

## Foreign Investment Law: How Customary Is Custom?

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The phalanxes of distinguished lawyers representing states and foreign investors in present-day international arbitration have the duty to bring tribunals' attention to the most minute details relevant to a determination on procedure and the merits of their respective cases. Yet, in so doing, it is not difficult to lose sight of the broader framework and trends in which international dispute settlement is inserted. The first major contribution, the lecture of Professor José Alvarez has made this morning, is to draw this broader outlook. It gives me particular pleasure to comment on some of his most thought provoking remarks.

### THE SEARCH FOR COMMON PRINCIPLES.

Little doubt can there be about the fact that Foreign Investment Law has become global. A global society where goods and capitals flow every passing day with fewer restrictions could not do otherwise. The process of internationalization begins with the old

treaties on Friendship, Commerce and Navigation, it follows with modern investment contracts governed by specific stabilization clauses and ends up, for the time being, with the ever expanding network of bilateral investment treaties and multilateral conventions, including recent Free Trade Agreements.

The legal framework underlying this process has become so interconnected and mutually-reinforced that it would not be an exaggeration to believe that the governing rules respond to common fundamental principles, in spite of the many variations in their application to specific cases. Domestic foreign investment legislation has for the most also become permeated by the main principles of this internationalized system. International arbitration and judicial decisions have also significantly contributed to this process of gradual integration and legal harmonization.

Professor Alvarez has of course identified this ongoing process with precision. Yet, realistically, he also raises some doubts about its future viability, mainly in connection with domestic tensions and eventual political backlash. It would be wrong to ignore these difficulties, but one must be also aware that they are typical of a transitional period in which rules and institutions are adjusted to new realities. What counts is the long-term outcome.

#### State functions in transition.

Sovereign prerogatives are today confronted with a new globalized regime concerning foreign investments, just as they are subject to continued pressures from the international trade system, human rights claims and other matters. This does not mean, however, that the sovereign state is fading away, as it is still the major actor of the international legal and political system and ultimately, in many cases, the guarantor of democratic rights and values of its citizens, on occasions threatened by ideological and miscarried interpretations of international law. State functions are not being abandoned, they are simply transiting from the absolute to the relative, from occasional arbitrariness to accountability, from serving over-powerful states to ensuring citizens' rights.

The distinction between the *jure imperii* and the *jure gestionis* is thus becoming sharper, as there is no reason for treating commercial activities differently if carried out by the state. By the same token, however, the issue of why should foreign investors be treated better than national economic agents has been rightly posed.

The privileged position of protected investors has been criticized in domestic debates and argued repeatedly in international arbitration.

Yet, the answer to this question does not lie in treating all operators, foreign or domestic, under the same national standard and have their disputes adjudicated by national courts. That would make Mr. Calvo and his doctrine most happy but would result in the uncertainty that arises from many different national standards, which on occasions are not conducive to attracting the needed capital investments. The real option appears to be different: to treat all economic agents, again foreign or domestic, under a same standard ensuring both certainty and predictability. This is precisely what is beginning to happen.

Transitions are quite naturally difficult to handle. While some states might be moving forward with this understanding, mainly out of necessity, others appear to be moving backward, mainly as a result of their passing from capital exporter to capital importer status. A number of debates in the United States in connection with NAFTA and other international bodies are clearly reminiscent of discussions in Latin America in the past, as Professor Alvarez has eloquently explained.

You may forgive me for asking whether the United States is in this respect becoming a developing country. Years ago I had the privilege to meet Secretary of State Dean Rusk, who was then professor of law at the Georgia Law School, on the occasion of a symposium discussing the restrictions to foreign investments then in favor in Latin America. I have not forgotten a remark he made to me to the effect that one should not be surprised if in the future the United States adopted similar restrictive attitudes as the flow of foreign capital into this country continued to increase. Has that future become the present?

I sincerely hope not. This of course begs the question of how a common standard can be achieved in the light of current tensions. Here is where the role of foreign investment law and international arbitration comes into play.

A first avenue for attaining this goal is the gargantuan expansion of bilateral investment treaties and multilateral instruments, also extending, as mentioned, to the new orientations of national legislation governing foreign investment. Professor Alvarez has raised the fascinating discussion about the effects this phenomenon may have on customary international law. In terms of which developments are to be attributed to treaty law and which to customary law the situation is in a state of flux. This is so, first, because rules of customary law are indeed reflected in a significant number of treaties and, next, because treaty rules are in a number of cases transiting into customary law. Whichever direction the process takes, the end result is that the standard envisaged becomes the law common to the international community.

In some matters, the identification and meaning of the relevant standard of treatment appears to have completed its process of harmonization. This is mainly the case of the standard governing expropriation and nationalization, which today may be considered common both to major domestic legal systems and international law, both customary and conventional, and has largely passed into the domain of basic human rights.

A greater debate surrounds, however, another major standard, that applicable to regulatory or indirect expropriation or other measures that seriously interfere with the rights to which an investor is entitled by contract, law or treaty. The question here is whether “fair and equitable treatment” and related aspects of protection extended to the investor are different in domestic law, customary law and treaty law, and if so which should prevail.

The NAFTA Free Trade Commission appears to have taken the view that customary law sets a standard less demanding than that which could be understood by panels and tribunals to be the case under that treaty and other recent free trade agreements. That may be true historically if you consider as customary the standard envisaged, say in the *Neer* case.

However, I may submit that today no one could identify with any precision which is the customary law standard, as it has been significantly evolving along time and embodies a number of concerns which are not alien, again, to major domestic legal systems and to

human rights. In fact, panels have not been uninspired by domestic standards, just as the European Court of Human Rights has significantly contributed to a more precise interconnection between property and human rights.

So too, I may submit that in the light of a number of recent decisions, “fair and equitable treatment” is not really different from legitimate expectation as developed, for example, by the English courts and also recently by the World Bank Administrative Tribunal. International law is not unaware of major domestic legal developments, particularly when the rights of citizens are entangled in promises made by their governments and have in good faith relied upon them. Whether this standard may be developed beyond foreign investments or international administrative law, is just a question of time. The common standard thus continues to evolve.

It is also interesting to note that in spite of common belief that all such standards are only there to benefit privileged investors, states have seldom been aware that they too can rely on many features of investment law to protect their own interest, particularly by means of counterclaims in arbitration proceedings. In addition, a few states have recently sought to concert their legal understandings with other states and international organizations so as to promote their interests.

This same state of flux and interaction determines that what used to be the *lex generalis* under customary law is in some respects not longer so and has been overtaken by the *lex specialis* of treaty developments. If you consider, for example, the mechanisms available for bringing international claims, it is not difficult to realize that the usual customary law mechanism of diplomatic protection has today become the exception and has ceded its preeminence to treaty-dispute settlement arrangements involving for the most direct rights of action by affected individuals. Diplomatic protection has still an important role, but it is a residual role called to intervene when direct right of action is unavailable.

## OVERCOMING DISCRIMINATION

A second major avenue for the harmonization of relevant standards is the combination of national treatment and the most

favored nation clause, all pointing to the need of eliminating discrimination. Under national treatment, citizens and foreigners are to be treated alike, in the understanding that the former might be in a situation more privileged than the latter. If the reverse turns out to be the case, then again the answer lies in upgrading the treatment of nationals to the international standard available and not the opposite.

More importantly, under most favored nation treatment no discrimination among foreign beneficiaries of certain defined rights should take place. The end result is again that the process of harmonization of international and domestic standards becomes yet more intense. This has become perhaps the best available tool for avoiding discrimination, particularly in the light of the most favored nation clause inserted in all commerce and navigation treaties, bilateral and multilateral investment treaties and a number of trade arrangements, most notably the WTO.

Simple as the rule is, it has nonetheless given rise to a wave of interpretations in the aftermath of the Maffezini decision by an ICSID tribunal. Dozens of arbitration requests now invoke that decision for one or other purpose, footnotes are written in treaties to narrow down its supposed scope and scholarly debates rage over its meaning. For the most, I may add, such interpretations are way beyond what was in fact said and decided. However, the whole exercise shows a point: there is a continuing search for the harmonization of applicable standards and mechanisms and however much Maffezini is narrowed or enlarged this concern will not fade away, just as the need to avoid discrimination will persevere.

#### THE BENEFITS OF DECENTRALIZATION

This takes me to a last comment, also prompted by important considerations made by Professor Alvarez on the institutional needs of foreign investment law. Tempting as the idea of channeling this evolving process by means of a single or central mechanism is, I am not quite persuaded by its merits. All large institutions, like states themselves, sooner or later tend to make policies directed to serve the institution and lose sight of the needs of their assumed beneficiaries.

I see more merit in a continuing decentralized function where various mechanisms will compete for efficiency, timeliness and professionalism. To the extent that users of the system, whether investors or host states, have a choice, this will result in the increased search for improvement. The availability of ICSID and UNCITRAL tribunals as major mechanisms for the settlement of investment disputes has been appropriate. The International Chamber of Commerce might consider developing an alternative facility to this effect, which is already in demand under some treaties and contracts.

The risk of contradictory decisions and forum shopping cannot be ignored, as recent cases have evidenced, but this is a rather minor inconvenience of the existing decentralized system when compared to its benefits. A strong community of arbitrators, scholars and practitioners is a guarantee sufficient to overcome difficulties of the sort as the process evolves.

The proposal to establish an appeals mechanism in the context of foreign investment arbitration decisions is today the hottest item in the menu. The very fact of an increasing number of requests for annulment, either under the ICSID convention or domestic courts under UNCITRAL rules, is also the expression of the search for a review mechanism. If the intention of these initiatives is to contribute to the improvement of the system of international arbitration, they may well succeed as has been the experience of the Appellate Body of WTO. However, if the intention is to reverse and to renationalize the evolving process, it might not meet an equally successful fate as the world moves in the opposite direction.

A number of alternative suggestions have been made and they certainly deserve a careful consideration. Why not extend the ICSID annulment mechanism to decisions under the special facility, if the concern has been to challenge NAFTA decisions in this context? Why not to establish a Court of International Arbitral Decisions, where international investment and commercial litigation might have the opportunity to challenge adverse decisions? This suggestion would certainly contribute to the full internationalization of arbitration departing from the present day challenges before domestic courts. The International Chamber of Commerce could make available a special facility to this effect under the Court of

International Arbitration. Again in this matter the system could offer the benefits of decentralization.

Global investments, like global trade and human rights, require truly international dispute settlement arrangements. The present day shortcomings can be well understood in a transitional period between the traditional system and the new endeavors of global society. Yet, they cannot last for long as they would hamper the very activities that are the engine of the ongoing changes.