective of coherence, namely coherence between treaties’ provisions and objectives. Thus, it can be said that the overall coherence of bilateral investment treaties requires the sacrificing of coherence in respect of certain customary international rules on foreign investment.

5. Conclusion

Generally, the interplay between treaty and customary law strata is described by Paparinskis as follows:

‘The results of the more recent efforts of [treaty] law-making sometimes accept and incorporate the classic [customary] rules; sometimes clarify the classic ambiguities or replace the unsatisfactory solutions; sometimes permit different approaches in parallel; and quite often maintain constructive ambiguity regarding the precise relationship between different rules.’

From the perspective of coherence, customary international rules on foreign investment are consistent with and in support of the network of bilateral investment treaties. The customary rules are used to interpret and compliment treaties’ provisions. In doing so a number of positive constraints are formed on the basis of consistency and support. On the other hand, it is evident that the proposition asserting that these treaties are the new customary law lacks coherence. Weak positive constraints are found under this argument. As for the negative constraints, they reflect a major gap in the consistency and support between these treaties and the elements of forming customary international rules.

Chapter 7

Coherence between Bilateral Investment Treaties and Free Trade Agreements

1. Introduction

International investment rules are not exclusive to bilateral investment treaties. They can also be found as part of agreements that address inter alia trade and investment. The majority of these agreements aim at facilitating international trade and cross-border movements of the components of production, generally referred to as ‘economic integration agreements’ (EIAs). 873 EIAs may be concluded at the multilateral, regional or bilateral levels. While trade remains their principle component, recent EIAs address an expansive set of investment issues. 874 Meanwhile, the proliferation of such agreements is creating important new challenges for investment rule-making and implementation. This section will focus on one type of EIA which are Free Trade Agreements (FTAs). Recent FTAs are likely to include a complete set of investment rules. 875 This chapter will evaluate the degree of coherence between these investment provisions and bilateral investment treaties in general. In doing so, both positive and negative constraints occurring between these treaties will be identified.

2. Historical Background and Current Trends

The general practice in earlier FTAs was not to include an investment chapter. 876 For example, the original 1960 Stockholm Convention Establishing the European Free Trade Association (EFTA), before it was updated by the Vaduz Convention in 2001, did not include

873 The term ‘economic integration agreement’ has been used in Article V of the WTO Agreement on Trade in Services (GATS) in relation to agreements that cover trade in services, as well as in the Energy Charter Treaty in relation to agreements that cover trade and investment, see UNCTAD, ‘Investment Provisions in Economic Integration Agreements’.
875 Not all FTAs include investment chapters. For a survey of FTAs, see J. Crawford and R. Fiorentino, ‘The Changing Landscape of Regional Agreements’, WTO Discussion Paper No. 8 (Geneva: WTO, 2005).
a single investment provision. Another example is the United States-Israel Free Trade Area Agreement, which took effect in 1985, and included only one investment-related provision. However, after the United States-Canada FTA of 1988, where a separate investment chapter was incorporated, the common practice of the United States became to include an investment chapter in the FTAs it concludes.

The literature identifies the recent expansion of FTAs covering a variable range of economic transactions as a major new phenomenon with potentially profound implications for international economic relations. Over the last decade, more than 130 FTAs have been concluded, a large number of which the United States and the European Union signed with developing countries. The inclusion of investment issues in FTAs promotes interactions between their provisions and those of bilateral investment treaties. As compared to FTAs, bilateral investment treaties are concerned with a more limited number of issues and tend to be quite uniform in that respect.

Examining the degree of coherence between FTAs and bilateral investment treaties will assist policymakers in making informed decisions regarding the negotiation and application of these agreements. In this respect, the analysis below will identify the areas of positive and negative constraints that occur between these provisions. As explained throughout the whole thesis, the positive constraints are based on the existence of consistency and support, while on the other hand. The negative constraints occur due to lack of consistency and support.

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877 Ibid.
878 Article 13 of the United States-Israel Free Trade Area Agreement 1985 states that: ‘Neither Party shall impose, as a condition of establishment, expansion or maintenance of investment by nationals or companies of the other party, requirements to export any amount of production resulting from such investments or to purchase locally-produced goods and services. Moreover, neither Party shall impose requirements on investment to purchase locally-produced goods and services as a condition for receiving any type of governmental incentives’.
880 See WTO’s ‘regional trade agreements’ (RTAs) database available at http://rtais.wto.org/UI/PublicAllRTAList.aspx.
However, unlike bilateral investment treaties, investment-related provisions in FTAs are not unified. Therefore, the manner of identifying the positive and negative constraints in this section will be different from that used throughout the whole thesis. To illustrate, the areas of interaction between FTAs and bilateral investment treaties will not be categorised under positive and negative constraints. Rather, each area will be examined separately and accordingly, the negative and positive constraints will be identified.

3. Definition of Investment

FTAs that define investment follow one of three different types of definitions.881 Firstly, there is the asset-based definition which tends to define investment in as broad terms as possible in order to cover the various types of assets that might need to be protected during the course of the investment.882 A typical asset-based definition would define investment as ‘every kind of asset’ and then include an illustrative list of assets to be covered.883 Accordingly, the scope can be broad, covering tangible as well as intangible property, property rights as well as contractual and administrative, direct investment as well as portfolio.884 This type is adopted by FTAs that are directed at protecting foreign investment, whether it is portfolio or direct investment.885 Second is the transaction-based definition, which is likely to be found in FTAs that concern the liberalisation of cross-border financial flows through which an investment is made.886 Thirdly, there is the enterprise-based definition, which defines investment in narrow terms based on the element of control over the enterprise.887

882 Ibid.
883 Ibid. For example see Article 1 of the Caribbean Community-Dominican Republic Free Trade Agreement.
885 South Centre, 'The European Union and United States' Approach to International Investment Agreement with Developing Countries: Free Trade Agreements and Bilateral Investment Treaties', op. cit., at 2.
886 Ibid. An example of this type is found in Annex A of the OECD Code of Liberalisation of Capital Movement.
887 Ibid. For example see United States-Canada Free Trade Agreement.
In relation to bilateral investment treaties practice, the most-used definition of investment is the broad asset-based definition. In this respect, a positive constraint is found between bilateral investment treaties and FTAS which adopt this definition. For example, a positive constraint exists between the bilateral investment treaties signed by the United States and the North American Free Trade Agreement (NAFTA). Although the definition may not be identical, these treaties apply an asset based definition. As for the FTAs that adopt either transaction-based or enterprise-based definition, they are likely to have negative constraints with virtually all bilateral investment treaties.

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890 Take for example Article 1139 of the NAFTA which states the following definition:

**Investment means:**

(a) ‘an enterprise;

(b) an equity security of an enterprise;

(c) a debt security of an enterprise (i) where the enterprise is an affiliation of the investor, or (ii) where the original maturity of the debt security is at least three years, but does not include a debt security, regardless of original maturity, of a state enterprise;

(d) a loan to an enterprise (i) where the enterprise is an affiliation of the investor, or (ii) where the original maturity of the loan is at least three years, but does not include a loan, regardless of original maturity, to a state enterprise;

(e) an interest in an enterprise that entitles the owner to share in income or profits of the enterprise;

(f) an interest in an that entitles the owner to share in the assets of that enterprise on dissolution, other than a debt security or a loan excluded from subparagraph (c) or (d);

(g) real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purpose; and

(h) interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under (i) contracts involving the presence of an investor’s property in the territory of the Party, including turnkey or construction contracts, or concessions, or (ii) contracts where remuneration depends substantially on the production, revenues or profits of an enterprise; but investment does not mean,

(i) claims to money that arise solely from (i) commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party, or (ii) the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraph (d); or

(j) any other claim to money, that do not involve the kinds of interests set out in subparagraph (a) through (h).

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On the other hand Article 1 of the United States-Uruguay BIT defines investment as follows:

‘“investment” means every asset that an investor owns or control, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment if capital or other resources, the expectation of gain or profit, or the assumption of risk. Forms that an investment may take include:

(a) an enterprise;

(b) shares, stock, and other forms of equity participation in an enterprise;

(c) bonds, debenture, other debt instruments, and loans;

(d) future, options and other derivatives;

(e) turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts;

(f) intellectual property rights;

(g) licenses, authorization, permits and similar rights conferred pursuant to domestic law; and

(h) other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges.’
4. Entry and Establishment

While bilateral investment treaties mainly focus on protecting foreign investment, FTAs seek to integrate economies through liberalising investment flows as well as protecting and promoting investment.\(^ {891}\) Generally, bilateral investment treaties provide for the protection of foreign investment once established according to the host states’ national laws and regulations, without providing for a right to establish foreign investment.\(^ {892}\) Thus, bilateral investment treaties usually cover post-establishment investment measures and do not regulate the access or admission of foreign investment into the host state. Accordingly, these treaties typically allow for investment in accordance with the domestic legal framework. In such cases, domestic laws and regulations should be consulted to determine the precise conditions for the entry and establishment of foreign investment.

By contrast, FTAs aim at opening domestic markets to foreign investors.\(^ {893}\) These treaties are considered path finding for providing foreign investors with rights of entry or establishment.\(^ {894}\) In regard to the right of establishment, three basic approaches are evident.\(^ {895}\) The first approach is to provide that investors originating in a member country have a right to establish investment in the other host member country.\(^ {896}\) A typical example of such an approach appears in Article 7 of the Framework Agreement on the Association of Southeast Asian Nations (ASEAN) Investment Area which provides that ‘subject to the provision of this Article, each Member State shall ... open immediately all its industries for investments by

\(^ {892}\) This is explained in more depth in Chapter 4 ‘Coherence between Bilateral Investment Treaties and Investment Liberalisation’.
\(^ {893}\) South Centre, ‘The European Union and United States’ Approach to International Investment Agreement with Developing Countries: Free Trade Agreements and Bilateral Investment Treaties’, op. cit., at 3.
\(^ {896}\) Ibid.
However, the right to establish investment is usually subject to exceptions. The second common approach is to provide for national and MFN treatment at the pre-entry level. In this context, governments are obliged to give no less favourable treatment to foreign investors than they do to national investors or investors from any other country. This approach has been adopted by the NAFTA. National treatment in respect to the right of establishment is provided for in Article 1102 which states that:

1. ‘Each Party shall accord to investors of another Party treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

2. Each Party shall accord to investment of investors of another Party treatment no less favourable that that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.’

Article 1103 provides for MFN treatment in stating the following:

1. ‘Each Party shall accord to investors of another Party treatment no less favourable than that it accords, in like circumstances, to investors of any other party or of a non-

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897 See the Framework Agreement on the ASEAN Investment Area 1998.
898 UNCTAD, 'Investment Provisions in Economic Integration Agreements', op. cit., at 76. For example the right of establishment in the Framework Agreement on the ASEAN Investment Area is further qualified by an emergency safeguard measure in Article 14, which provides that:

‘If as a result of the implementation of the liberalization programme under this Agreement, a Member State may take emergency safeguard measures to the extent and for such a period as may be necessary to prevent or remedy such injury. The measures taken shall be provisional and without discrimination.’

899 Arup, 'Services and Investment Chapters in Free Trade Agreements: Liberalisation, Regulation and Law', op. cit..
901 The NAFTA model has been followed by a number of agreements see for example the Canada-Chile FTA 1996, the Mexico-Northern Triangle FTA 2001.
Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

2. Each party shall accord to investments of investors of another Party treatment no less favourable than that it accords, in like circumstances, to investment of its investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.'

However, according to this approach the right of establishment depends on how ‘investor’ is defined. This is because the right to national and MFN treatment with respect to establishment is linked to the treatment provided to national investors or any investor from any other party or non-party country. Moreover, this approach does not provide for an unlimited right of establishment. Rather, in most cases it is subject to limited exceptions and, in some cases, to a negative list of exceptions.

The third approach is to provide for future liberalisation. This approach does not result in automatic liberalisation upon the agreement entering into force. Instead, its effect relies entirely upon the actions of the parties in the future. An example of this approach is found in Article 31 of the EU-Morocco FTA which provides that:

1. ‘The Parties agree to widen the scope of this Agreement to cover the right of establishment of one Party’s firms on the territory of the other and liberalisation of the provision of services by one Party’s firms to consumers of services in the other.'

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903 Ibid.
904 Ibid.
905 Ibid.
906 Ibid.
907 Ibid.
908 Ibid.
909 Ibid.
910 Ibid.
2. The Association Council will make recommendations for achieving the objective described in paragraph 1 ... 

3. The Association Council will make a first assessment of the achievements of this objective no later than five years after this Agreement enters into force.'

Based on the above, FTA provisions on entry and establishment are significant in regard to providing investment freedom. Whether they follow the first, second or third approach, they seem to depart from the general practice of bilateral investment treaties. For that reason and in terms of coherence, negative constraints are likely to form. However, there are two exceptions whereby positive constraints are created. Firstly, there is a positive constraint between bilateral investment treaties signed by the United States, Canada and Japan as they provide for applying national and MFN treatment at the entry level and FTAs adopting the second approach.\(^909\) Secondly, a positive constraint is likely to appear between most bilateral investment treaties and FTAs in respect to entry and establishment if the latter does not grant a right of establishment at all.\(^910\) In such a case, an investment can be established in a host country party to a FTA only if the host country allows the establishment of the concerned investment under its own laws and regulations.\(^911\)

5. Investment Protection

Although the main objective of FTAs is investment liberalisation, they also tend to include provisions granting legal protection to foreign investors.\(^912\) These treaties include NAFTA

\(^{909}\) South Centre, 'The European Union and United States' Approach to International Investment Agreement with Developing Countries: Free Trade Agreements and Bilateral Investment Treaties', *op. cit.*, at 3, 21.

\(^{910}\) UNCTAD, 'Investment Provisions in Economic Integration Agreements', *op. cit.*, at 80.

\(^{911}\) Ibid.

\(^{912}\) UNCTAD, 'Investment Provisions in Economic Integration Agreements', *op. cit.*, at 99.
and FTAs following the NAFTA model. Below is an analysis of the main protection provisions included in different FTAs.

5.1. ‘Fair and Equitable Treatment’ and ‘Full Protection and Security’
The ‘fair and equitable treatment’ and ‘full protection and security’ are the most common foreign investment protection provisions. In some FTAs these provisions appear together. For instance, article 909 of the Australian-Thailand FTA provides that:

2. ‘Each Party shall ensure fair and equitable treatment in its own territory of investments.

3. Each Party shall accord within its territory protection and security to investments.’

Some FTAs proceed further to explain the meaning of these standards. They define the commitment as limited to the protection by customary international law. For example, article 15.5.1 of the Singapore-United States FTA provides that ‘Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security’.

Furthermore, article 15.5.2 goes on to clarify the meaning by stating that:

‘For greater certainty, paragraph 1 prescribes the customary international law minimum standards of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights.’

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913 Ibid.
915 Ibid.
These standards seem to appear in a similar manner in bilateral investment treaties. Including them in FTAs creates positive constraints between these agreements and bilateral investment treaties. Thus, in this respect, bilateral investment treaties and FTAs seem coherent, as the protection they provide for covered foreign investments is consistent and supportive.

5.2. National and MFN Standards
The national treatment and MFN provisions ensure foreign investors treatment no less favourable than that granted to nationals of the host country, or treatment no less favourable than that granted to nationals of any third country.\(^{916}\) These standards are at the heart of international trade law.\(^{917}\) National treatment of imported products with respect to trade matters and internal measures is one of the basic principles which serve to liberalise international trade.\(^{918}\) In other words, the main purpose of national treatment is to ensure that internal measures are not imposed to nullify or impair the effect of tariff concessions and other international rules applicable to broader measures.\(^{919}\) Moreover, in trade matters the MFN principle is of fundamental significance.\(^{920}\) This principle is particularly relevant in regard to:

\[\text{\textquoteleft} \text{any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product}\text{\textquoteright}\]\n
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*\(^{919}\) Ibid.

In regard to investment, these principles involve a similar economic aim. National treatment aims at establishing a level playing field between foreign and domestic investors whereby all investors are subject to the same competitive conditions in the host country market, and accordingly domestic measures should not unduly favour domestic investors.\(^{922}\) Similar considerations apply to the MFN principle with respect to investment from other countries.\(^{923}\) However, unlike in the case of trade, one of the key matters that arises regarding the scope of application of these principles in the investment field is whether they are applicable at the entry level of foreign investment, or only to the treatment of foreign investment after entry. This matter is addressed by FTAs according to their objectives. FTAs that do not pursue the liberalisation of investment flows and are more concerned with investment protection provide for these principles after entry.\(^{924}\) An example is article 17-03 (1) and (2) of the Columbia, Mexico and Venezuela FTA which provides that:

1. ‘Each Party shall accord to investors of another Party, and to their investments, treatment no less favorable than that it accords, in like circumstances, to its own investors and investments.

2. Each Party shall grant investors from another Party, and to their investments, treatment no less favorable to that it accords, in like circumstances, to investors, and their investment of another or of a non-Party.’


\(^{922}\) UNCTAD, ‘National Treatment’, op. cit., at 8.

\(^{923}\) UNCTAD, ‘Most-Favoured-Nation Treatment’, op. cit., at 100.

\(^{924}\) UNCTAD, ‘Investment Provisions in Economic Integration Agreements’, op. cit., at 100.
To the contrary, FTAs that pursue both investment liberalisation and protection tend to extend the scope of these principles to cover the pre-entry and post-entry phases of the investment.\textsuperscript{925} This approach is adopted by NAFTA and many FTAs that follow the NAFTA model.\textsuperscript{926}

Based on the above, the coherence between bilateral investment treaties and FTAs with regard to national and MFN treatment depends on the scope of application of these standards. Accordingly, three scenarios are likely to occur. Firstly, due to the consistency and support features in their approach a positive constraint would occur between bilateral investment treaties and FTAs that provide for national and MFN treatment at both pre-entry and post-entry phases. Secondly, the same consistency and support is featured causing the creation of a positive constraint between bilateral investment treaties and FTAs that provide for the aforementioned principles only at the post-entry level. Finally, if a bilateral investment treaty follows a different approach from that available under an FTA, a negative constraint is then found due to inconsistency and lack of support.

5.3. Expropriation
Virtually all FTAs that deal with foreign investment protection include provisions on expropriation.\textsuperscript{927} These agreements recognise the host states’ right to expropriate investment, provided that they satisfy a number of conditions.\textsuperscript{928} These provisions start by identifying their scope of application. Some FTAs explicitly state that an expropriation includes measures ‘equivalent’ or ‘tantamount’ to an expropriation as well as ‘creeping

\textsuperscript{925} UNCTAD, ‘Investment Provisions in Economic Integration Agreements’, \textit{op. cit.}, at 101.
\textsuperscript{926} Ibid.
\textsuperscript{927} UNCTAD, ‘Investment Provisions in Economic Integration Agreements’, \textit{op. cit.}, at 106.
\textsuperscript{928} These conditions are explained in more depth in Chapter 3 ‘Coherence between Bilateral Investment Treaties and Investment Protection’.
expropriation'.\textsuperscript{929} For example, article 14-11 of the El Salvador, Guatemala, Honduras and Mexico FTA provides that:

‘No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such investment ...’

The question of what constitutes expropriation is very important. This is because a broad definition could be interpreted to the effect that routine regulatory acts by host states constitute expropriation, requiring that all those investments affected by the regulation be compensated.\textsuperscript{930} This type of language led to investment disputes regarding the type of government measures to which the expropriation provision applies.\textsuperscript{931} Thus, recent FTAs began to address this issue.\textsuperscript{932} For example, annex 10-C of the Dominican Republic-Central America Free Trade Agreement (CAFTA-DR) draws the following distinction between direct and indirect expropriation:

3. ‘Article 10.7.1 addresses two situations. The first is direct expropriation, where an investment is nationalized or otherwise directly expropriation through formal transfer of title or outright seizure.

4. The second situation addressed by article 10.7.1 is indirect expropriation, where an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure.’\textsuperscript{933}


\textsuperscript{932} UNCTAD, ‘Expropriation’, op. cit., at 9.

\textsuperscript{933} A similar approach is followed by other treaties such as Australia-Chile FTA and Japan-Philippines FTA.
The second issue with regard to expropriation is to clarify the conditions for lawful expropriation. These conditions include the expropriation being for public purpose, non-discriminatory, in accordance with due process of law and accompanied by compensation.\textsuperscript{934} The requirement for compensation is the most debated amongst these conditions. However, the most common standards for determining the amount of compensation are ‘fair market value’ or simply ‘fair’ or ‘just’ compensation.\textsuperscript{935} In general, with regard to compensation, FTAs seem to incorporate language consistent with the Hull formula.\textsuperscript{936}

In this respect, bilateral investment treaties and FTAs seem to include very similar expropriation provisions. The expropriation provisions in these treaties address the measures that amount to expropriation including direct and indirect expropriation along with the conditions for lawful expropriation. For that reason, positive constraints appear between bilateral investment treaties and FTAs as far as expropriation is concerned. These positive constraints promote consistency and support between these agreements.

6. Performance Requirements

As seen in the preceding chapters, performance requirements introduce barriers which may hinder the foreign investor’s ability to manage their investment and in some cases may impair the value of their investment.\textsuperscript{937} Besides their impact on investment, performance requirements may also distort trade by requiring the exportation of goods or services which otherwise would not be required, or by preventing the importation of goods or services that

\textsuperscript{934} These conditions are recognised by customary international law and are discussed in more depth in Chapter 2 ‘Coherence between Bilateral Investment treaties and Investment Protection’.

\textsuperscript{935} UNCTAD, ‘Expropriation’, \textit{op. cit.}, at 40-51.

\textsuperscript{936} UNCTAD, ‘Investment Provisions in Economic Integration Agreements’, \textit{op. cit.}, at 112.

\textsuperscript{937} This was explained in Chapter 4 ‘Coherence between Bilateral Investment Treaties and Investment Liberalisation’. For a thorough examination of the impact of performance requirements see UNCTAD, ‘Foreign Direct Investment and Performance Requirements: New Evidence from Selected Countries’, \textit{op. cit.}. 

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would otherwise be permitted. For these reasons the WTO Agreement on Trade Related Investment Measures (TRIMs) prohibits performance requirements that are inconsistent with the requirement of national treatment or the prohibition on quantitative restrictions under articles III(4) and XI(1) in the General Agreement on Tariffs and Trade (GATT). Upon the adoption of the TRIMs agreement, FTAs aiming at investment liberalisation began to include prohibitions on specific performance requirements.

FTAs that address performance requirements do not provide for general prohibition. Instead, they typically prohibit certain performance requirements. For example, the list included in the FTA between Colombia, Mexico and Venezuela covers the same measures identified in the TRIMs agreement. On the other hand, recent FTAs concluded by the United States based on NAFTA go beyond the measures listed by the TRIMs. In this respect, Article 1106 of NAFTA provides that:

‘No Part may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory:

(a) to export a given level or percentage of goods or services;

(b) to achieve a given level or percentage of domestic content;”

941 Ibid.
942 Ibid.
943 Ibid. However, the original FTA was signed in 1994 and included Colombia, Mexico and Venezuela. Venezuela withdrew from the agreements in 2006. In 2009, Mexico and Columbia resumed negotiations to deepen trade integration and signed a new agreement which entered into force in 2001, see M. Villarreal, 'Mexico's Free Trade Agreements', (Congressional Research Service, 2012) at 4. Available at http://www.fas.org/sgp/crs/row/R40784.pdf
(c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;

(d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;

(e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sale in any way to the value or value of its exports or foreign exchange earnings;

(f) to transfer technology, a production process or other proprietary knowledge to a person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of this Agreement; or

(g) to act as the exclusive supplier of the goods it produces or services it provides a specific region or world market.

However, NAFTA allows the parties to specify exceptions to the prohibition on performance requirements in an annex.\textsuperscript{945} Moreover, NAFTA allows performance requirements which are otherwise prohibited only if they meet certain conditions, such as being granted as a condition for the receipt of an advantage.\textsuperscript{946} In the same context, article 1106(3) singles out a number of performance requirements that cannot be associated with incentives, which implies

\textsuperscript{945} See Article 1108 (Reservations and Exceptions) of the NAFTA.

\textsuperscript{946} Article 1106(4) allows parties to condition the receipt of an advantage to 'locate production, provide a service, train or employ workers construct or expand particular facilities, or carry out research and development'.
that the remaining measures on the list can be allowed when linked to advantages. Although it is noted that while performance requirements are often prohibited as a condition of the establishment, NAFTA seems to prohibit them whether they are imposed as a condition of establishment or post-establishment.\footnote{Article 1106 of the NAFTA.} FTAs adopting the NAFTA approach include provisions on performance requirements that are more complex compared to NAFTA’s provisions, yet quite similar conceptually.\footnote{An example is Article 15.8 of the United States and Singapore FTA, see Unctad, ‘Investment Provisions in Economic Integration Agreements’, at 95.} Other FTAs refer to the TRIMs and require parties to abide by it in regard to performance requirements.\footnote{See for example annex III, Article VII, of the CARICOM and the Dominican Republic FTA, which states that: ‘no Party shall impose any preference requirements which are contrary to the World Trade Organisation Agreement on Trade Related Investment Measures as a condition for establishment, expanding or maintaining investments’.} As mentioned earlier, most bilateral investment treaties are silent on performance requirements.\footnote{This is explained in Chapter 4 ‘Coherence between Bilateral Investment Treaties and Investment Liberalisation’.} Therefore, a negative constraint appears between these treaties and FTAs. On the contrary, positive constraints are formed between bilateral investment treaties which regulate the use of performance requirements and FTAs.\footnote{An example for such treaties are El Salvador and Peru BIT (1996), The Dominican Republic and Ecuador BIT (1998), Bolivia and Mexico (1995) and United States BITs.} In a similar way to FTAs, these treaties prohibit performance requirements when applied as a condition for establishment, acquisition, expansion, management, conduct or operation of a covered investment, and in some cases allow parties to impose conditions for the receipt or continued receipt of benefits and incentives.\footnote{UNCTAD, ‘Foreign Direct Investment and Performance Requirements: New Evidence from Selected Countries’, op. cit., at 5.} Accordingly, in regard to performance requirements, negative constraints seem more dominant between bilateral investment treaties and FTAs, although in some cases positive constraints may also occur.
7. Free Transfer of Foreign Capital

Amongst the most common provisions in FTAs seeking to liberalise investment are those granting free transfer of funds. In this respect, a typical provision would guarantee to foreign investors the right to transfer their investment and any returns into a freely convertible currency out of the territory of the host country. An example is article 1109(1) of NAFTA which specifies that all transfers relating to an investment must be freely permitted and includes a nonexclusive listing of the type of transfers that must be permitted. The language used in NAFTA appears to be broad and more inclusive since it refers to all transfers. The phrase ‘all transfers relating to an investment’ or similar language seems to be broad enough to cover transfers into as well as out of the host country. In other words, this means that foreign investors have the right not only to repatriate capital, but also to bring capital into the host states’ territory.

However, transfer provisions may raise concerns on the part of host countries. Thus, FTAs often limit the right of free transfer in some way. For example, article 12 of chapter 8 of the FTA between Australia and Singapore limits the free transfer of capital in case of balance of payments difficulties, stating that:

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954 Ibid.
955 Article 1109(1) of NAFTA provides that:
‘each Party shall permit all transfers relating to an investment of an investor of another Party in the territory of the Party to be made freely and without delay. Such transfers include:
(a) profits, dividends, interest, capital gains, royalty payments, management fees, technical assistance and other fees, returns in kind and other amounts derived from the investment;
(b) proceeds from the sale of all or any part of the investment or form the partial or complete liquidation of the investment;
(c) payments made under a contract entered into by the investor, or its investment, including payments made pursuant to a loan agreement;
(d) payments made pursuant to Article 1110 [relating to compensation for expropriation];
(e) payments arising under Section B [relating to investor-state dispute resolution].’
956 FTAs that include transfer provisions that apply to specific transfers are usually broad enough to include most types of payments that a foreign investor would wish to repatriate. UNCTAD, ‘Investment Provisions in Economic Integration Agreements’, op. cit., at 90.
957 Ibid.
'1. In the event of serious balance of payments and external financial difficulties or threat thereof, a Party may adopt or maintain restrictions on payments or transfers related to investments. It is recognized that particular pressures on the balance of payments of a Party in the process of economic development may necessitate the use restrictions to ensure, inter alia, the maintenance of a level of financial reserves adequate for the implementation of its programme of economic development. '

In terms of coherence, the general approach adopted by bilateral investment treaties in regard to the transfer of capital is similar to that found in most FTAs. Bilateral investment treaties grant foreign investors the right to make capital transfers, albeit subject to certain limitations. This means that positive constraints link bilateral investment treaties and FTAs as far as capital transfer is concerned.

8. The Movement of Labour

Another important issue related to investment liberalisation as being the main objective of FTAs is to ensure that foreign investment is allowed to employ key managerial or professional personnel of their choice. Considering FTAs in this respect, several approaches can be identified. The first approach is found in article 13-07 of the Costa Rica-Mexico FTA which provides that ‘no Party may require that an enterprise of that Party that is an investment of an investor of another Party appoint to senior management positions individuals of any particular nationality’. This provision does not require that the host country allow unlimited immigration of nationals of the home country. Thus, the investment’s choice of senior management is restricted to those persons who can lawfully

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958 These limitations are discussed in more detail in Chapter 4 ‘Coherence between Bilateral Investment Treaties and Investment Liberalisation’.
960 Ibid.
gain entry into the home country. Moreover, this provision includes an exception that permits the host country to impose a requirement that a majority of the board of directors enjoy a particular nationality, provided that the requirement ‘does not materially impair the ability of the investor to exercise control over its investment’. This approach is adopted by NAFTA and FTAS following the NAFTA model.961

Another approach is to refer to the parties’ immigration laws and directly establish eligibility under their domestic laws and regulations.962 An example of such a provision is article 8 of the Jordan–United States FTA, which addresses the issue of entry of nationals of the other party as follows:

‘2. Subject to its laws relating to the entry, sojourn and employment of aliens, each Party shall permit to enter and to remain in its territory national of the other Party for the purpose of establishing, developing, administering or advising on the operation of an investment to which they are, or a company of the other Party that employs them, have committed or are in the process of committing a substantial amount of capital and other sources.’

In terms of coherence, there is a fair degree of consistency and support between bilateral investment treaties and FTAs’ provisions on the movement of labour. FTAs following the first approach which ensures foreign investors their ability to employ the key managerial or professional personnel of their choice have a positive constraint with bilateral investment treaties that address the entry and sojourn of personnel associated with covered investment. An example of such a treaty is article II(5) of the Estonia–United States BIT (1994), which

961 Ibid.
962 Ibid.
provides that ‘companies which are legally constituted under the applicable law or regulations of one Party, and which are investments, shall be permitted to engage top managerial personnel of their choice, regardless of nationality’. Moreover, FTAs following the second approach are coherent with bilateral investment treaties that refer the entry of foreign nationals to the host state’s legislation.\textsuperscript{963} Other than that, the majority of bilateral investment treaties do not address the movement of labour and thus have negative constraints with FTAs.\textsuperscript{964}

9. Investor-State Dispute Settlement

EIAs in general often provide for the possibility of settling disputes through means of consultations and negotiations between the parties.\textsuperscript{965} However, dispute settlement provisions in FTAs are drafted according to whether the agreement addresses investment liberalisation or protection.\textsuperscript{966} FTAs that address investment protection only authorise arbitration of disputes between investors and host states without the involvement of the investor’s home state.\textsuperscript{967} The most elaborate provisions for investor-state arbitration are found in the NAFTA and FTAs that follow the NAFTA model.\textsuperscript{968} The NAFTA allows foreign investors to submit claims for the breach of the investment chapter of the NAFTA to arbitration before the ICSID, the Additional Facility Rules of ICSID or an ad hoc tribunal under the UNCITRAL Arbitration Rules.\textsuperscript{969} Furthermore, the NAFTA proceeds to acknowledge that investment disputes may raise concerns on the part of those who are party to the treaty but not party to the dispute and thus it allows them to submit to the tribunal on issues involving the interpretation of the agreement.\textsuperscript{970}

\textsuperscript{963} This is explained in Chapter 4 ‘Coherence between Bilateral Investment Treaties and Investment Liberalisation’.
\textsuperscript{964} Regarding bilateral investment treaties and the movement of labour see Salacuse, \textit{The Law of Investment Treaties, op. cit.}, at 334.
\textsuperscript{965} UNCTAD, ‘Investment Provisions in Economic Integration Agreements’, \textit{op. cit.}, at 116.
\textsuperscript{966} Ibid.
\textsuperscript{967} Ibid.
\textsuperscript{968} UNCTAD, ‘Investment Provisions in Economic Integration Agreements’, \textit{op. cit.}, at 117.
\textsuperscript{969} See Chapter 11, article 1120 of the NAFTA.
\textsuperscript{970} See article 1128 of the NAFTA.
On the other hand, FTAs that particularly emphasize investment liberalisation rather than investment protection do not appear to include a right to investor-state dispute resolution.\(^{971}\) This approach is found in FTAs signed by the EC with third world countries.\(^{972}\) Instead of including special provisions on the settlement of investment disputes, these agreements deal with investment disputes under the general disputes settlement provisions which are at the state-to-state level.\(^{973}\) Nevertheless, some of these agreements contain provisions which provide for investor-state resolution only upon further agreement of the parties.\(^{974}\) An example of such a provision is found in article 48 of the EFTA States and Singapore FTA which authorise international arbitration of disputes between investors and the host state subject to both parties mutual agreement and as a result the dispute can be submitted to ICSID, the Additional Facility of the ICSID or an ad hoc tribunal under the UNCITRAL Rules.

With respect to the settlement of investment disputes from the perspective of coherence between bilateral investment treaties and FTAs, both positive and negative constraints are found. While virtually all bilateral investment treaties allow for direct settlement of investor-state disputes through international arbitration, certain types of FTAs seem to depart from this practice. Negative constraints are found between bilateral investment treaties and FTAs that do not allow for investor-state dispute settlement, or do not address specifically the issue of international arbitration of investment disputes. These negative constraints are formed due to inconsistency and lack of support between these agreements and bilateral investment treaties in general. To the contrary, positive constraints are found between FTAs that are more concerned with investment protection as they seem to address the settlement of investor-state

\(^{971}\) UNCTAD, 'Investment Provisions in Economic Integration Agreements', op. cit., at 116.

\(^{972}\) For general information on dispute settlement in EU FTAs see S. Woolcock, 'European Union Policy Towards Free Trade Agreements', ECIP Working Paper No. 03/2007 (European Centre for International Political Economy (ECIPE), 2007).

\(^{973}\) Ibid.

disputes through international arbitration and follow the approach of bilateral investment treaties, creating consistent and supportive relations between these agreements.

10. Conclusion

Most FTAs include a set of investment provisions. Unlike bilateral investment treaties, their main aim is to enhance liberalisation. Therefore, the positive and negative constraints between these different types of treaties depend on the extent of liberalisation provided for under FTAs. Positive constraints are likely to be found in relation to investment definition, substantive protection provisions, expropriation and capital transfer. As for negative constraints, they are mainly featured in respect to entry and establishment, performance requirements and investor-state dispute settlement. Accordingly, increasing coherence between these treaties requires the addressing of these negative constraints by removing inconsistencies and increasing support between their provisions. This is essential in order to provide policy makers and negotiators with informed options and higher predictability with respect to the scope of their obligations.
Chapter 8

Coherence between Investment and Non-Investment Obligations

1. Introduction

One of the very important challenges facing the international investment regime today is how to strike a balance between principles regarding the protection of foreign investment on one hand and those regarding the protection of society and public interest including sustainable development, human rights and environment on the other. Without doubt, investment has a considerable social and environmental impact besides economic growth. A number of recent investor-state disputes involved the question of states’ obligations towards investors as well as the rest of the society. In other words, the compliance of states with their obligations towards foreign investors is occasionally confronted with questions regarding the public interest and the rights of the citizens.

Most investment treaties do not address states’ right and duty to regulate in pursuit of certain policy objectives besides investment promotion and protection. This brings into question the relation between bilateral investment treaties and states' sovereign right to enact regulation and adopt measures to protect the public interest. The aim of this chapter is to assess the level of coherence between existing investment and non-investment obligations of states. In doing so, it will assess the positive and negative constraints which result from the interaction


977 Mann, 'International Investment Agreements, Business and Human Rights: Key Issues and Opportunities', *op. cit.*, at 17.
of these obligations. The chapter begins by explaining how the approach used in this analysis relates to the work of the International Law Commission on fragmentation.\textsuperscript{978} Afterwards, it identifies the link between bilateral investment treaties and the states' obligation to protect the society. It then proceeds to evaluate this relation in terms of coherence. Finally, it concludes by suggesting some reforms.

2. Fragmentation of International Law

Over half a century ago the fragmentation of international law was addressed by Wilfred Jenks.\textsuperscript{979} In this regard he noticed that the international law does not have a general legislative body and there should be a law regulating conflicts between regimes.\textsuperscript{980} The International Law Commission acknowledges this analysis and asserts that fragmentation has been accompanied by the emergence of specialised rules, legal institutions and spheres of legal practice.\textsuperscript{981}

The work of the Commission focuses on the splitting up of the international law into highly specialised schemes which claim relative autonomy from each other and from the general law.\textsuperscript{982} Accordingly, the emergence of new and special types of law and geographically or functionally limited treaties creates problems of coherence in international law.\textsuperscript{983} To deal with such problems it is necessary to determine the precise relationship between two or more rules and principles.\textsuperscript{984} For that purpose the relationships fall into four general categories: 1) relations between special and general law, 2) relations between prior and subsequent law, 3)


\textsuperscript{979}C.W. Jenks, 'The Conflict of Law-Making Treaties', \textit{British Yearbook of International Law}, 30 (1953), 401-543.

\textsuperscript{980}Ibid, at 13.

\textsuperscript{981}Ibid, at 14.

\textsuperscript{982}Ibid, at 15-16.
relations between laws at different hierarchical level and 4) relations of law to its ‘normative environment’ in general.\textsuperscript{985} According to the report, these relations are addressed within a conceptual frame provided by the Vienna Convention on the Law of Treaties of 1969 (VCLT).\textsuperscript{986}

As explained by the report, a conflict may exist if it is possible for a member of two treaties to comply with one rule and fail to comply with the other.\textsuperscript{987} This situation is known as the basic form of incompatibility.\textsuperscript{988} Another looser understanding of conflict is when a treaty frustrates the goals of another treaty without there being expressed incompatibility between their provisions.\textsuperscript{989} For example, investment law and human right law emerge from different types of policy and that may influence the interpretation and application of these rules. This type of ‘policy-conflict’ is relevant to fragmentation although it may not lead to incompatibilities between obligations imposed on a single party.\textsuperscript{990}

While the report has addressed the notion of conflict in general, this chapter only focuses on the policy conflict arising between investment and non-investment obligations and the effect of such a conflict on coherence. It is understood that two treaties or sets of rules may derive from different backgrounds or be the result of different legislative policies which aim at different objectives. Those differences may result in an investment obligation being fulfilled only by thereby failing to fulfil a non-investment obligation.

\textsuperscript{985} Ibid, at 16.
\textsuperscript{986} Ibid, at 15.
\textsuperscript{987} Ibid, at 19.
\textsuperscript{988} Ibid.
\textsuperscript{989} Ibid.
\textsuperscript{990} Ibid.
3. The Link between Investment and Non-Investment Obligations

The existing literature is generally concerned with the interaction between investment protection, human rights and environmental protection. It is well known that investment has a considerable social and environmental impact besides its main aim of economic growth. The question here is whether bilateral investment treaties have a social dimension connected with the activities of foreign investors in the host state. This will be the case if they impose obligations on foreign investors to avoid negative impact while ensuring the protection of the society and enhancing sustainable development. In this regard it is somewhat obvious that such treaties are single purpose instruments. The main reason behind conducting them is to protect foreign investors and their assets without imposing on them any sort of duties and responsibilities. Generally, these treaties are drafted to provide for investment protection and climate stability and therefore do not address investors’ obligations towards the society in which they carry out their activities.

The purpose of bilateral investment treaties is expressly stated in the preamble of such treaties. Generally, the preamble contains states’ intentions from concluding the treaty as well


994 Ibid.

as treaties’ objectives. A standard preamble will provide for the reciprocal encouragement and protection of investment under the belief that the flow of foreign investment between member states is mutually beneficial to their economic development. In addition they highlight the following:

‘the desire to intensify economic cooperation, the creation of favourable conditions for investment by nationals and companies of one State in the territory of the other, and the encouragement of contractual protection for such investment’.

However, the preambles became more important as investment treaties are critically examined by some parts of the civil society. Consequently, countries have started to include specific language in their investment treaties in order to clarify that the objective of investment promotion and protection must not be pursued at the expense of other key public interests. As noted by the UNCTAD there are now two categories of preambles. The first, and by far the most popular, is that which focuses on ‘the importance of fostering economic cooperation among the contracting parties, promoting favourable conditions for reciprocal investment and recognizing the impact that such investment may have in generating prosperity in the host countries’.

The second category acknowledges that investment promotion and protection need to respect other key public policy objectives. For Sornarajah, such preambles ‘encapsulate notions

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997 Sornarajah, The International Law on Foreign Investment, op. cit., at 188-89.
1000 These public interests include the protection of health, safety, the environment and so on; see ibid.
1001 Ibid.
1002 Ibid.
of development and it could well be that they provide a genesis for the emergence of defences to liability in circumstances where it can be shown that the conduct of the foreign investor was harmful to the economic development of the host state'.

An example of such a treaty is the US BIT Model 2004, which states the following in the preamble:

‘Desiring to achieve these objectives in a manner consistent with the protection of health, safety, and the environment, and the promotion of internationally recognized labor rights.’

The importance of the preamble derives from Article 31 of the VCLT, according to which, the preamble constitutes part of the context of the agreement. Therefore, the wording and the language used in it is highly relevant for the interpretation of the substantive provisions of the treaty. Nevertheless, the contracting parties should ensure that what is stated in the preamble is reflected and consistent with the substantive provisions of the concluded bilateral investment treaty. If this is the case, then the preambles are more likely to play a more significant role in guiding tribunals in the interpretation of such treaties' provisions.

Based on the above, most bilateral investment treaties include preambles that only focus on prosperity and economic growth, while keeping out other relevant societal interests. It is crucial that states recognise the fact that economic growth generates higher societal expectations for higher living standards, quality jobs and labour protection, corporate social responsibility, health standards and safety. While economic growth is the immediate goal

1004 Sornarajah, The International Law on Foreign Investment, op. cit., at 190.
1007 Ibid.
1008 Ibid.
1009 Ibid.
of investment treaties, this does not revoke their social dimension. Having bilateral investment treaties that ignore the pursuit of non-economic public policies creates a situation of 'investment' versus 'human rights' or 'investment' versus 'environmental protection'.

The fact that bilateral investment treaties do not articulate clear views as to the relationship between investment and non-investment obligations of states is against the elements of consistency and support in respect of coherence. Coherence requires such treaties to expressly deal with broader societal interests. In doing so, they should refer to non-investment related obligations of states as well as introduce duties for states and investors to respect such obligations. There have been various proposals calling for imposing obligations on investors into the text of investment treaties. These obligations would include, for example, conditioning the legal protection granted to foreign investors upon operating their investment in a way suitable to not circumvent international labour of human rights conventions. Until this becomes the common practice in international investment law, bilateral investment treaties will continue to lack consistency and support between investment and non-investment obligations.

The link between bilateral investment treaties and sustainable development, human rights and environmental law is established by the law applicable to investment arbitration. For example, Article 40 of the Canadian Model BIT (2004) provides that tribunals shall decide ‘in accordance with this agreement and applicable rules of international law’.

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1011 Ibid.
1012 Ibid, at 246.
1014 Ibid.
under the international rules of treaty interpretation as stated in Article 31.3(c) of the Vienna Convention, arbitrators may interpret treaty obligations in the light of ‘relevant rules of international law applicable in relations between parties’. In this case the relevant rules are those related to human rights, environment and sustainable development. Accordingly, arbitrators may consider other international law obligations in the course of interpreting the obligations contained in an investment treaty. However, there is also an emerging trend whereby non-investment obligations owed by the host state to non-investors have been raised.

In this respect, coherence requires establishing consistency and support between investment and non-investment obligations. A positive constraint is formed whenever non-investment obligations are used to aid in constructing the meaning of an investment obligation. This is because using a non-investment obligation in the course of interpreting an investment obligation is a sign of consistency and support between them both. On the other hand, coherence fails to exist if these obligations conflict with each other. A conflict arises whenever these obligations lack both consistency and support. These two scenarios are explained respectively.

4. Positive Constraints

Bilateral investment treaties create broad obligations rather than specific standards which means that they must be interpreted before they are applied. For example, human rights jurisprudence has been referred to by arbitrators on several occasions. In the case of Tecmed v. Mexico, the arbitrators considered human rights case-law for interpreting a key

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bilateral investment treaty obligation, which is expropriation.\textsuperscript{1020} They looked into the jurisprudence of the European Court of Human Rights on the ‘peaceful enjoyment of possession’ to support the investment treaty protection against expropriation.\textsuperscript{1021} A similar approach was followed in \textit{Azurix v. Argentina}, whereby a judgment of the European Court of Human Rights was deemed to provide ‘useful guidance’ to the interpretation of the expropriation clause stated in the United States and The Argentine Republic’s bilateral investment treaty.\textsuperscript{1022}

Another example can be seen in a recent arbitration concerning a bilateral investment treaty between Sweden and Romania.\textsuperscript{1023} In this case, the tribunal explored whether the claimants were indeed national under Swedish law and thus entitled to sue Romania. In this regard they noted that:

\begin{quote}
\textit{[they] will be mindful of Article 15 of the Universal Declaration of Human Rights according to which everyone has the right to nationality, and that no one shall be arbitrarily deprived of this nationality nor denied the right to change his nationality’}.\textsuperscript{1024}
\end{quote}

Based on the above, investment and non-investment obligations may cohere with each other. Coherence depends on the amount of consistency and support in place. As seen in the preceding paragraphs, in some cases non-investment obligations contribute to clarifying the ambiguity surrounding investment obligations.\textsuperscript{1025} Tribunals interpret treaty provisions in

\begin{footnotesize}
\begin{enumerate}
\item\textsuperscript{1020} \textit{Tecnicas Medioambientales Tecmed, S.A. v. United Mexican States}, ICSID Case No ARB(AF)/00/2, Award of May 29, 2003, at para. 116-122, available at ita.law.uvic.ca/documents/Tecnicas_001.pdf.
\item\textsuperscript{1021} Ibid.
\item\textsuperscript{1022} \textit{Azunix Corp. v. Argentina}, ICSID Case No ARB/01/12, Award of July 14, 2006, para. 311-12, available at ita.law.uvic.ca/documents/AzurixAwardJuly2006.pdf.
\item\textsuperscript{1023} \textit{Ioan Michula and Others v. Romania}, ICSID Case No ARB/05/20, Decision on Jurisdiction and Admissibility, September 24, 2008.
\item\textsuperscript{1024} Ibid., at para 88.
\item\textsuperscript{1025} See Hirsch, ‘Interactions between Investment and Non-Investment Obligations’, \textit{op. cit.}.
\end{enumerate}
\end{footnotesize}
light of non-investment jurisprudence if these obligations complement and reinforce each other.\textsuperscript{1026} This is strong evidence of consistency and support. Therefore, in such a case the relationship between investment and non-investment obligations can be described as coherent.

5. Negative Constraints

The relevance of international non-investment obligations to bilateral investment treaties is not limited to interpretation. It is more often that an investor-state dispute is raised involving international non-investment rights of non-parties to the arbitration.\textsuperscript{1027} The reason for such a conflict is that international non-investment regimes impose a positive duty on states to adopt and enforce measures to ensure that the economic activities conducted within their territories do not negatively impact the society.\textsuperscript{1028} For example, the positive duty of states is well established in the jurisprudence of human rights, arising from treaty terms such as ‘respect’, ‘ensure’ or ‘secure’ in relation to human rights for those subject to the state’s jurisdiction.\textsuperscript{1029} There is no doubt that such a duty extends to both domestic and foreign investors, which means that there is a possibility it may go against the protection granted to foreign investors under a bilateral investment treaty. Thus, the investment obligations may limit or condition the positive duty of states in respect to non-investment obligations.\textsuperscript{1030} In addition, certain activities of foreign investors may harm societal interest within a host state, which raises the

\textsuperscript{1026} Ibid.

\textsuperscript{1028} Mann, ‘International Investment Agreements, Business and Human Rights: Key Issues and Opportunities’, op. cit., at 15.
\textsuperscript{1030} Ibid.
question of whether such conduct should result in disqualifying the involved foreign investors from bringing a claim under a bilateral investment treaty.\textsuperscript{1031}

Unfortunately, bilateral investment treaties do not provide answers to the above questions as they are silent about non-investment obligations. For that reason, the nearest equivalent alternative in international investment law to the duty to protect public interests is the notion of states' right to regulate.\textsuperscript{1032} In other words, the right to regulate becomes the closest related concept in bilateral investment treaties because for states to comply with their international non-investment obligations they are required to enact legal means to protect the public interests.\textsuperscript{1033}

The states' right to regulate in international investment law lies in the customary international law concept of 'police powers'.\textsuperscript{1034} Police powers has been defined as

\begin{quote}
the power of a state to place restraints on personal freedom and property rights of persons for the protection of public safety, health, and morals, or the promotions of the public convenience and general prosperity... The public power is exercise of the sovereign right of a government to promote order, safety, health, morals and general welfare within the constitutional limits and is an essential attitude of governments.\textsuperscript{1035}
\end{quote}

Although it is submitted that the states' right to regulate is inherent in its sovereign status, by concluding a bilateral investment treaty a state accepts certain limitations upon its

\textsuperscript{1031} UNCTAD, 'Selected Recent Developments in Iia Arbitration and Human Rights', \textit{op. cit.}, at 2-3.
\textsuperscript{1032} Mann, 'International Investment Agreements, Business and Human Rights: Key Issues and Opportunities', \textit{op. cit.}, at 17.
\textsuperscript{1033} Ibid.
\textsuperscript{1034} Jacob, 'International Investment Agreements and Human Rights', \textit{op. cit.}, at 18.
sovereignty. Hence, the host state grants assurance to foreign investors that the exercise of its sovereign powers will be subject to the provisions of the treaty concerned.

Due to bilateral investment treaties and the positive duty of states to protect and respect international non-investment, states may find themselves facing contradicting obligations. In terms of coherence, such a contradiction would bring consistency to an end and cut off any supportive links between these obligations. However, existing laws at the time of investment are not that much of problem as most bilateral investment treaties recognise the host state's right to admit foreign investment according to its own laws and regulations. Rather, legal reforms are likely to lead to assertions of breach of the protection these treaties offer to foreign investors. To assess the degree of coherence we shall examine the right to regulate versus a number of bilateral investment treaties' obligations.

5.1. Expropriation

Bilateral investment treaties do not ban expropriation. They allow it as long as it is done for public purpose and in accordance with the law. Nonetheless, there are two types of expropriation: direct and indirect. Indirect expropriation in particular may have threatening implications for the host state's regulatory capacity. The United Nations High Commissioner for Human Rights has noted that:

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1037 Ibid.
1039 Ibid.
1040 Expropriations can be defined as an action by the host state that deprives investors of the ownership, control and economic benefit of the investment, see L. Cotula, ‘Strengthening Citizens’ Oversight of Foreign Investment: Investment Law and Sustainable Development’, *Sustainable Markets Investment Briefings* (1: International Institute for Environment and Development, 2007b).
1041 ‘There is broad agreement that [under international law,] the exercise of the right [of expropriation] should not be discriminatory and should have a basis in public purpose...It is such customary law that is reiterated in [bilateral investment treaties]’, M. Sornarajah, *International Law on Foreign Investment* (Cambridge: Cambridge University Press, 1994) at 253.
1043 Indirect expropriation also known as 'creeping' or 'de facto' expropriation see Dolzer and Stevens, *Bilateral Investment Treaties*, op. cit., at 98-100.
‘To the extent that broad interpretation of expropriation provisions could affect states’ willingness or capacity to introduce new measures to promote and protect human rights, then the and interpretation of expropriation provisions is a cause of concern’.\textsuperscript{1044}

The jurisprudence of international tribunals in regards to indirect expropriation embraces two distinct doctrines: the sole effect doctrine and the police powers doctrine.\textsuperscript{1045} The sole effect doctrine rests on the principle of effect. Based on this doctrine, indirect expropriation is determined solely as to the effect the governmental measure may have on the property owner notwithstanding the purpose behind the measure.\textsuperscript{1046} On the other hand, the police powers doctrine implements a wider perspective which takes into consideration the interest of the government.\textsuperscript{1047} The status of these doctrines as reflected by arbitral tribunals indicates that both doctrines co-exist without either of them being characterised as dominant or representing the mainstream of international thinking.\textsuperscript{1048}

A number of recent investor-state arbitral awards indicate that the government purpose of regulations should not be accorded much weight when it comes to expropriation. For instance, the case of \textit{Santa Elena v Costa Rica} involves expropriation motivated by international non-
investment obligations. Although the expropriation was motivated by environmental concerns, the tribunal stated:

‘While an expropriation or taking for environment reasons may be classified as a taking for a public purpose, and thus may be legitimate, the fact that the property was taken for this reason does not affect either the nature or the measure of compensation to be paid for the taking. That is, the purpose of protecting the environment for which the property was taken does not alter the legal character of the taking for which adequate compensation must be paid. The international source of the obligation to protect the environment makes no difference.’

Further, it also added:

‘Expropriatory environmental measures- no matter how laudable and beneficial to society as a whole- are, in this respect, similar to any other expropriatory measures that a state might take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state's obligation to pay compensation remains.’

The same approach was adopted by the ICSID tribunal in the TECMED case. Despite the fact that this case does not directly involve international non-investment obligations, the TECMED tribunal has disregarded the purpose of the governmental conduct and asserted that the failure to renew an operating permit for a landfill by the Mexican authority constitutes expropriation, and is therefore in violation of the bilateral investment treaty between Mexico

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1049 Compania del Desarrollo de Santa Elena S.A. v Republic of Costa Rica, ICSID Case No ARB/96/1 2000.
1051 Ibid, at para. 72.
and Spain. In this regard, the arbitral tribunal reaffirmed what has been mentioned by the tribunal in *Santa Elena v Costa Rica* case and stated that:

‘The government's intention is less important than the effects of the measure (i.e. the economic value of the use, enjoyment or disposition of the assets of the rights affected by the administrative action or decision have been destroyed or neutralized) on the owner of the assets on the benefits arising from such assets affected by the measures; and the form of the deprivation measures is less important than the actual effects’.

Moreover, in the recent case of *Siemens Corporation v. Argentina*, the ICSID tribunal agreed with the above decisions. The tribunal stated that:

‘A different measure is the purpose of the expropriation, but that is one of the requirements for determining whether the expropriation is in accordance with the terms of the treaty and not for determining whether an expropriation had occurred’.

It is not only cases arising from bilateral investment treaties that have adopted the sole effect doctrine. Other NAFTA cases have also considered the issue of regulatory expropriation and held the effect doctrine as the relevant factor in assessing whether a taking or an expropriation had occurred and ruled out the police power doctrine. A good example is the case of *Metalclad Corporation v. Mexico*, whereby the tribunal explained that there is no

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1053 Ibid.
1054 Ibid.
1056 Ibid, at para. 270.
need to consider the motivation or intent of the host state to determine whether an indirect expropriation occurred.\textsuperscript{1058}

On the other hand, there is the doctrine of ‘police powers’, which is based on the notion that the exercise of the state's right to regulate will not give rise to a right to compensation. This doctrine has been widely accepted in international law.\textsuperscript{1059} If implemented, the host state would not be held responsible for loss of property or any other economic damages resulting from bona fide non-discriminatory actions accepted to be within the state's police powers such as imposing general taxation, regulation or forfeiture for crime.\textsuperscript{1060}

The police power doctrine has been followed in the context of the Iran-United States Claims Tribunal in the case of \textit{Too v. Greater Modesto Insurance Association}, where the claimant was asking for compensation for the seizure of his liquor licence by the United States Internal Revenue Service.\textsuperscript{1061} In this regard, the tribunal states that:

\begin{quote}
“A state is not responsible for loss of property or for other economic disadvantages from bona fide genera taxation or any other action that is commonly accepted as within the police power of States, provided it is not discriminatory and is not designed to cause the alien to abandon the property to the State or sell it as a distress price”\textsuperscript{1062}.
\end{quote}

\begin{footnotes}
\footnote{1058}{See Metalclad Corp. v. United Mexico States, ICSID Case No ARB (AF)/97/1 2000. The tribunal further elaborated that ‘Expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure of formal or obligatory transfer of title in favour of the host state, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use of reasonably to be expected economic benefit of the property, even if not necessarily to the obvious benefit of the host State’, at para. 41.}
\footnote{1059}{It is an acknowledges principle of international law that compensation is not required in case economic injury results from a bona fide non-discriminatory regulation within the police powers of the state. See OECD, ‘Indirect Expropriation’ and the ‘Right to Regulate’ in International Investment Law, \textit{op. cit.}, at 5.}
\footnote{1060}{This has been mentioned in the commentary to the American Law Institute's Restatement Third of Foreign Relations Law of the United States. See ‘Restatement of the Law Third: the Foreign Relations of the United States’, 1 American Law Institute 1987, section 712.}
\footnote{1061}{Too v. Greater Modesto Insurance Associations, Award December 29, 1989, 23 Iran-United States Claims Tribunal Rep 378.}
\footnote{1062}{Ibid.}
\end{footnotes}
Another example is the case of *Lauder v. Czech Republic*. This arbitration is possibly the first public dispute under a bilateral investment treaty decided by the UNCITRAL rules rather than the ICSID. In regard to the interference with property rights, the tribunal in this case decided that ‘*Parties to [the Bilateral] Treaty are not liable for economic injury that is the consequences of bona fide regulations within the accepted police powers of the State*’.1065

The same broad notion was adopted by the tribunal in the NAFTA case of *Methanex v. United States*.1066 The decision explains:

‘... as a matter of general international law, a non-discriminatory regulation for a public purpose which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments has been given by the regulating government to the then putative foreign investor contemplating investment that the other government would refrain from such regulation’.1067

From the aforementioned judgments it is understood that the expropriation clause in bilateral investment treaties has given rise to conflicts when considering whether the states' right to regulate should be regarded as a fundamental principle in determining expropriation. As can be seen in the preceding paragraphs, the decisions of tribunals arbitrating bilateral investment treaties’ disputes undermine the host states' ability to impose non-investment obligations.

1063 *CME Czech Republic B.V. (Lauder) v. Czech Republic*, UNCITRAL award (March 14, 2003), 9 ICSID Reports 264.
1065 *CME Czech Republic B.V. (Lauder) v. Czech Republic*, UNCITRAL award (March 14, 2003), 9 ICSID Reports 264, at para. 198.
1067 Ibid, at para. 7.
Such a situation is likely to create regulatory chill due to the possibility of being sued for expropriation and pay compensation. This was the case in Indonesia where a number of foreign owned mining companies threatened to launch international arbitration against the Indonesian government for banning open-pit mining in protected forests.\textsuperscript{1068} The foreign investors, which at the time were about 150 companies, implied that such a measure would allege indirect expropriation under at least two applicable bilateral investment treaties.\textsuperscript{1069} As a result, the Indonesian government decided to repeal the ban following a statement made by the Indonesian Environment Minister stating that ‘there were Investment Activities before the Forest Act was effective. If shut down, investors demand compensation and Indonesia cannot pay’.\textsuperscript{1070}

Investment and non-investment obligations sometimes provide overlapping forms of property protection. For instance both bilateral investment treaties and human rights law provide protection against expropriation. However, they seem to follow different approaches.\textsuperscript{1071} They also fail to agree on when a particular governmental action constitutes expropriation, and whether compensation should be paid and the amount of compensation.\textsuperscript{1072} Additionally, conflicting views also exist in relation to whether compensation for moral damages should be awarded or not.\textsuperscript{1073}

From the above, it is evident that in the context of expropriation, inconsistency may arise between investment and non-investment obligations. Investment tribunals have chosen to develop their own views in a random manner without an attempt to lay out a coherent set of

\textsuperscript{1069}Ibid, at 897.
\textsuperscript{1070}Ibid, at 895.
\textsuperscript{1071}Both bilateral investment treaties and human rights law provide protection against expropriation. See Peterson, 'Human Rights and Investment Treaties: Mapping the Role of Human Rights Law within Investor-State Arbitration', \textit{op. cit.}, at 44.
\textsuperscript{1072}Ibid.
\textsuperscript{1073}Ibid.
regulatory principles.\textsuperscript{1074} Thus, there are no specific set of consistent and supportive views as to expropriation under bilateral investment treaties and states’ right to regulate. The lack of coherence means that occasionally host states may find themselves in a position where complying with their non-investment obligations goes hand in hand with breaching their investment obligations.

5.2. Standards of Treatment
International law requires a minimum of fairness in treating foreigners as well as foreign investors.\textsuperscript{1075} However, most bilateral investment treaties expressly incorporate higher standards including fair and equitable treatment, full protection and security, non-discrimination and national and most-favoured-nation treatment.\textsuperscript{1076} Although these standards were introduced to enhance certainty and protection accorded to foreign investment, their scope is vague and unpredictable.\textsuperscript{1077} The broad terms used to describe most of these standards make them subject of debate. It is not clear whether they call for something more than the international minimum standard and, if so, may in fact reach states' actions that do not rise to the level of indirect expropriation.\textsuperscript{1078}

Available in almost every bilateral investment treaty is the standard of fair and equitable treatment, according to which, host states are required to accord foreign investment fair and equitable treatment.\textsuperscript{1079} If this standard is considered as a mere reflection of the international minimum standard then it will only be violated by 'egregious' states’ conduct where there is evidence 'showing bad faith, discriminatory intent, and/or ultra vires actions on the part of

\textsuperscript{1074}Hirsch, 'Interactions between Investment and Non-Investment Obligations', \textit{op. cit.}.
\textsuperscript{1075}Dolzer and Stevens, \textit{Bilateral Investment Treaties, op. cit.}, at 58.
\textsuperscript{1076}Sornarajah, \textit{The International Law on Foreign Investment, op. cit.}, at 187-224.
\textsuperscript{1077}The standards of treatment in most bilateral investment treaties are drafted using broad terms such as 'reasonable', 'fair and equitable' and 'full protection', ibid.
\textsuperscript{1078}Gross, 'Student Note: Inordinate Chill: Bits, Non-Nafta Mits, and Host-State Regulatory Freedom - an Indonesian Case Study', at 934.
\textsuperscript{1079}For further details see Tudor, \textit{The Fair and Equitable Treatment Standard in the International Law of Foreign Investment, op. cit.}.
In this regard, the tribunal in the TECMED case unequivocally rejected the position that the fair and equitable clause is equivalent to the minimum standard in international law. Otherwise, it stated that the clause ‘would be deprived of any semantic content or practical utility of its own’.

Over and beyond, in the case of Occidental, the tribunal held that a violation of the fair and equitable treatment automatically constitutes violation of the full protection and security standard.

Bilateral investment treaties use different drafting styles when referring to the fair and equitable treatment standard. The standard has also been interpreted differently. However, it is agreed that the standard requires host states’ actions towards foreign investors to be transparent, in good faith, consistent with due process and not arbitrary, unjust or unfair. Hence, states should not violate the investors’ legitimate expectations in regards to the applicable legal and regulatory framework as well as the states’ performance of contractual obligations.

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1080 Gross, ‘Student Note: Inordinate Chill: BITs, Non-NAFTA MITs, and Host-State Regulatory Freedom - an Indonesian Case Study’, op. cit., at 937.
1084 Ibid; See also Dolzer and Schreuer, Principles of International Investment Law, op. cit., at 121.
1086 Proving bad faith is not a requirement to establish violation. See Johnson, ‘Investment Agreements and Climate Change: The Potential for Investor-State Conflicts and Possible Strategies for Minimizing It’, op. cit., at 11153.
The fair and equitable treatment standard seems to cover broad and varied governmental actions.\textsuperscript{1087} In the case of \textit{Biwater Gauff v. Tanzania}, the tribunal found that the government had violated the fair and equitable treatment standard by publicly criticising the investor's performance in providing water and publicly announced that it had terminated the investor's contract.\textsuperscript{1088} Another example is the case of \textit{National Grid v. Argentina}, where the tribunal found that the fair and equitable treatment standard had been breached due to the government failing to conduct 'meaningful negotiations' with the investor.\textsuperscript{1089}

Thus, the fair and equitable treatment standard forms a very important legal basis for investors seeking redress for negative non-investment measures on their investment.\textsuperscript{1090} Whenever expropriation claims fail, the fair and equitable treatment obligation may provide a basis for relief.\textsuperscript{1091} This explains why states may face challenges based on fair and equitable treatment while they were in pursuit of legitimate non-investment policies.

Besides the fair and equitable treatment, bilateral investment treaties require states to avoid conducting unreasonable or discriminatory measures.\textsuperscript{1092} Such a standard has two components: first, that states are prohibited from impairing foreign investment through 'discriminatory' measures, and second, through 'unreasonable' measures.\textsuperscript{1093} There are

\begin{itemize}
\item \textsuperscript{1087} According to the UNCTAD the fair and equitable treatment claims are the most relied upon and successful basis for a treaty claim, on the basis that investors prevailed on the majority of the 13 known decisions issued in 2008 involving fair and equitable treatment claim, UNCTAD, 'Latest Developments in Investor-State Dispute Settlement', \textit{op. cit.}, at 7.
\item \textsuperscript{1088} The tribunal stated that 'despite [the investor's] poor record, and despite all the public criticisms, City Water still had the right to the proper and unhindered performance of the contractual termination process'. The tribunal proceeds to explain how the government undermined such a right by making statements that 'inflamed the situation ... and polarized public opinion still further', \textit{Biwater Gauff Ltd. v. Tanzania}, ICSID Case No ARB/05/22 of July 18, 2008, at para. 627.
\item \textsuperscript{1090} Johnson, 'Investment Agreements and Climate Change: The Potential for Investor-State Conflicts and Possible Strategies for Minimizing It', \textit{op. cit.}, at 11153.
\item \textsuperscript{1091} Ibid.
\item \textsuperscript{1092} International law recognises the prohibition of discriminatory treatment of aliens. Under this principle discrimination is actionable if two conditions are met which are the intent to injure the alien combined with factual injury. See Dolzer and Stevens, \textit{Bilateral Investment Treaties, op. cit.}, at 61-62.
\item \textsuperscript{1093} Ibid, at 62.
\end{itemize}
different ways in which this standard would limit a host state's ability to enforce non-investment obligations. The non-discrimination obligation could have an impact on

‘living wage laws covering a certain class of investors, laws mandating
union neutrality in specific industries, requirements to remain in a state or
municipality for a minimum period of time, laws requiring severance
payments to dislocated workers and communities, and other existing or
proposed policies to stem capital flight and create high quality jobs for
local citizens’. 1094

On the other hand, the ‘unreasonableness’ clause may provide excessive discretion to arbitral tribunals in validating investors' challenges against host states' environmental, human rights, land use, public health and worker safety regulations. 1095

Moreover, bilateral investment treaties are likely to contain clauses requiring host states to accord foreign investors a treatment not less favourable than the treatment accorded to its own nationals (national treatment) and/or that accorded to nationals of any other third party (most-favoured-nation). 1096 A recent arbitral award suggests that national treatment could be used to challenge states’ imposition of non-investment obligations if domestic corporations, even in other economic sectors, are excluded from such obligations. 1097 Adopting such a broad approach as to what is comparable could serve to challenge states' regulations aimed at

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1095 Ibid.
1096 Dolzer and Stevens, Bilateral Investment Treaties, op. cit., at 63.
1097 See Occidental Exploration and Production Company v. Ecuador, UNCITRAL, Final Award, 1 July 2004, at para 168-179. In this case the tribunal accepted the claimant's (oil company) argument that the discontinuation of its value-added tax (VAT) refunds violated the national treatment provisions as other exporters in Ecuador continued to enjoy VAT refunds.
achieving certain non-investment policies or obligations by supporting different sectors or groups of society.  

As under the MFN treatment, it is sometimes possible to secure substantive and procedural advantages provided for in other investment agreements signed by the host state. In MTD Equity, the tribunal decided that the claimant has recourse to substantive investment protection under the Denmark-Chile and Croatia-Chile bilateral investment treaties due to the MFN clause contained in the governing Malaysia-Chile bilateral investment treaty. In addition, in the decision on jurisdiction in Siemens v. The Argentine Republic, the tribunal permitted the claimant to access the dispute settlement procedure without the exhaustion of local remedies relying on the most-favoured-nation clause.

With respect to the aforementioned clauses, the balance between investor protection and the state's right to regulate remains elusive. The issue of non-investment and public purpose justifications of state regulation within the investment jurisprudence is neither clear nor uniform. The lack of consistency and certainty makes it difficult for states to distinguish between actions that are likely to amount to a breach of a bilateral investment treaty and those which are lawful. Until clearer normative benchmarks have been established, coherence will remain weak.

5.3. Other Provisions
There are several other provisions contained in most bilateral investment treaties which may have an impact on the host state's capacity to regulate and impose non-investment obligations.

1099 Ibid, at 18.
1100 MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile, ICSID Case No ARB/01/7 2004.
1101 Ibid, at para. 100-104.
1102 Siemens v. The Argentine Republic, ICSID Case No ARB/02/8 2004.
1103 Ibid, at para 107-09.
One of these provisions is the definition of covered investment. The broader the scope of the definition, the wider the range of protected assets becomes.\textsuperscript{1104} Another example is the admission clause which governs the circumstances according to which an investment is granted admission to the host state.\textsuperscript{1105} If such a clause provides for 'right of establishment' or 'national treatment in the pre-establishment phase',\textsuperscript{1106} the host state would then be obliged to permit the admission of a foreign investment despite, for instance, the investor's record of lack of respect for human rights or environmental law.

Over and beyond, some bilateral investment treaties include stabilisation clauses.\textsuperscript{1107} These clauses are considered as a risk-management device incorporated to ensure investors that the legal and regulatory framework related to their investment will not change, and if changed, the investor will be entitled to compensation for any resulting harm.\textsuperscript{1108} Generally, the provisions vary in form and scope. Nonetheless, they can be divided into three broad categories: 1) freezing clauses which aim at making new laws inapplicable to the investment, 2) economic equilibrium clauses which require foreign investors to comply with the new laws provided that the host state pay them compensation for the cost of compliance and 3) hybrid clauses obliging the host state to restore the foreign investors to the same position they had prior to changes in law.\textsuperscript{1109} Although these act as strong incentives for foreign investors, they

\textsuperscript{1104}Recent BITs often define investment 'by a list of five groups of specific rights which usually include traditional property rights, rights in companies, monetary claims and titles to performance, copyright and industrial property rights as well as concessions and similar rights', Dolzer and Stevens, Bilateral Investment Treaties, op. cit., at 26.

\textsuperscript{1105}Dolzer and Stevens, Bilateral Investment Treaties, op. cit., at 50-58 and 76-78.


\textsuperscript{1107}Most stabilisation clauses are set forth in contracts between the investor and the host state rather than a clause in the treaty itself. However if the host state breach such a contract, the investor might be able to raise such a breach as violation of a bilateral investment treaty by arguing that it constitutes a breach of the fair and equitable treatment obligation or an umbrella provision. See International Financial Corporation (IFC), 'Stabilization Clauses and Human Rights: A Research Project Conducted for IFC and the United Nations Special Representative to the Secretary General on Business and Human Rights', (2008) at 4, 36. available at http://www.ifc.org/ifcext/sustainability.nsf/AttachmentsByTitle/p_StabilizationClausesandHumanRights/$FILE/Stabilization+Paper.pdf.

\textsuperscript{1108}Ibid, at 1.

\textsuperscript{1109}Ibid, at 5-6.
are likely to prevent host states from implementing crucial non-investment policies and obligations.\textsuperscript{1110}

Finally, the host states' right to regulate is greatly hindered by the dispute settlement provisions. The investor-state dispute settlement mechanism is a standard feature of investment treaties and in most cases does not require the exhaustion of local remedies before international arbitration is invoked.\textsuperscript{1111} Despite the different venues of arbitration including institutional and ad hoc arbitration,\textsuperscript{1112} the process itself lacks in transparency, legitimacy and accountability.\textsuperscript{1113} ICSID is the only arbitral process requiring disputes to be publicly registered, showing the parties, the date of registration and an indication of the dispute's subject matter.\textsuperscript{1114} However, this will be the only information available, since in order to publish an award, the consent of the parties involved is required.\textsuperscript{1115} As a result of such secrecy, the law governing foreign investment is not fully available to governments which in turn increases the possibility of regulatory chill.\textsuperscript{1116}

In addition, the legal uncertainty surrounding investor-state arbitration is further enhanced by the absence of a consistent and binding body of precedent.\textsuperscript{1117} Bilateral investment treaties do

\textsuperscript{1110} Ibid, at 34.
\textsuperscript{1112} Bilateral investment treaties may provide for either institutional or ad-hoc arbitration. The institutional arbitration can be governed by the ICSID, the International Chamber of Commerce and the Stockholm Chamber of Commerce. As for the ad-hoc arbitration it is likely to be conducted in accordance with the rules prescribed by the treaty or by the rules provided by the UN Commission on International Trade Law (UNCITRAL). See Peterson, ‘All Roads Lead out of Rome: Divergent Paths of Dispute Settlement in Bilateral Investment Treaties’, \textit{op. cit.}, at 8-9.
\textsuperscript{1113} Ibid.
\textsuperscript{1114} Ibid, at 10-11.
\textsuperscript{1115} Ibid, at 12.
\textsuperscript{1116} Ibid.
\textsuperscript{1117} Ibid, at 16.
not require consolidation of related cases into a single proceeding.\textsuperscript{1118} Thus, common issues are likely to be re-litigated separately leading to greater inconsistent results. The impact of that issue on non-investment obligations is almost certain whenever

\begin{quote}
\textit{the prospect of multiple arbitrations -running in parallel or consecutively- sets up the very situation where sensitive government regulations or measures will be scrutinized by a number of tribunals (under one or many different bilateral investment treaties with the host state) which could reach different, and even contradicting conclusions}.
\end{quote}

\section*{6. Reforms to Enhance Coherence}

Certainly there are a growing number of investment treaty arbitrations where non-investment issues have been raised. These cases pose important questions as to coherence between bilateral investment treaties and non-investment obligations as well as to how the latter can fit with the former. Accordingly, serious consideration should be given to modifying the structure and content of future bilateral investment treaties to address situations where states face competing international obligations.\textsuperscript{1120} Nevertheless, some may argue that current bilateral investment treaties already contain a tool that helps in avoiding such contradiction.\textsuperscript{1121} Generally, these treaties provide for exemptions allowing host states to deviate from their obligations under specific circumstances.\textsuperscript{1122}

\begin{flushleft}
\textsuperscript{1118} Ibid.
\textsuperscript{1119} Ibid.
\textsuperscript{1121} This is based on the principle of customary international law allowing states to take necessary measures in order to protect their national security provided that certain conditions are met. See S. Rose-Ackerman and B. Billa, ‘Treaties and National Security’, New York University of International Law and Politics, 40 (2008), 437-96 at 443-51.
\textsuperscript{1122} See Sornarajah, The International Law on Foreign Investment, op. cit., at 222-24.
\end{flushleft}
An exception that could cover host states' non-investment measures is the so-called national
security or essential security exception.\textsuperscript{1123} In order to assess whether and to what extent this
exception will ensure a higher level of coherence, it is first necessary to examine the links
between non-investment obligations and threats to national security. Considering for example,
the implications of climate change for national security issues, climate change may be a
proximate and powerful cause.\textsuperscript{1124} Climate change is predicted to cause the loss of land by
rising seas, the redrawing of borders due to melting glaciers and a decline in water resources
and agricultural production, spreading desertification and long-term drought.\textsuperscript{1125} The impact
of these predicted effects varies greatly within and between countries.\textsuperscript{1126} However, the link
between climate change and national security is undeniable.\textsuperscript{1127} Hence, as investors are likely
to bring challenges against climate change related measures adopted by host states, the states
may seek to defend their position by relying on a national security exception if available in
the applicable bilateral investment treaty.\textsuperscript{1128}

The merits of host states' reliance on the national security exception are determined by the
treatment of such an exception in practice.\textsuperscript{1129} The language used for expressing the exception
varies between treaties, and those differences have implications for the exception's scope.\textsuperscript{1130}

The key variation between provisions is whether the exception is 'self-judging' or 'non-self-

\textsuperscript{1123} According to a study by UNCTAD, national security exceptions are ‘included in the majority of the [free trade
agreements] with investment provisions, and in 12 per cent of the [bilateral investment treaties] reviewed’, UNCTAD, 'The
Protection of National Security in IIAs', \textit{UNCTAD Series on International Investment Policies for Development} (New York,
16/2 (1991), 76-116 at 76-77.
\textsuperscript{1125} L. Johnson, 'Investment Agreements and Climate Change: The Potential for Investor-State Conflicts and Possible
Strategies for Minimizing It', \textit{op. cit.}, at 11155.
\textsuperscript{1126} Ibid, at 11156.
\textsuperscript{1127} Ibid.
\textsuperscript{1128} Ibid.
\textsuperscript{1129} For a detailed analysis on this issue see A. Reinisch, 'Necessity in Investment Arbitration', \textit{Netherlands Yearbook of
\textsuperscript{1130} The UNCTAD study found that ‘Countries have adopted a variety of approaches concerning the drafting of a national
security exception in IIAs. Differences exist with regard to the term used (e.g. national security, essential security interests,
international peace and security, or public order), the conditions under which the exception can be invoked, and the degree
of autonomy that Contracting Parties reserve for themselves in assessing whether a threat to national security exists and
how to respond to it. Countries considering national security exception in IIAs therefore face a number of critical choices’. See
UNCTAD, 'The Protection of National Security in IIAs', \textit{op. cit.}, at xviii-xix.
judging'. Arbitral decisions reviewing the application of the national security exception show that the existence or absence of self-judging words such as "considers" or "determines" will have significant implications for a state's ability to invoke that defence. In case the provision contains self-judging language, tribunals will generally defer to the state's determination of necessity, subject to whether the state acted reasonably and in good faith. To the contrary, when a provision is non-self-judging, the host state's actions will then be subject to greater scrutiny.

A good example is the reasoning in the *Enron v. Argentina* award. In this case the arbitral tribunal turned down Argentina's claim that the U.S.-Argentina bilateral investment treaty allowed 'each party to be the sole judge of when the situation requires measures of the kind envisioned by the Article, subject only to a determination of good faith by tribunals that might be called upon to settle the dispute on this question'. In this regard the tribunal noted that "truly exceptional and extraordinary clauses such as a self-judging provision normally must be expressly drafted to reflect that intent". Given the absence of such precise self-judging language in the concerned treaty, the tribunal decided that it had to look beyond the issue of whether Argentina acted in good faith and inquire 'whether the requirements under customary law or the Treaty' were met.

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1133 Ibid.
1134 Ibid.
1135 Ibid.
1137 Ibid, at para 324.
1138 Ibid, at para 335.
It is evident from the development of jurisprudence that states' discretion to deviate from their investment obligations is greater when the exceptions are self-judging.\textsuperscript{1139} In cases of self-judging exceptions the primary restriction on state action will be the requirement that the actions were conducted in good faith. On the other hand, states face more obstacles when seeking to rely on non-self-judging exceptions or customary international law to justify those actions which are inconsistent with investment treaties. In addition to good faith, host states in such cases are required to prove that their measures were the only available means of safeguarding their essential interests against imminent harm. So, in order to enhance coherence the following consolidation should take place.

\textbf{6.1. Non-Investment Provisions}

The current text of bilateral investment treaties is limited to foreign investment protection. It accords rights to investors without imposing any duties or obligations on them.\textsuperscript{1140} To remedy this issue, these treaties should include a broader set of actors, rights and responsibilities going beyond the exclusive focus on investors' rights.\textsuperscript{1141} The imposed obligations may cover both the pre-establishment and post-establishment phases of the investment.

To illustrate, host states would be responsible for maintaining development priorities and guaranteeing high environmental, human rights and health standards in the pre-establishment phase.\textsuperscript{1142} In addition, host states’ responsibilities during the post-establishment phase relate


\textsuperscript{1140} Peterson, ’All Roads Lead out of Rome: Divergent Paths of Dispute Settlement in Bilateral Investment Treaties ’, \textit{op. cit.}, at 35.

\textsuperscript{1141} Ibid, at 30.

\textsuperscript{1142} Ibid, at 32.
to regulating in the public interest.\textsuperscript{1143} On the other hand, foreign investors would be obliged to respect non-investment obligations, such as being required to undertake

‘human rights impact assessment [and] adhere to transparency requirements with respect to royalties and taxes paid to host states; or [agreement might include] an explicit conditioning of rights upon respect for domestic and international human rights rules’.\textsuperscript{1144}

As a result of imposing non-investment obligations on both state parties and foreign investors within the context of bilateral investment treaties, the degree of coherence is likely to increase. The explicit obligations would ensure the legal relevance of non-investment obligations to the adjudication of investment claims and that, in turn, would enhance comprehensiveness,\textsuperscript{1145} consistency and strengthen the supportive links between investment and non-investment obligations. Moreover, even better results could be achieved by having investment treaties that explicitly condition investors’ rights on investors’ compliance with non-investment norms.\textsuperscript{1146}

\textbf{6.2. Clarifying the Scope of Investment Provisions}

As addressed earlier, bilateral investment treaties’ provisions are generally drafted using broad terms. Although the nature of these treaties and the subject matter they regulate require having a certain level of flexibility to ensure treaties’ ability to adapt to future changes, occasionally disadvantages may arise. This is because most of the time, investment provisions are interpreted in favour of strong investor protection while preventing states from pursuing non-investment interests.\textsuperscript{1147}

\textsuperscript{1143} Ibid.
\textsuperscript{1144} Ibid, at 39.
\textsuperscript{1145} Ibid, at 35.
\textsuperscript{1146} Ibid.
\textsuperscript{1147} Bilateral investment treaties were first concluded between developed and developing countries as the later being in most cases the host state. Thus perhaps it is the power imbalance between these countries that has sustained the strong investor protection in investment treaties until now. See R. Suda, ‘The Effect of Bilateral Investment Treaties on Human Rights...
In order to avoid limiting states' right to regulate, the scope of expropriation in bilateral investment treaties should be restricted to exclude regulatory takings and measures. Host state should not be required to compensate foreign investors as long as their actions generate regulations in the public interest. This approach was followed by the United States and Canada as both countries attempted to restrict the scope of indirect expropriation by providing a definition for it. Consequently, coherence would be higher if investment tribunals were required to consider the nature of the government actions whenever they interpreted investment provisions, as opposed to focusing on the economic impact of their conduct.

6.3. Dispute Settlement Reforms

It is evident that there is an increasing impact of investment disputes on a number of public interest matters. In addition, the lack of transparency, legitimacy and accountability in the dispute settlement process increase the possibility of regulatory chill. Responding to these issues requires the consideration of a number of suggestions. Firstly, the establishment of a multilateral court dedicated to investor-state investment disputes featuring independent jurists and public proceedings. By doing so, international investment law is likely to witness substantial development.

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1148 The most recent U.S. Model BIT 2004 provides that the nature of the government action, not simply its economic impact, is to be taken into account in determining whether the action constitutes an indirect expropriation. See U.S. Model BIT 2004 at Annex B, 4(a) (2004), available at http://www.state.gov/document/organization/38710.pdf. The U.S. model BIT also provides that ‘except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations’, at Annex B, 4(b). For more information in respect of the changes in U.S and Canadian approaches to bilateral investment treaties see Peterson, ‘All Roads Lead out of Rome: Divergent Paths of Dispute Settlement in Bilateral Investment Treaties’, op. cit., at 28-29.

1149 In this regard Peterson states that ‘the establishment of a multilateral tribunal and/or an appellate process geared specifically to issues of foreign investment agreements and customary international law standards’, Peterson, ‘All Roads Lead out of Rome: Divergent Paths of Dispute Settlement in Bilateral Investment Treaties’, op. cit., at 35.

Secondly, if the above suggestion is not possible to implement, bilateral investment treaties should ensure transparency, legitimacy and accountability by adopting a number of mechanisms. This can be done by having a standing body of panellists, public proceedings, third-party amicus curiae status, public access to documents and the availability of an appeal process. Another possible improvement can easily be achieved if bilateral investment treaties oblige international investment tribunals encountering arguments regarding inconsistencies between investment and non-investment obligations to draw on the principles of public international law. Public international law sets forth a coherent body of rules that regulates inconsistencies among international legal rules. In addition, tribunals should be required to resort to Articles 30 and 53 of the Vienna Convention which set out explicit rules regarding inconsistent treaties. In this way, bilateral investment treaties would be able to limit tribunals' practice of developing their own rules in an incoherent sporadic manner.

7. Conclusion

The above analysis indicates that the increasing interaction between investment and non-investment obligations highlights a host of questions regarding the relationship between these spheres of international law. Although occasionally the legal rules deriving from these international spheres complement and reinforce each other, they often contradict and conflict. Nowadays, international investment law is required more than ever to strike a balance between these competing obligations. This necessity derives from how bilateral investment treaties’ provisions affect states' regulatory capacity through preventing states from introducing new laws and limiting enforcement actions taken under existing laws and regulations.

1153 Ibid.
Enhancing coherence between bilateral investment treaties and non-investment obligations is key to solving the above problem. However, to achieve higher levels of coherence, investment treaties must experience a wide range of reforms. These reforms include containing explicit non-investment provisions, specifying the scope of investment provisions and reforming the dispute settlement process. Until that is done, coherence between bilateral investment treaties and other spheres of international law will remain weak. Such weakness undermines the objectives of international law which aims at bringing order and stability to all.
Conclusion

International foreign investment has evolved over the years in response to a number of economic and political changes. Bilateral investment treaties remain the main instrument governing the relation of foreign investors and host states. It is important for these treaties to remain coherent in order to meet their purpose. Coherence entails consistency and mutual support. In applying coherence, bilateral investment treaties are divided into subsets. The subset that features consistency and mutual support forms positive constraints. The other subset reflects inconsistency and lack of support and is thus referred to as the negative constraints. The coherence of bilateral investment treaties has been addressed in six areas: coherence between bilateral investment treaties and the fundamental principles of international investment law, coherence between bilateral investment treaties and treaties’ objectives of investment promotion and investment liberalisation, coherence within the network of bilateral investment treaties, coherence between bilateral investment treaties and customary international law on foreign investment, coherence between bilateral investment treaties and free trade agreements and coherence between bilateral investment treaties and states’ non-investment obligations.

The examination of international investment law demonstrates the existence of two fundamental principles: the principle of national treatment and the principle of minimum international standard. These principles reflect the tension between developed and developing countries. Developed countries are strong supporters of the minimum international standard while developing countries maintain the view of the principle of national treatment. However, each of these principles has been coherent with an economic theory and a number of political commitments. The principle of national treatment formed positive constraints with the
economic theory of dependence. In following this theory, developing states adopted political commitments in coherence with the principle of national treatment.

On the other hand, developing states maintained their position regarding the assertion of a minimum international standard. They adopted the theory of classical economies which reflect positive constraints with their views. At the same time they were trying to confirm a minimum international standard at the international level. In support of this standard a number of international regulative initiatives were launched. Each of these regulations is consistent with and supportive to the minimum international standard for the protection of foreign investment. However, amongst these initiatives bilateral investment treaties are by far the most important. These treaties came to strongly reflect the view of developed countries. Treaties’ provisions are drafted to cohere with the minimum international standard and ignore the principle of national treatment. Although these treaties are significantly incoherent with the views of developing countries, the economic and political reality of the world left these countries with no option other than to change their policies and sign bilateral investment treaties.

Coherence is then applied to bilateral investment treaties and their objectives of investment promotion and investment liberalisation. In respect of the first objective, a high degree of coherence is established. Treaties’ provisions which include a definition clause, standards of treatment, protection against expropriation and compensation and dispute settlement form positive constraints with the objective of investment promotion. On the other hand, less coherence is found between these treaties and the objective of investment liberalisation. The number of negative constraints between this objective and the provisions of bilateral
investment treaties make these treaties of very limited use for investment liberalisation. In this context, a wide range of reforms must be undertaken in order to enhance coherence.

A potential for coherence between bilateral investment treaties is found through the MFN clause and investor-state dispute settlement procedure. The fact that it is possible to import ‘more favourable’ substantial protection procedures along with importing procedural provisions concerning admissibility enhances the overall coherence of the network of bilateral investment treaties. In addition, the investor-state dispute resolution mechanism under bilateral investment treaties creates a level playing field for the settlement of investment disputes and the enforcement of substantial investment protection. However, a number of issues stand between these tools and attaining better coherence.

Controversial arguments exist in regard to bilateral investment treaties and customary international law in the area of foreign investment. For some, these treaties are seen as tools which influence and enhance customary international rules related to foreign investment, while others assert that the sweeping practice of these treaties make them the new customary rule. In applying coherence, it is found that in some areas customary international law interprets and compliments treaties’ provisions and thus demonstrates a coherent relation. On the other hand, in some cases these treaties derogate from customary international law to avoid risk associated with customary rules and on such occasions they may both be incoherent. However, such incoherence is accepted as it is justified to achieve better overall coherence.


Moreover, is it important to consider the degree of coherence between bilateral investment treaties and the investment provisions included in most free trade agreements. In this respect, it is important to highlight the fact that FTAs’ main aim is liberalisation while bilateral investment treaties focus more on investment protection and promotion. Nonetheless, a number of positive constraints appear between these provisions vis a vis investment definition, substantial protection provisions, expropriation and capital transfer. On the other hand, negative constraints between these provisions are featured in respect to entry and establishment, performance requirements and investor-state dispute settlement. Accordingly, coherence in this area can only be increased by addressing these negative constraints.

Another form of interaction is found between investment obligations imposed by bilateral investment treaties and non-investment obligations of states which include human rights, environment protection, development and sustainable development. The coherence between these obligations reflects that occasionally they can complement and reinforce each other, but nonetheless, they often contradict. The incoherence derives from bilateral investment treaties’ provisions affecting states’ capacity to regulate by introducing new laws and limiting enforcement actions taken under existing laws and regulations. As seen in the preceding chapter, a lot can be done in terms of coherence in this area.

Based on the above, the consolidation of bilateral investment treaties in terms of making them more coherent is divided into subtractive consolidation and additive consolidation.\textsuperscript{1156} Subtractive consolidation includes the existing provisions that should be ruled out or amended due to their incoherence in regards to a certain matter. As for additive consolidation, it requires adding provisions that extend or further strengthen the overall coherence of these

\textsuperscript{1156} The terms subtractive consolidation and additive consolidation are adopted from Olsson’s theory of coherence and semi-revision, see Olsson, ‘A Coherence Interpretation of Semi-Revisions’, \textit{op. cit.}, at 123-25.
treaties. However, this process is solely based on making bilateral investment treaties more coherent as it has been explained throughout this whole study. The recommendations below should be read as general guidelines within the context of coherence. In this sense, states should take them into consideration when reviewing their bilateral investment treaties network and adopt those which they believe would help in optimising their overall development strategy. Moreover, there are a number of options which states can follow when trying to implement these recommendations. For example some of these recommendations can be implemented within the main body of these treaties while others can be mentioned in annexes and protocols attached to such treaties. Nonetheless, this study is only concerned with providing these recommendations and leaving states free to implement them in whatever manner they find suitable.

Based on the preceding chapter the recommendations for subtractive and additive consolidations are as follows:

1. **Subtractive Consolidation**
   
   1. Admission clauses should be amended to limit states’ control over the entry of foreign investors to be more coherent with their objective of investment liberalisation. Coherence requires these treaties to guarantee the admission of foreign investment into the territory of either of the member states.
   
   2. Bilateral investment treaties should not refer to the minimum standard of protection for foreign investment or customary international law unless they identify their meaning. This is because coherence requires these treaties to provide certainty to foreign investors and reduce risk associated with the investment. However, referring to these standards without clarifying their meaning brings ambiguity to treaties and thus affects their coherence.
2. Additive Consolidation

1. Bilateral investment treaties should add provisions for the purpose of imposing an obligation on the home state of investors to encourage and facilitate outward investment. In doing so, the coherence between bilateral investment treaties and their objective of investment promotion will increase.

2. Bilateral investment treaties should include provisions tailored for attracting new and re-investment by existing investors such as granting them some kind of incentive. Such provisions will enhance the coherence between treaties and the objective of investment promotion.

3. To strengthen the coherence between bilateral investment treaties and the objective of investment liberalisation, these treaties must prevent private intervention. Private intervention can be limited by addressing anti-competitive practices and the pirating of intellectual property.

4. Bilateral investment treaties should expressly prevent performance requirements to increase their overall coherence. Performance requirements are against investment liberalisation as they allow host states to maintain power and control over the activities of foreign investment. Unless bilateral investment treaties prevent performance requirements, coherence between these treaties and the objective of investment liberalisation will remain weak.

5. For the purpose of strengthening coherence between bilateral investment treaties and investment liberalisation, these treaties should deal with the movement of labour. Treaties’ provisions should expressly oblige member parties to allow the entry and sojourn of all persons associated with covered investment.

6. Investment liberalisation requires bilateral investment treaties to contain a set of provisions dedicated to ensure that a properly functioning market is in place. As
far as these treaties do not remedy or ameliorate market failure, coherence between bilateral investment treaties and investment liberalisation will remain very limited.

7. Coherence within bilateral investment treaties necessitates identifying the scope of MFN clauses to ensure their ultimate contribution to enhancing treaties’ overall coherence.

8. Reforms should take place in relation to the dispute settlement mechanism to provide for internal and/or external controls.

9. Investment provisions in FTAs and bilateral investment treaties should be reconsidered in the same context to avoid possible incoherence.

10. The activities of foreign investment can have implications on states’ non-investment obligations. Therefore, bilateral investment treaties should ensure coherence between investment and non-investment obligations. In this respect, treaties’ text must be reconsidered to impose duties and responsibilities on investors when it comes to environment, human rights and sustainable development. Such provisions would promise better coherence between investment and non-investment obligations.

11. To ensure coherence between investment and non-investment obligations, bilateral investment treaties must provide for host states’ responsibility to maintain development priorities and guarantee high environmental, human rights and health standards.

12. Investment and non-investment obligations would be more coherent if the scope of treaties’ provisions was amended to exclude regulatory takings and measures. For example, this can be done by limiting the scope of indirect expropriation. As
a result, host states would be able to generate regulations in the public interest without being afraid of facing investment claims.

13. Coherence requires increasing transparency, legitimacy and accountability in the dispute settlement process. Bilateral investment treaties can achieve that by adopting a number of mechanisms. For example, these treaties can provide for a standing body of panellists, public proceedings, third-party amicus curiae status, public access to documents and the availability of an appeal process. Another possible improvement can be easily achieved if these treaties oblige international investment tribunals to draw on the principles of public international law when encountering inconsistency between investment and non-investment obligations.
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