Democratizing Investment Laws: Ensuring Minimum Standards for Host States

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Democratizing Investment Laws: Ensuring ‘Minimum Standards’ for Host States

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Abstract
The ad hoc development of international investment law has resulted in catering to the needs of capital exporting states. However, owing to the weaker bargaining power of the then newly independent capital importing states, no comparable internationally recognized standards of minimum protection of national interests from foreign firms could be formulated, even though such firms today are known to have a profound impact on local economies because of the extensive protection and power they yield through lopsided BITs and other general customary standards of treatment of foreign investment. This paper is therefore an attempt to develop and advocate a new ‘national minimum standard of protection’ in investment law that focuses particularly on the rights of the host states to regulate their economies and to protect their nationals on the basis of a social contract between the State and the individual.

Keywords
International Investment Law; Social Contract; Democracy; Minimum Standard of Protection; Host States

Introduction

The law of foreign investment has mainly developed on an ad hoc and piece-meal basis in response to the changing political and economic situation of the world at any given time.

As explained by Subedi (2008), the foundation of modern international investment law can be traced back to the time when traders from European empires started engaging in trade and business with the local communities in Asia, Africa and Latin America. Considering that these States did not gain independence from their colonial rulers until the early 20th century, it is by no

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surprise that much of the early development of the principles of foreign investment law dealt mainly with investment protection and the protection of aliens on the basis of the notions of Diplomatic Protection and State Responsibility to protect their citizens abroad.

For instance, The Permanent Court of International Justice (PCIJ) in the Mavrommatis Palestine Concessions case held that,

“it is an elementary principle of international law that a State is entitled to protect its subjects, when injured by acts contrary to international law committed by another State, from when they have been unable to obtain satisfaction through the ordinary channels. By taking up the case of one of its subjects and by resorting to diplomatic action or international judicial proceedings on his behalf, a State is in reality asserting its own rights-the right to ensure, in the person of its subjects, respect for the rules of international law”.

2) PCIJ Rep Series (1924) A No. 2.

Similar basis for the States to step in and protect their citizens found expression in the writings of several early notable scholars such as Vattel who asserted that,

“anyone who mistreats a citizen directly offends the State. The sovereign of that State must avenge its injury, and if it can, force the aggressor to make full reparation or punish him since otherwise the citizen would simply not obtain the goal of civil association, namely, security.”


4) See for example, the UNGA Resolution 626 (VII) of 21 December 1952 and UNGA Resolution 1803 (XVII) on 14 December 1962 on Permanent Sovereignty of States over their Natural Resources, wherein through the efforts of developing countries, particularly the Latin American states, the notions of economic self-determination and permanent sovereignty of states over natural resources were put on to the UN agenda and came to be accepted as representing an articulation of customary international law on this point; in Texaco v Libya (1977), 53 ILR 389, Para 87, the arbitrator held that the 1803 Resolution reflects the state of customary international law existing in this field.

The law of foreign investment therefore, traces its origins in the principles of Diplomatic Protection and State Responsibility to protect its citizens abroad. Accordingly, the focus in the initial years was on investment protection in foreign lands from political risks, such as that of expropriation of foreign assets, by (a) seeking ‘prompt, adequate and effective compensation’ and (b) by ensuring basic standards of non-discrimination, fairness, equity and justice towards the treatment of foreign investment.

The need for protection and for ensuring the basic standards of treatment of foreign investment became more important once the colonial States began to gain their independence and started to exert their political, and more importantly, their economic sovereignty. This entailed the notion that ownership of
all lands and materials within the national territory belonged to the State and that it had an inherent right to nationalize private property for public purposes with appropriate compensation.

As articulated in Article 27 of the Mexican Constitution of 1917,

“Ownership of the lands and materials included within the boundaries of national territory belongs to the Nation, which has had and continues to have the right to transmit ownership thereof to private parties, thereby constituting private property. Expropriations may only be made for reasons of public utility and by means of compensation. The Nation shall have at all times the right to impose on private property the modalities required by the public interest, as well as the right to regulate the exploitation of natural resources capable of expropriation in order to conserve them and to make equitable distribution of public wealth.”

Furthermore, as explained by Subedi (2008), “the very notion of sovereignty meant that the foreigners residing within the national borders of the country were subject to the law of the land.” Hence the standard, as advocated by the leading Latin American jurist Carlos Calvo, which ought to apply to foreign investors, was that of ‘National Treatment’. He stated that, “it is certain that aliens who establish themselves in a country have the same right to protection as nationals, but they ought not to lay claim to a protection more extended.” The implication of this was that foreigners did not merit any special or superior treatment than the nationals in a State unlike as asserted previously by scholars such as Grotius and Vattel. If all States were equal and sovereign, then the assertion that foreigners were subject to the superior law of their home land did not hold true.

Nonetheless, the investors and their Home States argued and insisted on an International Minimum Standard of Protection below which the National Treatment could not fall. Elihu Root, an American lawyer wrote that,

“If any country’s system of law does not conform to that (general international) standard, although the people of the country may be content or compelled to live under it, no other country can be compelled to accept it as furnishing a satisfactory measure of treatment to its citizens.”

5) The 1917 Constitution of Mexico together with Article 27 is still valid, but in its amended form (as amended in 1992), as cited by Subedi, supra note 1, 15.
6) Subedi, supra note 1, 8.
7) Translated and quoted from Calvo’s work in Spanish by DR Shea, The Calvo Clause (1955) 17-9, as cited by Subedi, supra note 1, 14.
The argument thus was, that a State may treat its nationals in any way it wished, however, foreigners should in no event be treated below the International Minimum Standard of Treatment as a matter of general principle of international law.\textsuperscript{10}

Further, as stated by Asante,

“Host States are enjoined by international law to observe an international minimum standard in the treatment of aliens and alien property. The duty to observe this standard - objective international standard - is not necessarily discharged by according to aliens and alien property the same treatment available to nationals. Where international standards fall below the international minimum standard, the latter prevails.”\textsuperscript{11}

The assertions of these authors were further substantiated by the General Claims Commission in the \textit{Roberts Claim},\textsuperscript{12} where it was held that,

“facts with respect to equality of treatment of aliens and nationals may be important in determining the merits of a complaint of mistreatment of an alien. But such equality is not the ultimate test of the propriety of the acts of authorities in the light of international law. That test is, broadly speaking, whether aliens are treated in accordance with ordinary standards of civilization.”

In this way, the capital exporting States were able to assert and establish the pro-investment and investor-friendly principles in international investment law, such as the ‘International Minimum Standard of Treatment’. The tenets of this standard were later expounded in the Diplomatic Exchange of 1938 between Mexico and the US, where the then US Secretary of State, Cordell Hull advocated the application of the International Minimum Standard of Protection for the US investors whose assets were expropriated by the Mexican Government following the Agrarian Revolution of 1917. He asserted that, taking of property without compensation is confiscation as opposed to expropriation and that for expropriation to be lawful it must always be accompanied by ‘prompt, adequate and effective’ compensation.\textsuperscript{13}

The International Minimum Standard of international investment law, therefore, requires the Host State to, in the least pay ‘prompt, adequate and effective’ compensation to the injured party whose assets it has expropriated.


\textsuperscript{12} The Roberts, Hopkins and British claims in the Spanish Zone of Morocco cases (1926), RIAA, iv.41; (1926) RIAA iv.41’ and (1925) RIAA ii.617, respectively, as cited in JC Thomas, ‘Reflections on Article 1105 of NAFTA: History, State Practice and Influence of commentators’ (2002) 17(1) ICSID Review: Foreign Investment Law Journal 21-101, 33, quoted by Subedi, supra note 1, 10.

This formulation later came to be known as the ‘Hull Formula’, and it found expression in most bilateral investment treaties (BITs) that have been concluded ever since. Consequently, it has become an established and well documented principle of general international investment law.

In addition to that, once the consensus between the South began to diminish and when the political and economic conditions of developing countries compelled them to attract foreign investment by adopting investor-friendly policies, the capital exporting States, in addition to the International Minimum Standard of Treatment, got a chance to advocate other general favorable principles of international investment law, such as the Most Favored Nation Treatment, National Treatment and the Fair and Equitable Treatment, thereby seeking ever greater protection for their investors abroad.

However, owing to their weak bargaining position, no corresponding internationally recognized principle on the basis of which the capital importing States could offer ‘minimum protection’ to their citizens from foreign firms could be formulated, irrespective of the fact that such a status quo conflicts with the very foundations of democracy, social contract and other competing principles of international law such as human rights, labor and environmental laws.

This paper is therefore an attempt to develop and advocate a new ‘National Minimum Standard of Protection’ as a general principle of protection in investment law that focuses particularly on the rights of the Host States to regulate their economies and to protect their nationals on the basis of a social contract between the State and the individual.

The argument is that, if Home States have a right to demand an International Minimum Standard of Treatment for their investors, based on Diplomatic Protection and State Responsibility, from political risks abroad, the Host States should also have the right to offer protection by taking measures at a basic minimum level for their nationals from firms from abroad, which today are known to have a profound impact on local economies, as a result of extensive protection and power they yield through instruments such as bilateral investment treaties (BITs) and other general standards of treatment in international law.

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14) See for example, the BIT concluded between Japan and Pakistan (1998) and between Pakistan and United Kingdom (1994) at http://www.unctadxi.org/templates/docsearch____779.aspx.

Part One

This part of the paper will explore how the development of international investment law has curbed the regulatory freedom of Host States, such that they are unable to regulate in the interest of their people.

International Investment Law and the Limits on the Regulatory Freedom of States

Considering that international investment law has mainly been geared towards developing the ‘standards of treatment’ and ‘principles of protection’ for foreign investment, it is important to explore in depth, the key principles and standards of international investment law as enunciated in, (1) Customary International Law and (2) in the Bilateral Investment Treaties (BITs) to show:

a. how their expansive interpretation and application has led to extensive protection for foreign companies and;

b. how in turn, that has contributed to limiting the regulatory freedom of the Host States, and in increasing the disparity between domestic and foreign investors inter se.

1. Customary International Law Principles

a. International Minimum Standard of Protection

The International Minimum Standard of Protection is a customary legal standard of protection that is to be accorded to foreign investors and their investments. This standard was developed in response to the assertion of the Latin American States to accord to aliens treatment no greater than that accorded to the nationals in the Host State.

However, early western scholars were of the view that there was an International Minimum Standard of justice in international law which called for a certain standard of decent treatment to be accorded to foreign investors. For instance, Schwarzenberger stated that,

“The national standard cannot be used as a means of evading international obligations under the minimum standard of international law...”

Furthermore, Asante asserted that, according to the doctrine of State Responsibility,

“Host States are enjoined by international law to observe an international minimum standard in the treatment of aliens and alien property. The duty to observe this standard - objective international standard, is not necessarily discharged by according to aliens and alien property the same treatment available to nationals. Where national standards fall below the international minimum standard, the latter prevails.”

Moreover, Elihu Root, an American International Lawyer argued that,

“there was a standard of justice which formed part of international law [and that] if any country’s system of law does not conform to that standard, although the people of the country may be content or compelled to live under it, no other country can be compelled to accept it as furnishing a satisfactory measure of treatment to its citizens.”

Accordingly, the International Minimum Standard of Treatment called for the basic standards of justice, non-discrimination, due-process, fairness, equity and basic human rights including right to property to be accorded to foreign investors. This ensured investors protection against political risk of expropriation i.e. taking of property or other assets by host states for a public purpose on a non-discriminatory basis in accordance with due process of law, with prompt, adequate and effective compensation.

b. Fair and Equitable Standard of Treatment
It is a general principle of customary international law that foreign investors are to be met with ‘Fair and Equitable Treatment’ in pursuance of their investment in the Host State territory. The obligation usually rests with the Host State to treat foreign investors and their investments in accordance with due process of law and principles of fairness, equity and non-discrimination.

The breach of this principle is one of the most common allegations that foreign investors levy on the Host States in event of a dispute primarily because the concepts of fairness, justice and equity are not capable of any precise definition.

On the one hand, if ‘Fair and Equitable Standard’ is considered to be an elaboration of the ‘International Minimum Standard’ itself; then the test as to whether a country has breached its obligation under this principle is ‘objective’, in that, the standard is based on the existing body of customary international law of State Responsibility for injury to aliens. In the Neer case for example, it was held that the treatment of aliens, in order to constitute an international delinquency “should amount to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action so far short of

17) Asante, supra note 11, 590.
18) E Root, supra note 9, 517, 521-2.
19) See for example, Enron v Argentina ICSID Case No ARB/01/3 (2004), and Azurix v Argentina ICSID Case No ARB/01/12 (2003).
international standards that every reasonable and impartial man would recognize its insufficiency.” The threshold as envisaged in this case, for governmental treatment of foreign investors so as to amount to an unfair treatment under international law is therefore very high and hence it is not capable of being easily breached.

On the other hand however, if the words ‘fairness’ and ‘equity’ are given their plain and ordinary meaning, then the test is more ‘subjective’ such that it will suffice that a country either commits an action found to be ‘unfair’ and ‘inequitable’, or one that ‘unreasonably interferes’ or ‘impairs’ the investments of foreign investors. The threshold for governmental treatment of foreign investors so as to amount to an unfair treatment under international law is therefore much lower in this case with the result that numerous governmental regulatory actions may be held to be inconsistent with this standard. Moreover, there is chance that any violation of any other obligation in a BIT could in effect be treated as a violation of ‘Fair and Equitable Standard’ if the plain and ordinary meaning is adopted.

Accordingly, while this principle often surfaces as a cardinal issue in international investment disputes, nonetheless the tribunals have not been able to denote a settled meaning to the phrase. The standard that therefore, ought to be exercised by the Host State remains unclear and may vary on a case to case basis, depending upon the actual words used in the BIT or upon the context within which the tribunal is interpreting it.

c. National Treatment

National Treatment can be defined as a principle whereby a host country extends to foreign investors treatment that is at least as favorable as the treatment that it accords to national investors in like circumstances.

Carlos Calvo asserted that,

“it is certain that aliens who establish themselves in a country have the same right to protection 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.”

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20) USA (LF Neer) v United Mexican States, 4 R.I.A.A. 60, 3 I.L.R. (1927) 21 AJIL 555, 556.
21) See for example, Article 3 (1) of BIT between Netherlands and Czech Republic which states that, “Each Contracting Party shall ensure fair and equitable treatment to the investments of investors of other Contracting Party and shall not impair, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those investors”.
In other words, as per Verwey and Schrijver, the Calvo Doctrine basically stipulates that the principle of territorial sovereignty of the State entails:

i) *The principle of absolute equality before the law between nationals and foreigners;*

ii) *The exclusive subjection of foreigners and their property to the laws and juridical regimes of the State in which they reside or invest, and*

iii) *Strict abstention from interference by other governments, notably the governments of the States of which the foreigners are nationals, in disputes arising over the treatment of foreigners or their property (i.e. abstention from diplomatic protection).*²³

However, the way international investment law has evolved the notion of National Treatment has not been embraced strictly in conjunction with the tenets of the Calvo Doctrine. In particular the notion of exclusive subjection of foreigners and their property to the laws and juridical regimes of the Host State is in most cases substituted by the legal and juridical regime of the BITs and international investment tribunals such as ICSID.

Thus, the idea of National Treatment as it stands today is more along the lines of securing a level playing field and equality of competitive opportunity amongst domestic and foreign investors based on inveterate principles such as equity, justice and non-discrimination rather than as idealistically expounded by Calvo in his doctrine.

For instance, as mentioned earlier, the UNCTAD Report (1999) states that,

*National Treatment can be defined as a principle whereby a host country extends to foreign investors treatment that is at least as favorable as the treatment that it accords to national investors in like circumstances...*²⁴

Hence, the notion of ‘National Treatment’ has been reduced to a mere ‘standard of treatment’ instead of a ‘standard of subjection’ under international investment law.

d. Most Favored Nation Treatment

Most Favoured Nation (MFN) treatment in the context of foreign investment means that, *“a host country treats investors from one foreign country no less favorably than investors from any other foreign country.”*²⁵ The idea is to

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promote equality of competitive opportunities between foreign investors and to provide a level playing field amongst them.

Although host countries may express reservations or exceptions in the application of the MFN treatment vis-à-vis different States,\(^{26}\) nonetheless, the scope of this principle has been subject of much controversy ever since the expansive interpretation to this principle was adopted by an ICSID tribunal in the Maffezini case.

In Maffezini v Kingdom of Spain (2003),\(^{27}\) the ICSID tribunal held that the MFN clause as expounded in the BIT between Argentina and Spain was broad enough to encompass not only the substantive rights but also dispute settlement procedures.\(^{28}\) Accordingly, Mr. Maffezini was allowed to import the dispute settlement provision contained in the BIT between Spain and Chile as per which the dispute could directly be submitted to ICSID for arbitration without the need to exhaust any local remedies.

This decision therefore has the potential to render the (technically) bilateral obligations of a BIT into obligations ‘erga omnes’ (i.e. binding against all). In that, while previously MFN was thought to be limited to substantive rights, this decision made it possible to extend the MFN treatment down to procedural provisions whereby, as correctly pointed out by Subedi (2008), it became possible for foreign investors to resort to dispute settlement mechanisms that were not stipulated or envisaged in the BIT between Home and Host States concerned, but rather had been provided for in another BIT to which the Host State was a Party.\(^{29}\)

Although, the approach of the ICSID tribunals has not been consistent in this regard and there have been cases in which ICSID tribunals have sought to retreat from the Maffezini approach,\(^{30}\) nonetheless, a trend towards expansive interpretation has been established and States have begun to expressly extend

\(^{26}\) See diplomatic note between Nepal and UK, wherein “Nepal was willing to accord to British goods entering Nepal the MFN treatment, save for the exceptional treatment given to India and Tibet... and likewise that... UK would continue to accord to imports from Nepal the MFN treatment, save for the special tariff reserved for the members of the Commonwealth Preference Area and the European Free Trade Association." Agreement on Most Favored Nation Treatment effected by exchange of notes signed at Kathmandu in 1965: www.tpcnepal.org.np/tagree/britain.htm, as cited by Subedi, supra note 1, 69.

\(^{27}\) Emilio Augustin Maffezini v Kingdom of Spain, ICSID Case No ARB/97/7 2000; (2003).

\(^{28}\) Article IV, Para 2 of Argentina-Spain BIT: “In all matters subject to this agreement, this treatment shall not be less favorable than that extended by each Party to the investments made in its territory by investors of a third country”.

\(^{29}\) See Subedi, supra note 1, 69.

\(^{30}\) See for example, Plama Construction v Bulgaria, ICSID Case No ARB/03/24 of 8 February 2005, Para 203 and 204.
the scope of MFN to procedural and dispute settlement provisions in the BITs they conclude.\textsuperscript{31}

e. Expropriation
Expropriation can be defined as a (limited) right of the Host States to ‘nationalize’ or take away the property of investors provided that certain conditions are met, in that, expropriation must be for a public purpose, on a non-discriminatory basis, in accordance with due process of law, followed by prompt, adequate and effective compensation.\textsuperscript{32}

The right appears to be based on the notion of Permanent Sovereignty of States over their Natural Resources as codified in the UN Resolution 1803 and acknowledged as representing the customary international law on the point by the arbitral tribunal in the \textit{Texaco v Libya} case.\textsuperscript{33}

The right is limited so that a basic level of protection may be secured for foreign investors against political risks, such that should they materialize, the investors will be in the least, entitled to full compensation of their investment.

However, owing to broad provisions in Free Trade Agreements such as Article 1110 of North American Free Trade Agreement (NAFTA) and expansive interpretations of international investment tribunals such as ICSID in cases like \textit{Metalclad},\textsuperscript{34} the meaning and scope of ‘expropriation’ has been extended to new heights, wherein words or statements like ‘indirect expropriation’ or measures that tantamount to expropriation or those which have the effect equivalent to expropriation; allow protection to be extended to foreign investors, not just against the actual takings of property by the government, but also against regulatory measures which may have the effect of undermining the profitability of an investment venture.

For instance, in the \textit{Metalclad} case, the decision by a local government authority to ‘withhold planning permission’ to construct a facility by Metalclad for the disposal of hazardous waste in accordance with the agreement between

\textsuperscript{31} See for example, BIT between Austria and Saudi Arabia (2001) which explicitly extends the MFN to dispute resolution provisions: Article 3, “each Contracting Party shall accord the investors of the other Contracting Party in connection with the management, operations, maintenance, use, enjoyment, or disposal of investments or with the \textit{means to assure their rights to such investments} like transfers or indemnification or with any other activity associated with this in its territory, treatment not less favorable than the treatment it accords to its investors or to investors of a third state, whichever is more favorable”.

\textsuperscript{32} See Subedi, supra note 1, 74.

\textsuperscript{33} See UNGA Resolution 1803, on the ‘Permanent Sovereignty of States over their Natural Resources’, (1962). See \textit{Texaco v Libya} (1977) 53 ILR 389 Para 87.

\textsuperscript{34} See Metalclad Corporation v United Mexican States, ICSID Case No ARB (AF)/97/1 (2000).
the company and the Mexican government, was held to constitute indirect expropriation of the rights of the company.

The ICSID tribunal in the **Metalclad** case stated that,

“expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favor 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 or reasonably-to-be expected economic benefit of property even if not necessarily to the obvious benefit of the Host State.”

In an earlier case, the Iran-US claims tribunal had also held that,

“a deprivation or taking of property may occur under international law through interference by a State in the use of that property or with the enjoyment of its benefits, even where legal title to the property is not affected.”

International law therefore very clearly accommodates the concept of indirect expropriations which have the potential, as rightly pointed out by Subedi (2008), to give rise to challenges to any governmental regulatory measure, whether these are related to human rights or environmental protection for that matter, by foreign investors if such measures go against their interests, notwithstanding that international law recognizes rights of States to take regulatory measures relating to environment and essential development work.

Subedi (2008) further asserts that,

“the implication of the recent trend in jurisprudence could be that Host States should do nothing that undermines the profitability of foreign business or undermines the ‘favorable conditions’ in the Host States assured under the BITs. These are tendencies that are likely to undermine the sovereign powers of States to regulate their economy or to exploit their natural resources in accordance with their national development policies; and they may clash with other obligations of States under various international environmental or human rights treaties which require States to have more stringent regulatory regimes in favor of environmental or human rights protection.”

Moreover, Lowe is of the opinion that the **Metalclad** decision has the potential to impose, “… a very significant limitation upon the right of the State.”

The ICSID tribunals however, have not been consistent in their approach on the meaning and scope of Article 110 of NAFTA that relates to expropriation. For instance, the Panel in **Pope & Talbot** case did not believe that the export

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35) ibid.
37) Subedi, supra note 1, 134.
38) ibid.
39) V Lowe, ‘Regulation or Expropriation’ (2003) 1-21, 6, as cited by Subedi, supra note 1, 134-5.
control regime of Canada constituted an interference substantial enough to be characterized as expropriation under international law. The panel held that it did not regard the phrase ‘measure tantamount to nationalization or expropriation in Article 1101 of NAFTA to broaden the ordinary concept of expropriation under international law so as to require compensation’.

Furthermore, a recent decision of an UNCITRAL tribunal in the Saluka Investments case held that in imposing forced administration over a Czech bank, the Czech government adopted a measure that was valid and permissible as within its regulatory powers, notwithstanding that the measure had the effect of undermining Saluka’s investment in that bank.

The tribunal further asserted that,

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\text{“it is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner bona fide regulations that are aimed at the general welfare.”}
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Some recent BITs and FTAs that have been concluded do accept the regulatory right of the States and expressly exclude non-discriminatory regulatory measures from the definition of indirect expropriation. However, as noted by Subedi (2008),

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\text{“the developed countries supported the investors as long as they were initiating legal proceedings against the regulatory powers of the developing countries, but when the investors began to challenge the regulatory powers of the developed countries themselves, there was a shift in attitude in these countries.”}
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Indeed, the provisions of the US Trade Act of 2002, clearly demonstrates that while the US will continue to seek greater protection for its investors abroad than the protection available to domestic investors in the Host States, it would not accord any protection to foreign investors in the US greater than that available to US investors in the US.

Hence, though some efforts have been made by international players to retreat from the expansive approach of the ICSID tribunal in the notorious Metalclad case, nonetheless, it is clear that the developed countries are still

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41) See, Saluka Investments (BV) v Czech Republic, (A partial award), (2006), Permanent Court of Arbitration.
43) See for example, Annex 10-C (4) of CAFTA, Article 10(2) of FTA between Chile and US, Article 12 of the 2004 Model US BIT and 15.10 of the Singapore-US FTA.
44) Subedi, supra note 1, 144.
45) U.S Trade Act of 2002, Pub L107-210 (107th Cong, 2d Sess), s 2102 (b) (3), as cited by Subedi, supra note 1, 144-145.
lopsided in their approach in the level of protection they seek for themselves and in the level of protection they are willing to offer to others. Such a status quo is not healthy from a developing country’s point of view owing to their weaker bargaining position, as a result of which, the developed States may still be able to press for greater protection for their investors abroad and at the same time, absolve themselves from the responsibility to extend the same degree of protection to foreign investors in their own territory.

The customary principles of international law as discussed above depict clearly the stance of the economically and politically strong countries that have been able to negotiate, develop and assert the standards that are most favorable to their situation. The law of foreign investment as developed traditionally should be read as ‘the law for foreign investment’. Clearly, the lopsidedness of the key principles in favor of foreign investors is quite manifest in the way the norms have been developed, interpreted and applied. The notion of economic strength continues to rule the arena of international investment law which caters to only very limited rights for the States, particularly those that are economically weak. In order to democratize investment laws, minimum standards for (even the economically weak) Host States must be advocated and ensured, so that a level playing field, in true sense of the term can be achieved between rich and poor States inter se, and between domestic and foreign investors of those States.

2. Protection Under Bilateral Investment Treaties

Bilateral Investments Treaties (BITs) have been the single most influential instrument of investment promotion and protection since their inception in 1959, when the first BIT between Germany and Pakistan was signed. In the absence of a global investment treaty, negotiation at a bilateral level has been much easier to achieve, given the North-South divide on the content and scope of key investment principles. States are generally more willing to compromise when dealing bilaterally, keeping in view the fact that the BIT will eventually last for a certain number of years and would not create a binding universal norm, as would be the case if a multilateral treaty on investment was being negotiated.

The Bilateral Investment Treaties commonly provide for a framework in which investment is to be received and managed in the Host State. It typically imposes obligations on the Host States to provide for the basic standards of treatment and investment protection as enunciated in the customary international law, such as the MFN and National Treatment standards.

However, in addition to the codification of the general and absolute customary standards of treatment, the provisions in a BIT are much more detailed and go beyond the principles as established in the customary international law. This part of the paper will endeavor to explore the extensive protection that
Home States are able to secure for their investors through BITs, as codified instruments of investment promotion and protection.

a. **Provisions on Definitions of key terms**
A typical BIT usually contains a section on definitions in which important terms such as what would constitute an ‘investment’ and who will be considered an ‘investor’ within the purview of that treaty are defined. These definitions determine the type of investments/investors to which/whom protection is to be accorded by the Host State. These questions become particularly important for arbitral tribunals as issues of fact in event of a dispute, in which case, deciding whether a particular investment or investor was covered by the protection of the treaty, would depend much on the exact words used for their definition.

For instance, if investment is defined broadly in a BIT, as including ‘*any or every kind of asset owned or controlled by an investor*’, then the investments of a vast majority of investors who have a controlling interest in a company incorporated under the laws of the Host State in question or under any other third State for that matter, may be protected.\(^{46}\)

This is to say that if there is a BIT between X and Y which defines investment as mentioned above, then, owing to the broad definition of investment contained in that BIT, investors from country X, having a controlling interest in an enterprise incorporated in country Z but operating in country Y, might be able to seek protection of the BIT between country X and Y. Hence, BITs have the potential to make Host States extend protection to the investments of majority shareholders of a company despite there being a direct treaty to that effect between the country in which the company is incorporated and that Host State inter se.\(^{47}\) In other words, the broad definitions of terms like ‘investment’ or ‘investor’ in BITs have the potential to lift the veil of incorporation and grant rights and protection directly to shareholders.

b. **Entry of Investments**
Under the customary international law States have the right to regulate the entry of aliens into their territory, and this right is based on economic, social, political or national security grounds.

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\(^{46}\) See for example, Article 1 of the BIT between Belgium-Luxembourg and Saudi Arabia (2002), which defines investment as ‘*every kind of asset, owned or controlled by an investor of a Contracting Party in the territory of the other Contracting Party*’.

\(^{47}\) See Barcelona Traction, Light and Power Co. Case (Belgium v Spain), ICJ Rep (1970) for example, where ICJ upheld the ‘veil of incorporation’ and did not allow Belgian shareholders to bring a claim against Spain because the company of which they were shareholders was incorporated in Canada (hence Canadian). The implication of adding the control element to the definition of ‘investment’ or ‘investor’ is therefore to render the Barcelona judgment inapplicable.
In the context of investment laws, the Host States are to regulate the entry of alien investment and investors in their territory. While traditionally the entry of foreign investment was regulated through the ‘Admission Clause Model’, which allowed the Host States to apply admission and screening mechanisms and determine the conditions on which investment would be allowed in the State, the recent trend in the BITs, particularly those concluded by US, Canada and Japan, is to incorporate and inculcate the ‘Right of Establishment Model’ instead.\(^{48}\)

Under the ‘Right of Establishment Model’ increased liberalization of investment flows is envisaged by calling for MFN and National Treatment even with respect to the establishment of the investment.\(^{49}\) In that, prospective investors and their investments are to receive treatment no less favorable with regard to investing, than domestic investors and investors from third countries. In this way, the Host States lose some of their ability to impose any screening methods and have an obligation to eliminate all discriminatory legislation affecting the establishment of foreign investment, thereby making it more conducive for foreign investors to operate in the territory and more lopsided for the domestic investors to do the same.

c. Investment Promotion Provisions

BITs have introduced another very innovative provision that has become common in practice. This provision introduces an obligation for the Host State to promote foreign investment in its territory by creating a conducive and attractive environment for investors to invest.

For example, the BIT between Hungary and India (2003) states that, Contracting Parties, “shall encourage and create favorable conditions for investors to make investments in its territory.”\(^ {50}\)

Such statements were traditionally and usually mentioned in the preambles, which are only part of the context of the treaty, as per Article 31 of the Vienna Convention on Law of Treaties 1969, and are a mere aid to interpretation i.e. preambles do not constitute binding obligations.

However, when such commitments are sought from the States within the actual text of the bilateral agreement, its connotation and implication for the State becomes much more serious. The Host State will have to abide by the

\(^{48}\) For Admission Clause Model, see Article 2 (1) of the BIT between Ethiopia and Russian Federation which states that ‘each state Party... shall admit such investments in accordance with its laws and regulations...’

\(^{49}\) Although, the host state may be able to pronounce certain exceptions as far as granting the MFN and National Treatment standards to prospective investors and their investments is concerned. See for example Article 3 (2) of the BIT between Canada and Costa Rica (1998).

\(^{50}\) Article 3 of the Hungary-India BIT (2003).
obligation, which could be very vast in this case and which has the potential to encompass a plethora of standards and other requirements that may be needed to create the necessary ‘favorable conditions’ as implied in such a provision; failing which the foreign investor may initiate arbitration proceedings in an international tribunal against the State, alleging the breach of this provision and seeking compensation.

Although States may commit themselves to a lower threshold of investment promotion, as in the BIT between Spain and Uzbekistan (2003), which states that, the Contracting Parties “shall in its territory promote investments as far as is possible...” Nevertheless, the weaker States may, owing to their circumstances, be compelled to deliver a higher threshold of commitment with respect to promoting favorable conditions for investment and hence, be held to undertake a more absolute obligation, capable of being contested in an international arbitral forum.

Such a commitment could also come under the purview of an ‘umbrella clause’, which is another innovation of the BITs in the extent of protection it secures for foreign investors.

d. Umbrella Clauses
Umbrella clauses require the Contracting Parties to observe ‘any other obligation’ it may have entered into with regard to investments. In that, the Host State usually assumes the responsibility to respect other obligations, it has in relation to the investment, including potentially, contractual undertakings as in the SGS v Philippines case, in which the ICSID tribunal held that Article X(2) of the Swiss-Philippines BIT, which stated that, “each Contracting Party shall observe any obligation it has assumed with regard to specific investments in its territory by investors of the other Contracting Party”, had incorporated the contractual commitment and brought it within the framework of the BIT.

The implication of this for the Host State lies in the fact that such a clause has a broad scope of application and gives ample protection to foreign investors by protecting their contractual rights. Elevating a private law matter (i.e. contractual breaches) to breaches of international law can have very serious ramifications for a Host State bound by investor-state international dispute resolution provisions. In that even a contractual breach, for which remedy is to be sought in local courts, would be akin to a breach of the BIT thereby attracting the provisions, norms and principles of international law. In other words, the local contractual dispute becomes an international investment law dispute, making it possible for private international arbitral dispute resolution

51 Article 2 of the Spain-Uzbekistan BIT (2003).
52 SGS v Philippines, ICSID Case No ARB/02/6 (2004), Para 127.
forums such as ICSID to have jurisdiction over the dispute in place of the domestic courts of the host country.

The approach towards this issue by ICSID tribunals has not been uniform and there have been cases where ICSID has taken a more cautious approach in elevating contractual disputes to BIT disputes.\(^{53}\) However, the mere potential of a broad umbrella clause in a BIT to have such an effect is a major extension by BITs that has been further facilitated by the expansive interpretations of international arbitral forums such as ICSID.

e. **Stabilization Clauses**

Stabilization clauses stipulate that the law prevailing at the time the decision was taken by foreign investors to invest in the host countries would be applicable to them, and such laws would not be altered to the detriment of such investors.\(^{54}\) In other words, the stabilization clauses have the effect of ‘freezing’ the law in time in relation to those investors, as it prevents the Host State from enacting new legislation which would have the effect of undermining the profitability of the investment venture of the relevant foreign investor(s).

Such a clause can be found in the investments contracts or concession agreements between the Host State and the foreign investor. An example of such a clause may be found in the, ‘Petroleum Production Sharing Agreement of 10\(^{th}\) November 1995 between the State Oil Company of Azerbaijan and a Consortium of Oil Companies’, which states that,

> “the rights and interests accruing to Contractor (or its assignees) under this Agreement and its sub-contractors under this Agreement shall not be amended, modified or reduced without the prior consent of Contractor. In the event that any Government authority invokes any present or future law, treaty, intergovernmental agreement, decree or administrative order which contravenes the provisions of this Agreement or adversely or positively affects the rights or interests of Contractor hereunder, including, but not limited to, any changes in tax legislation, regulations, or administrative practice, or jurisdictional changes pertaining to the Contract Area, the terms of this Agreement shall be adjusted to re-establish the economic equilibrium of the Parties, and if the rights or interests of Contractor have been adversely affected, then the State entity shall indemnify the Contractor (and its assignees) for any disbenefit, deterioration in economic circumstances, loss or damages that ensue therefrom. The State entity shall within the full limits of its authority use its reasonable lawful endeavors to ensure that the appropriate Governmental Authorities will take appropriate measures to resolve promptly in accordance with the foregoing principles any conflict or anomaly between any such treaty, intergovernmental agreement, law decree or administrative order and this Agreement.”

Such clauses are usually included for want of certainty and as the name suggests, for stability against political risks and regime changes in the Host State which might have an effect on the laws in place.

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\(^{53}\) See for example, SGS v Pakistan, ICSID Case No ARB/01/13 (2003).

\(^{54}\) As explained by Subedi, supra note 1, 104.
This indicates that investment contracts containing such clauses offer even greater protection to foreign investors. While on the one hand, the right of the Host State to take general non-discriminatory regulatory measures is now being preserved in the BITs, yet on the other hand, the device of stabilization clauses is being evolved that has the effect of rendering the limited right of Host States to regulate their economies on human rights, environmental or other grounds almost null and void. In other words, the limited right of Host States that had just started getting recognized, is being rendered almost futile through the incorporation of stabilization clauses in the investment agreements between Host States and foreign investors.

Furthermore, given that umbrella clauses require the Host States to fulfill ‘any other obligation’ it may have entered into, the stabilization clause in the investment contract, owing to ICSID decision in cases such as SGS v Philippines, has the potential to be eventually elevated to the status of a BIT clause if viewed from the umbrella clause perspective.\(^{55}\)

The international investment law, as it has evolved reflects the interests of capital exporting states at every phase of its development. The customary principles that focused heavily on the promotion and protection of investment, and the extensive and innovative protection under BITs and the utterly expansive decisions by ICSID in cases such as Metalclad, Maffezini and SGS v Philippines, make Host States hostage to the foreign investors in a way that maximum protection is established for those investors at almost nil responsibility. The States are unable to fulfill their democratic mandate. In that, should any measure be taken by the Host State that affects the economic equilibrium of the foreign investor, the host state is liable to pay compensation or to ‘indemnify’ the loss of the investor, even if the measure undertaken by the State in question is based on its economic necessity. In Enron v Argentine Republic for example, the ICSID tribunal was not prepared to accept the doctrine of necessity argument for the measure that Argentina had undertaken in wake of its recent economic crisis. The Tribunal held that, ‘these unfortunate events do not in themselves amount to a legal excuse.’\(^{56}\)

Thus, having established that the development of international investment law has been lopsided and against the interests of Host States, it is important to consider the impacts of those principles and arbitral decisions on the local economies and domestic investors of weak Host States so that the issues and myths associated with foreign direct investment can come to fore and then addressed and dealt with accordingly.

\(^{55}\) See SGS v Philippines, ICSID Case No ARB/02/6 (2004), Para 127.

\(^{56}\) Enron Corporation and Ponderosa, LP v Argentine Republic, ICSID Case No ARB/01/3, Award (2007), Para 232.
Part Two

This part of the paper will seek to highlight the impact of international investment law in its current state on the interests of domestic investors and the Host States.

The Impact of International Investment Law on Domestic Investors and Host States

In the previous section, this paper endeavored to understand ‘how’ the international investment law has curtailed the right of the Host States to regulate their economies and fulfill their democratic mandate. We saw that it does so by offering tremendous grounds of protection to foreign investors while continuously limiting the right of host states to regulate the multinational companies as well as their own economies.

In this section, this paper shall address the second important issue originating from the limitation of State’s policy space and regulatory powers through international investment law, and that is to understand ‘what’ that impact has, in practice, been for the domestic investors and the local economies of weaker Host States.

a) Impact of FDI on Host State’s Economic Growth and National Production Capabilities

Although, the basis for asserting the increased liberalization of investment inflows is advocated on the premise that Foreign Direct Investment (FDI) is a pivotal source of economic growth, technological advancement, better income, increased employment and an overall improvement in the Gross Domestic Product (GDP) and foreign currency reserves for the host countries. Nonetheless, a number of recent studies have shown that in majority of instances, the actual outcomes have been quite to the contrary than the perceived outcomes of FDI.57

According to UNCTAD Report (1999), corporate strategies such as transfer pricing can reduce the level of corporate tax received by host governments. Furthermore, the importation of intermediate goods, management fees,

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royalties, profit repatriation, capital flight and interest repayments on loans can limit the economic gain to the host economy.\textsuperscript{58}

Moreover, Rosalie Gardiner in her briefing paper on foreign direct investment explains with reference to the OECD Report (1999), that the benefits of increased wages and employment that are associated with foreign investment may only be felt by small portion of the population that comes from the wealthy elite and is more educated. Hence, income disparity and wage differentials between rich and poor may actually be exacerbated.\textsuperscript{59}

Furthermore, as highlighted by Gardiner, the ECOSOC Report (2000) documents that small local businesses which have less capacity to attract foreign investment or seek loans or bank credit are likely to be forced out of business, in which case the FDI is said to have a ‘crowding out’ impact on local economies.\textsuperscript{60} In that, the MNCs through Product Market Competition substitute the products of domestic firms in host countries, making it inefficient and non-profitable for smaller domestic producers to compete, such that they are compelled to close down. As a result, the national production capacities of the host economies are undermined and remain underdeveloped because fierce and lopsided competition from foreign firms is too much for local producers to compete against with successfully, given their limited resources and lack of support from the government.

For instance, in Pakistan, a dominant local ice cream manufacturer ‘Polka’ was acquired by Walls (Unilever), because it could no longer compete with its international competitor. As illustrated by Shehla Riza Arifeen in her paper,

\begin{quote}
“Unilever/Walls ice-cream began its marketing with two distributors from Lahore in April 1995, and then in Karachi. Most of the smaller towns were initially fed by these distributors but as the market grew, Unilever/Walls appointed distributors for exclusive geographical zones. During 1995 to 1997, Unilever/Walls made considerable inroads into the market due to their superior products and services, which Polka could not match, and they lost some market share. In 1998, when an MNC showed some interest in acquiring Polka, Unilever/Walls stepped in and acquired the business. In this manner they avoided having a large player in the market other than themselves in the branded segment.”\textsuperscript{61}
\end{quote}

The benefits of FDI for which it is attracted in the first place thus, appear to be more of a myth. On the contrary, there could be some extremely potent


negative impacts that can result from unregulated FDI in an economy, especially when the economy in question is a low income or a weak economy. The increased dependence on foreign investment that results from the destruction of local entrepreneurship makes the Host State even more vulnerable to foreign pressure for granting more rights and protection to the multinational corporations. The Host States get lured in a vicious cycle wherein their dependence on foreign investment makes them lower their democratic standards (environmental, labor, human rights and overall development policy) to attract more foreign investment, which in turn further hampers and undermines their national production capacity and in the end leaves Host States even more dependent on foreign investment and so on and so forth. In other words, the dependence on foreign investment disables the capital importing States to be in the best position to safeguard their minimum and basic interests.

For instance, the national production capacity of Pakistan as well as its technical expertise is hugely insufficient to finance and carry out the basic infrastructure projects such as power plants, railways, mining and manufacturing. It is a country that is heavily dependent upon foreign investment and foreign investors to invest and carry out these projects of national significance with little or no government control and involvement. In other words, the economic conditions necessitate Pakistan to have favorable foreign investment laws so that investors would be attracted to invest in projects which Pakistan cannot support domestically but which are nonetheless needed. This investment is admitted on most favorable terms and highest standards of international treatment through BITs, as explained earlier, which in turn does not lead to the economic prosperity as perceived and so therefore, the country does never really prosper in the long run and consequently the dependence on foreign investment never really does end either.

For any real headway to be made, in order to break this vicious cycle, the regulation of FDI at a democratic level will have to be harnessed and allowed so that, (a) there is no rampant exploitation of a host country’s weaker bargaining situation and (b) a foreign company’s ability to take a Host State hostage and force it to binding international arbitration for any regulatory or policy measures it may adopt, is restrained and balanced.

b) Impact on Domestic Investors
The second most questionable impact of foreign investment laws has undoubtedly been on the domestic investors who have, by operation of law, been subjected to ‘reverse discrimination’. As stated in a concept paper submitted by the EU to the WTO’s Working Group on Trade and Investment, ‘many
countries that are keen to attract foreign investment are creating a sort of reverse discrimination against their own local companies.\[^{62}\] In that, it is more favorable to operate as a foreign investor in your country than as a domestic investor given the additional protection under customary law and BITs, the standards of treatment and access to international courts of arbitration in event of a dispute.

For this reason, “domestic investors are increasingly looking into ways of bringing themselves under the umbrella or parentage of international business organizations and a trend towards ‘nationality shopping’ is coming to the fore, as seen in a case brought before ICSID by two Egyptian nationals who changed their nationality to bring a claim as foreign investors against Egypt under the Italy-Egypt BIT.\[^{63}\] Likewise in another case, Bechtel Corporation shifted its registration from Cayman Islands to the Netherlands to sue the Government of Bolivia for the losses it incurred in Bolivia because Cayman Islands did not have a BIT with Bolivia, whereas Netherlands did.”\[^{64}\]

This impact does not quite settle in with the foundational notions of ‘non-discrimination’, ‘justice’, ‘equality’, and ‘level playing field’, on the basis of which foreign investment law has traditionally been developed. Furthermore, ‘reverse discrimination’ is a major disincentive for national investors who cannot resort to ‘nationality shopping’ and therefore, it is all the more important for the State to be able to regulate and fulfill its democratic mandate vis a vis its citizens so that a level playing field in the true sense of the term can be ensured by host governments by taking corrective and balancing measures at a bare minimum level without the threat of being held hostage by foreign investors to international arbitration.

Only if the State has the requisite policy space and freedom to regulate will it be able to address this issue and encourage domestic investors to invest in the local economy and consequently improve its economic footprint and develop its national production capabilities to a sustainable extent.

c) Impact on the Social Contract
Perhaps the most crucial impact of international investment law has been on the relationship of the State with regard to their citizens and on the very basic premise from which a State derives its legitimacy, i.e. the social contract.

\[^{64}\] Aguas del Tunari SA v Republic of Bolivia, ICSID Case No ARB/02/3 (2005).
An instructive insight into this phenomenon was illustrated by Alvaro J de Regil in his critique on John Ruggie’s report titled, ‘Protect, Respect and Remedy: Framework for Business and Human Rights’.65

He states that Mr Ruggie’s “insistence on market as the overriding principle under which societies supposedly should function is in direct conflict with the basic purpose of true democracy, which is – on the basis of implicit social contract- to procure the welfare of every rank of society”.66

In assessing Mr Ruggie’s report further, Regil raises some very pertinent issues with regard to the allocation of resources via the market mechanisms for he questions the ability of the governments to fulfill their democratic mandate in the market context, given that ‘markets will never consider allocating resources from the perspective of democratic principles such as opportunity, equality, solidarity and the dignified welfare of all ranks of society’. This is because the primary goal of the market is accumulation of capital in pursuit of greater shareholder values, and not social welfare per se.67

Moreover, Regil highlights the “power that markets have imposed on States and on their capacity to regulate how markets should function in order for states to fulfill their democratic mandate”. He notes that Ruggie himself acknowledges that “companies can take States hostage and force them to binding international arbitration, including for alleged damages resulting from implementation of legislation to improve domestic social and environmental standards”. He substantiates by stating that “Ruggie mentions the case of a European mining company challenging South Africa’s black economic empowerment laws and the case of Metalclad, a US waste management company that- as a result of NAFTA - successfully forced Mexico’s federal government to compensate it because a municipality denied Metalclad the license to open a toxic waste management site”.68

This clearly establishes the fact that Host States, particularly those with weak bargaining position are unable to fulfill their duty under the social contract towards their citizens because of the extensive protection that foreign investors yield under international investment law and the expansive interpretations of the principles by international arbitral forums that has the effect of rendering a plethora of regulatory measures of the Host States susceptible of being challenged in international courts by foreign investors.

Thus, given that ‘market has effectively supplanted democracy’ and States have become mere agents of the multinational companies, it is difficult to perceive how any real progress in the context of business and human rights can be made. To achieve this end, ‘the private interests, as correctly pointed out by

65) Regil, supra note 15.
66) Regil, supra note 15, 5.
67) ibid, 6.
68) Regil, supra note 15, 7.
Regil, must be allowed to be pursued only insofar as it does not infringe the human rights of any person and that this should be the principle underlying all other considerations." In other words, foreign investment law will need to be placed in the proper rights based and democratic context, and the policy and regulatory freedom of the States will have to be accommodated and preserved in international investment law for it to be truly democratic, just and non-discriminatory as it was initially supposed to always be.

Part Three

This part of the paper will explore the duty of the State to protect its citizens as enshrined in various domestic, regional and international legal documents with the aim to establish that it is a fundamental duty a State owes to its citizens which cannot and should not be displaced or curbed by developments in international investment law.

The State’s Duty to Protect

Traditionally, it was only the States that were the subjects of international law. Consequently, all the rights and corresponding duties that accrued were applicable to the States alone instead of the individuals or the multinational companies. For this reason the origin of all aspects of international law, including human rights and international investment law can be traced back to the diplomatic relations among nations and the resulting principles that those relations carved out. Likewise, the State Duty to Protect is a well enshrined traditional international law concept that traces its roots in the notions of Diplomatic Protection and State Responsibility to protect its citizens.

Today however, the international legal personality of multinationals and even individuals has been admitted in international law under limited circumstances and situations such as under the Rome Statute of International Criminal Court, where individuals can be tried in an international forum for war crimes and crimes against humanity, and under the convention setting up the International Centre for Settlement of Investment Disputes between States and National of other States (ICSID Convention) where foreign investors are allowed to bring a claim against the State for disputes arising out of their investment in the Host State.70

69) ibid.
Nonetheless, the basic duty vis-à-vis the protection of its people, lies with the State as has been recognized under various international conventions, human rights laws and in the writings of prominent scholars.

In this part of the paper, the widely trumpeted State Duty to Protect its citizens will be understood in the human rights context. The idea is not to negate the existence of such a duty but to find its meaning under the notion of ‘social contract’ and human rights law instead of taking the traditional stance of finding its meaning under the notion of ‘State Responsibility’ and ‘Diplomatic Protection’, so that the Host State’s Duty to Protect its domestic citizens from foreign entities can be established in response to the Home State’s duty to protect its citizens from political risks abroad (as was the case traditionally).

a. **Duty Under International Law**

The foundation of contemporary international human rights law is contained within the various declarations and conventions of the United Nations, which consistently reaffirm that the primary duty to protect its citizens rests with the States.71

In fact, the Human Rights Committee in its General Comment goes on to state that under the **International Covenant on Civil and Political Rights (ICCPR) (1966)**,

> “the positive obligations on State Parties to ensure Covenant rights will only be fully discharged if individuals are protected by the State, not just against violations of Covenant rights by its agents, but also against acts committed by private persons or entities”72

The State’s duty towards its people is, thus, very well entrenched all throughout the United Nations system and various international human rights documents. Indeed, as acceded, by the Special Representative of the Secretary-General of UN on Business and Human Rights, John Ruggie,

> “the duty to protect exists under the core United Nations human rights treaties as elaborated by the treaty bodies, and is also generally agreed to exist under customary international law.” In particular, “the State Duty to Protect against non-state abuses is part of the international human rights regime’s very foundation, and that, the duty requires States to play a key role in regulating and adjudicating abuses by business enterprises or risk breaching their international obligations.”73

71) See for instance, Article 55 and 56 of the UN Charter (1945); Para 8, Preamble of Universal Declaration of Human Rights (1948); Article 2 of International Covenant on Economic Social and Cultural Rights (1966); Article 2 and 5 of the International Covenant on Civil and Political Rights (1966) and Article 2 and 7 of the UN Charter of Economic Rights and Duties of States (1974).

72) HRC, General Comment 31, Para 8, as cited by Ruggie, A/HRC/4/035, 6.

73) Ruggie, supra note 71, 5, 7.
b. Duty under Regional Human Rights Protection Regimes

The European, African and the American system of human rights protection is akin to the international human rights protection regime of the UN. These regions have attempted to develop their own system of human rights protection and it is interesting to observe that even in these regimes, the paramount duty to protect the rights rests with the State.

The Courts and Commissions in these regional regimes have also lent their support in affirming the duty of the State to protect the rights of its citizens. For instance, in the case of *L.C.B v United Kingdom*, the European Court stated that,

"the first sentence of Article 2 (1) enjoins the State not only to refrain from the intentional and unlawful taking of life, but also to take appropriate steps to safeguard the lives of those within its jurisdiction." Likewise, the Court has upheld several other positive and negative obligations of the State in relation to various other civil and political rights contained in the European Convention in a number of other cases, thereby establishing the legal duty of the State to 'protect'.

In *Amnesty International and Others v Sudan (1999)*, the African Commission on Human and Peoples Rights established that even if the violation of rights was not the work of forces of the government, the government nevertheless, had a responsibility to protect all people residing under its jurisdiction.

Perhaps, the most important and the most elaborate of all decisions of the African Commission on Human and Peoples Rights regarding the State Duty to Protect against abuse by non-state actors can be found in the case of, *Social and Economic Rights Action Center for Economic and Social Rights v Nigeria (SERAC)*, where the Commission held that International Human

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74) See for instance, Article 1 and 2 of European Convention of Human Rights (1950); Articles 1, 2, 35, 37, 41 and 51 of the European Union Charter of Fundamental Human Rights (2000); Article 1, 21 (5), 25 and 26 of the African Charter of Human and Peoples Rights (1986); Para 1 of the American Declaration of the Rights and Duties of Man (1948) and Articles 1 and 2 of the American Convention of Human Rights (1978).


76) See for example the case of Assanidzé v. Georgia judgment of 8 April 2004, where the Court stated that, “the Convention does not merely oblige the higher authorities of the Contracting States themselves to respect the rights and freedoms it embodies; it also has the consequence that, in order to secure the enjoyment of those rights and freedoms, those authorities must prevent or remedy any breach at subordinate levels. The higher authorities of the State are under a duty to require their subordinates to comply with the Convention and cannot shelter behind their inability to ensure that it is respected”.

Rights instruments including the African Charter mandated the States to ‘respect, protect, promote and fulfill’ those rights. The Commission went on to state that, ‘these obligations universally applied to all rights, including civil and political, as well as social and economic rights’. The obligations entail a combination of both, positive and negative duties for States.

The Commission in giving its judgment, concurred with the holding of Inter-American Court of Human Rights in *Velazquez Rodriguez v Honduras (1988)*, that,

“when a State allows private persons or groups to act freely and with impunity to the detriment of the rights recognized, it would be in clear violation of its obligations to protect the human rights of its citizens.”

c. **Duty under Domestic Law**

That a State has a legal duty to protect human rights and other standards of living in a democratic state is a well enshrined principle in not only international and/or regional human rights instruments, but is also a well-established undertaking found in the Constitutions of most States of the world, under which they have guaranteed to uphold the fundamental rights of their people. Thus, the fundamental law of all States is manifested in the Constitution of the countries, in which the State guarantees to grant and uphold, inter alia, the fundamental rights of its citizens.

In addition to the Constitution, many States also enact special laws through Acts or Statutes guaranteeing further rights to their citizens, for instance the UK Human Rights Act (1998).

Having discussed the various avenues of rights protection and establishing that, (a) a State has a duty towards its people to protect their rights such that by failing to meet the ‘general interest’, it can be violator of this duty and (b) recognizing how central the role of the State and its duty to protect is towards assurance of such rights, it is important to assert that international law should never act, or be used or developed in a way so as to disable the trumpeted ability of the State to protect its citizens.

In that, at the bare minimum, the regulatory freedom of the State to fulfill its democratic mandate and its responsibility towards its citizens to offer them a safe, healthy environment with an assurance of all fundamental rights including right to life and adequate standard of living with dignity and equality, should never be hampered, particularly by virtue of international investment

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law. Instead, this ability of the States should be preserved and secured through all international legal avenues, including international conventions, courts and arbitralional tribunals.

The grounds or the basis for asserting and preserving the State Duty to Protect its citizens within its own boundaries can be found in the eighteenth century notion of the ‘Social Contract’ found in the theories of Jean-Jacques Rousseau and John Locke, who in their prominent works explored the origins of a civil human society and the basis upon which the State derives its legitimacy and the right to govern its subjects i.e. the social contract.81

Rousseau asserted that,

“The first and most important deduction from the principles we have so far laid down is that the general will alone can direct the State according to the object for which it was instituted i.e. the common good... it is solely on the basis of this common interest that every society should be governed.”

Locke agreed with Rousseau, arguing that the main reason people form societies and subject themselves to a government is for “preservation of their property and safety.”

However, as explained by Abramchayev, Locke believed that,

“the fiduciary relationship between the State and the citizen creates a wide array of powers for the government, but that those powers are subject to an obligation i.e. protection of the rights of individuals who had given the government the power to act.”

A State’s Duty to Protect is therefore, very much inherent in the notion of social contract, as is the duty of the citizen to abide by the laws promulgated by the sovereign for the common good. That is to say that, “the undertakings which bind us to the social body are obligatory only because they are mutual...”

Consequently, a strong proposition can be developed for finding a basis in social contract theories to argue and assert that every State has the first and foremost duty to preserve its people and protect its national interests for the common good and that therefore its basic regulatory freedom and powers to act should in no way be restricted and/or alienated. Should this be the case, i.e. should the State fail to meet the general interest or if and when it enacts a law that goes against ‘preservation of property’ and ‘protection of safety’, it can be,

83) ibid.
85) Rousseau, supra note 81, 204.
just as much a violator of the social contract, from which it derives all its legitimacy and supremacy, as any other deviant citizen may be.

Part Four

Part four of the paper will endeavor to expound a ‘national minimum standard of protection’ in favor of the Host States on which they can rely and assert their regulatory freedom and policy space to fulfill their democratic responsibility. In doing so, the paper will also address why and how the assertion of a new general and customary standard of protection (this time in favor of Host States for protection of their citizens and fulfillment of their democratic mandate) on grounds of social contract, may be better for Host States, than negotiating independent provisions in BITs.

1. The National Minimum Standard of Protection as Proposed

a. Background

The preceding sections of this paper have attempted to explain in considerable detail how and why the foreign investment law has traditionally developed in favor of capital exporting nations and how as a consequence, the interests, rights and freedom of the capital importing States have been comprised along the way. Indeed, the freedom of the States to regulate has been curbed to an extent that even though a well-established ‘duty to protect’ is said to exist, the States receiving the foreign investments are nonetheless hostage to and subjected to the lopsided tenets of international investment law and the many rights it brings along with itself for foreign investors, including most importantly, the investor’s right to bring a claim in international arbitral forums against the Host State. Needless to suggest the impacts that this trend has had on the people, policies and environment of the Host States whose public issues are open to debate and subject to the scrutiny of private forums such as ICSID.

b. Purpose for advocating the Proposed Standard

It is against this backdrop that the ‘National Minimum Standard of Protection’ is hereby being proposed for Host States, so that they have a basis upon which to rely and assert their sovereignty, regulatory freedom as well as a basis upon which they can fulfill their democratic mandate vis a vis their people. The idea is to capacitate the Host States in a way so that they are actually able to fulfill their trumpeted ‘duty to protect’ the rights of their citizens. Unless they are ‘enabled’ to do so legally, it is only unfair to impose such an obligation upon them and expect them to deliver when in fact, as things stand, they cannot.
In addition to this, by advocating a national ‘minimum’ standard of protection as a general principle of international investment law, the idea is to achieve an effective and operative balance of interests between foreign investors and citizens at the bare minimum and basic level.

c. Basis of the Proposed Standard
As discussed in vehement detail in Part Three of this Paper, the fact that a democratic State derives its legitimacy and supremacy from the very notion of the social contract under which the State has a duty to protect the rights of its people in exchange for the wide array of powers that the citizens forfeit in favor of the State, it is only then appropriate to assert that the proposed National Minimum Standard of Protection traces its roots in the inherent notion of the ‘social contract’ between the State and the citizens.

In addition to this, considering that the State’s legal duty to protect is now recognized worldwide under all human rights instruments, treaties and conventions, there exists a strong basis in tracing the ‘National Minimum Standard of Protection’ within the international human rights regime as well.

d. Elements of the Proposed Standard
The ‘National Minimum Standard of Protection’ traces its origin in the notion of the social contract between the State and the citizen and therefore, on that basis this standard of protection is to allow the Host States the ability and freedom to extend ‘minimum protection’ to the rights of their citizens.

The protection is sought from the excesses of the multinational corporations which have a profound impact on the local communities and domestic investors in the Host States. The idea is to capacitate the government to take the ‘bare minimum measures’ needed for the ‘survival’ of their citizens as persons or as legal entities. In this regard, it is important to ensure that government is allowed to (a) ‘take all basic measures to ensure, safeguard and protect the health, safety, and environment of the people; and (b) to take the bare minimum steps towards the economic sustenance of the small domestic industries owned and controlled by small local investors’, so that they do not risk going ‘out of business’ in face of fierce ‘lopsided’ and hence unfair competition from foreign firms operating within the Host State. The idea is to protect the locals as well as the local industry so that the national productive capacities of the receiving States are not undermined and/or compromised.

By advocating bare ‘minimum’ protection and not more, the objective is to keep this notion balanced and equitable between foreign investors and local people. The idea is to protect only to the extent necessary to ensure a ‘level playing field’ in true sense of the term. If the protection exceeds the ‘bare minimum’ level, it may then be regarded as ‘discriminatory’ and the resulting consequences of a governmental action being discriminatory may then flow by all
means. Whether the measure taken was up to the bare minimum level or not would, however, depend on a case-to-case basis.

The key word here is ‘survival’ and the regulations or measures adopted under the proposed standard of protection should seek to ensure only that - the survival of (a) the people (which includes their basic rights as to life, health, safety and clean environment) and (b) the local investors (which includes equality of competitive opportunities in real sense of the term) in the Host State.

2. Benefits of the Proposed Minimum Standard of Protection

In view of the fact that there are competing principles of international human rights and international investment law and recognizing that there is a conflict when the State Duty to Protect the rights of its citizens as envisaged under the international human rights regime is curbed by the principles of international investment law, there exists a need for the convergence of the competing principles of international law in order to avoid the conflict between the fields of international human rights and investment law. Such a convergence can be achieved if the National Minimum Standard of Protection is admitted and embraced in international investment law as it would allow the States the regulatory freedom to protect the basic rights of its people and fulfill its democratic mandate.

Also, considering that the proposed National Minimum Standard of Protection calls for a basic minimum level of protection and not more, this standard would help achieve the necessary balance between the rights and interests of all parties concerned thereby democratizing international investment laws that are currently, in majority of cases, lopsided.

3. Reasons for advocating Lex Generalis as opposed to Lex Specialis

It is also important to understand why such a standard should be developed as a general principle of international (investment) law rather than negotiated independently and included as a clause of a BIT. For this it must be understood that BITs are lex specialis between the State Parties where the capital importing States are often not in the best bargaining position to secure their interests or that of their citizens.

On the other hand, if the Minimum Standard of Protection is consistently demanded multilaterally and or collectively, its evidence ultimately as

86) It is the author’s contention that in any instance where the conflict may be irreconcilable, the preference be given to international human rights law instead of international investment law, given the public law nature of the international human rights regime.
‘Customary International Law’ will become binding on all parties concerned without the need for it to be negotiated independently in a BIT where the bargaining position of the parties is not always equated.

For this reason, this paper proposes that capital importing States facing the impacts of the lopsided BITs and international investment law regime should, as a matter of policy, adopt and assert the ‘National Minimum Standard of Protection’ in all multilateral forums such as the United Nations so that eventually it is established as a rule of customary international law.

Alternatively, should the UN General Assembly support this contention and if it believes in the need for convergence and balance of competing international law principles, it may even seek to adopt a Resolution to that effect, as they did so when they adopted the Resolution 1803 on the Permanent Sovereignty of States over their Natural Resources to pledge support for and to endorse the new ‘National Minimum Standard of Protection’ for Host States.

Conclusion

Globalization has had a profound effect on the way of life of people and much has been said about the way it has engulfed the world and changed the way in which it works. Increased inter-dependence has brought increased risk of impacts for the world economy and environment and the trickle-down effect of the crash of the housing market, Wal-Mart, banks and other financial institutions has been felt by the common man the world over.

In addition to this, incidents of corporate abuses of human rights and debates on the notion of corporate social responsibility have been on a rise, to the extent that it has been expressly included as a director’s duty under the new UK Companies Act 2006.

87) UNGA Resolution 1803 (XVII) on Permanent Sovereignty of States over their Natural Resources, 14 December 1962.
89) See Section 172, UK Companies Act (2006) Duty to promote the success of the company, which reads as follows:

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—

(a) the likely consequences of any decision in the long term,
(b) the interests of the company’s employees,
(c) the need to foster the company’s business relationships with suppliers, customers and others,
(d) the impact of the company’s operations on the community and the environment,
The impact of the activities of MNCs have been so vast on both the human rights as well as on the environment of the world that the debate surrounding their accountability is on the rise in the agendas of all key players in the international arena, including the United Nations which has appointed a Special Representative on Business and Human Rights, John Ruggie on this very point. Although Mr Ruggie has opted for the softer and voluntary notion of ‘responsibility to respect’ as opposed to a more assertive ‘duty to protect’ in the case of multinational corporations, nonetheless, the idea that now seems to be gaining greater acceptance is the fact that companies now need to be more mindful of their activities and proceed with due diligence their operations for a greater social acceptability of their entities.

Therefore, given that the law of foreign investment has developed mainly in response to the changing political and economic situation of the world at any given time, it is once again time to reconsider and revisit the foreign investment law not in isolation, but within the context of the human rights and environmental laws, making the latter an overriding backdrop within which principles of foreign investment law develop. The proposed National Minimum Standard of Protection can prove to be instrumental in this regard as it has the potential for democratizing investment laws and ensuring minimum standards for Host States as result of which they will, (a) have a basis to fulfill their democratic mandate and the basic covenant with their citizens from which they derive the very legitimacy of their supremacy and existence and (b) be capacitated to fulfill their ‘duty to protect’ that is so widely and blindly credited into their account.

Bibliography


(e) the desirability of the company maintaining a reputation for high standards of business conduct and

(f) the need to act fairly as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.