# PROTECTION OF FOREIGN INVESTMENTS UNDER INTERNATIONAL LAW *

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Political scientists aver that in order to have a state, there must be a group of people more or less numerous, permanently occupying a definite portion of the earth's territory, where they establish a government free from external control and to which the great body of inhabitants render habitual obedience.

Political economists, on the other hand, maintain that any people, to survive, must live on the resources found within its territory. When the resources dwindle or become insufficient, the necessity arises for the people to look for resources in other territories.

This ancient mode of satisfying human wants is no longer acceptable to the international community as war and conquest are almost always the ultimate result. Modern practice dictates that when the resources of any given territory are no longer sufficient to meet growing demands, the people must increase production or else resort to international trade.

The scarcity of, and demand, for goods and services have led peoples to engage in their transfer across national boundaries on a global scale. While it is true that in earlier times, the traditional mode for international trade was merely the transfer of goods produced in one country for consumption or use in another country, growing complexities of life have compelled peoples to transfer their assets, properties, cash, and investments from the country where they originate to some other country where they can be of use.

As a consequence, the desirability of legal protection of foreign investments has inevitably arisen. The legal protection that may be accorded to foreign investments, of course, will depend upon the form in which the foreign investment is being brought into any given country.

*Forms of Entry of Foreign Investments*

Universally, there are two ways by which investments may be brought into any country: first, by participation of the foreign investor in the equity

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of domestic enterprises; and second, by permitting foreign investors to engage in trade or business in the host countries after securing the proper license for the purpose.

In most developed countries, there are no limitations as to the percentage of the equity participation that may be permitted in the case of domestic enterprises. However, in many of the developing economies, the host government usually permits foreign equity investment only if it will constitute a minority participation in the capital structure of domestic entities. The nature of the legal protection that may be extended to such kind of foreign investments will naturally depend upon the manner by which the foreign investor had been permitted to enter a particular political jurisdiction.

*Modes of Government Intervention*

Traditionally, political authority interferes with property rights of foreign investors through the three inherent powers of government: namely, the power of taxation, the power of eminent domain and police power.

*Power of Taxation* — Taxation is often referred to as the power of the sovereign to impose burdens or charges upon persons, property, or property rights for the use and support of government to enable it to discharge its appropriate functions.[1] It is a power of the sovereign state to recover a contribution of money and other property in accordance with some reasonable rule of apportionment, from the property or occupations within its jurisdiction for the purpose of defraying the public expense.[2] By this method of state interference, it is assumed that the person, whether natural or juridical, receives from the state the equivalent of the tax in the form of protection and of other benefits accruing from a civilized society.

*Power of Eminent Domain* — By the power of eminent domain, private property is taken by the government for public use upon payment of just compensation. The term "just compensation" means "fair market value" of the property, which is the price at which a seller willing, but not compelled, to sell, will dispose of his or its property in favor of a buyer, willing but not compelled, to purchase the property.[3] For the public "taking" to property, compensation must be made because the same is taken not as the owner's share of contribution to a public burden but as much beyond his share.[4]

*Police Power* — The police power is exercised for the purpose of promoting the general welfare. This is the power through which the state

[1] Des Moines Union v. Chicago Great Western, 186 Ia. 1019, 9 A.L.R. 1557, 177 N.W. 90 (1920).
[2] 1 Cooley, Law of Taxation 149 (4th Ed., 1924).
[3] Phillips v. U.S., 12 F. 2d 598 (1926).
[4] People v. City of Brooklyn, 4 N.Y. 419 (1951).

regulates businesses and occupations within its territorial jurisdiction. Usually, annoyance and financial loss are caused to the person, leaving the reward to be reaped through his recognition that the restraint is for the public good.

*Sources of Protection*

As against these inherent powers of government to interfere with private property rights, including those of foreign investments, the international community of nations had been compelled to look for solutions in order to accord protection, not only to foreign investments but also to domestic investors. In the world today, there are four significant sources of protection for foreign investments, to wit: treaties; organic laws or constitutions of governments; state legislation; and, international arbitration rules.

1. *Treaties*

There are two kinds of treaties that provide protection for foreign investments. These are multilateral treaties in the form of international conventions, and bilateral treaties between governments.

A. *Multilateral Treaties*

Some multilateral treaties are already in force. Others are in the process of negotiation.

*Washington Convention of 1965*[5]

The Board of Governors of the International Bank for Reconstruction and Development, during its 1962 annual meeting, realized the desirability for the establishment of institutional facilities for the settlement of disputes arising from foreign investments through arbitration and conciliation. For such purpose, legal experts from 86 countries were invited to regional consultative meetings. In 1963, one was held in Addis Ababa, Ethiopia, for the continent of Africa. In 1964, conferences were held in Santiago de Chile, for Latin America; in Geneva, for Europe, and in Bangkok, for Asia.

The regional conferences were held with the assistance and under the auspices of different agencies of the United Nations.

Pursuant to a resolution of the Board of Governors, a draft Convention was prepared by the Executive Directors of the International Bank for Reconstruction and Development. The said draft Convention was

[5] Otherwise known as the International Convention on the Settlement of Investment Disputes between States and Nationals of other States. Opened for signature at Washington on 18 March 1965 [hereinafter referred to as ICSID].

transmitted to member governments and, today, there are about 100 country-signatories thereto.

The most important feature of what is now popularly known as the 1965 Washington Convention[6] is the establishment of the International Center for the Settlement of Investment Disputes (ICSID) as an autonomous international machinery.[7] The Center has an administrative council where each member-government is represented.[8]

For greater efficiency, the International Center maintains two panels: 1) a panel of arbitrators and 2) a panel of conciliators.[9] Each government may nominate to the Administrative Council through the Secretariat four persons[10] any one of whom may ultimately be chosen by the Chairman of the Council to be member of either the panel of arbitrators or the panel of conciliators.[11] There are supposed to be ten members that may be chosen for the panel of arbitrators and another ten members for the panel of conciliator.[12] The persons designated to each panel shall be of different nationalities.[13]

The International Center was established to settle legal disputes directly arising out of investment.[14] A dispute, to be within its jurisdiction, must be between a state, party to the convention, and a national of another contracting state.[15] This is obvious, because the national of a contracting state cannot bring an action in the Center for the settlement of any investment dispute against its own state.

*UNCITRAL Rules on Arbitration*

Another acceptable mode for the settlement of investment disputes is that which had been accomplished by the United Nations Commission on International Trade Law (UNCITRAL).

On December 16, 1966, the United Nations General Assembly, created the United Nations Commission on International Trade Law.[16] During its first session, the Commission placed in its agenda the matter of settlement of investment disputes through arbitration. At its second session, a *special rapporteur*[17] was appointed, and given the function of making studies on the various problems that may arise in connection with

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6 For Text, *see* 575 U.N.T.S. 160 (1966).
7 Article 1, ICSID, *supra.*, note 5.
8 Article 4, ICSID, *supra.*, note 5.
9 Article 12, ICSID, *supra.*, note 5.
10 Article 13.1, ICSID, *supra.*, note 5.
11 Article 13.2 ICSID, *supra.*, note 5.
12 Article 13.2, ICSID, *supra.*, note 5.
13 Article 13.2, ICSID, *supra.*, note 5.
14 Article 25, ICSID, *supra.*, note 5.
15 Article 25, ICSID, *supra.*, note 5.
16 Under General Assembly Resolution 2205 (XXI), by which UNCITRAL was established, the commission consists of twenty nine states, elected by the Assembly.
17 Mr. Jon Nestor of Rumania.

the settlement of disputes related to investments.[18] A report was ultimately prepared by the *special rapporteur* and this was submitted in 1972 to the Commission.[19] Subsequently, the Commission requested the Secretary-General of the United Nations to prepare a draft of a set of rules for the settlement of disputes by arbitration.[20] The Secretary-General complied with the request, and the draft was presented to the United Nations Commission on International Trade Law, acting as a Committee of the Whole. The Commission itself unanimously approved the draft[21] and transmitted the same to the General Assembly, which subsequently passed a resolution[22] recommending the use of the rules for the settlement of disputes by arbitration.

Today, they are known as the UNCITRAL Arbitration Rules.

*The 1958 New York Convention*

Another multilateral agreement on the matter of dispute settlement is the so-called Convention on the Recognition and Enforcement of Foreign Arbitral Awards.[23]

After the First World War, there was a clamor for the settlement of international disputes of a private nature through international legal procedures. One of the first steps taken by the international community in this regard was the adoption of the Protocol of Geneva of 1923 relating to arbitration clauses.[24] This was followed by the so-called Convention of Geneva of 1927 relating to the enforcement of foreign arbitral awards.[25]

These two multilateral agreements were effective up to 1958 when the United Nations called the Conference on International Commercial Arbitration in New York.[26] The government representatives to this particular conference worked on the problems involved, and the result is the 1958 New York Convention for the enforcement of foreign arbitral awards.

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[18] U.N. GEN. ASS. REC. 24th Sess., Suppl. 18 (A/7618), para. 112 as cited in UNCITRAL Y.B. vol. 1: 1968-1970, part two, II, A.

[19] Document A/CN. 9/64 as cited in UNCITRAL Y.B., vol. III: 1972, part two, III.

[20] *Report of the United Nations Commission on International Trade Law on the work of its sixth session,* 2-13 April 1973, U.N. GEN. ASS. REC. 28th Sess., Suppl. 17 (A/9017), para. 85 as cited in UNCITRAL Y.B., vol. IV: 1973, part one, II, A.

[21] *Report of the United Nations Commission on International Trade Law on the work of its ninth session,* U.N. GEN. ASS. REC. 31st Sess., Suppl. 17 (A/31/17), para. 56-57 as cited in UNCITRAL Y.B., vol. VII: 1976, part one, II, A.

[22] U.N. GEN. ASS. Res. 31/98, as recommended by Sixth Committee, A/31/390, adopted by consensus by the Assembly on 15 December 1976, meeting 99, cited at 30 U.N. Y.B. 825 (1976).

[23] 330 U.N.T.S. 38 (1959).

[24] Registered No. 678. *See* 27 L.N.T.S. 157.

[25] Registered No. 2096. *See* 92 L.N.T.S. 301.

[26] The conference was called in accordance with the terms of Resolution 604 (XXI) adopted on 3 May 1956 by the U.N. Economic and Social Council for the purpose of concluding a convention on the recognition and enforcement of foreign arbitral awards, and to consider other possible measures for increasing the effectiveness of arbitration in the settlement of private law disputes.

The concept underlying the Convention is that, in the case of a dispute, the same may be settled through arbitration, and the award of any arbitral tribunal handed down in ay one country, may be recognized and enforced in another country.

Each signatory to the Convention has three principal duties, to wit:

1) To recognize an agreement in writing under which the parties undertake to submit to arbitration all or any disputes which have arisen or which might arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration;[27]

2) To recognize arbitral awards as binding;[28] and,

3) To enforce arbitral awards in accordance with its own internal rules of procedure, and to impose no conditions more onerous than those imposed on the recognition or enforcement of domestic arbitral awards.[29]

*The Proposed Code of Conduct for Transnational Corporations*

One of the more recent moves taken by the international community for the protection of foreign investment is the initiation of discussion on the proposed Code of Conduct for Transnational Corporations.

By a resolution[30] adopted in July 1972, the Economic and Social Council of the United Nations requested the Secretary-General to establish a group of eminent persons to study the impact of transnational corporations on development and on international relations. Pursuant to a report[31] of the Group that was subsequently constituted, the United Nations Economic and Social Council (ECOSOC) created the Commission on Transnational Corporations.[32]

During the second session of the Commission on Transnational Corporations, an inter-governmental working group was organized for the purpose of drafting a code of conduct.[33] In all, the working group held 17 sessions and after lengthy deliberations, adopted the draft code of conduct. The same was submitted to the Commission during its Eight Session.

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27 Article 2.1 of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards [hereinafter referred to as CREFAA].

28 Article 3, CREFAA, *supra.*, note 27.

29 Article 3, CREFAA, *supra.*, note 24.

30 *The Impact of Multinational Corporations on the Development Process and on International Relations* U.N. ECOSOC Res. 1721 (LIII) adopted on its 1836th plenary meeting, dated 28 July 1974 as cited in 1 Simmonds, Multinational Corporations Law D. 1 (1979).

31 E/5500/Rev. 1 (New York, 1974), *id.* at E.

32 ECOSOC Res. 1913 (LVII) dated 5 December 1974, *id.* at D. 3.

33 *See* Commission on Transnational Corporations, "Report on the 2d Session" ECOSOC OFF. REC. 61st Sess., Suppl. 5 (E/5782), Chap. 1, paras. 10-17.

The first discussion on the draft Code of Conduct for Transnational Corporations by the Commission was conducted in New York City during the March Special Session. This was followed by the Second Special Session in May, 1983.

As to the issues relating to the protection of foreign investments, there are three (3) significant provisions in the draft Code, namely: 1) the treatment to be accorded to transnational corporations, which in reality are the carriers of foreign investments; 2) expropriation or nationalization; and, 3) settlement of disputes.

Among the various groupings in the United Nations are the Group of 77 composed of the developing countries of Asia, Africa and Latin America; the G2 which is the group of the European and other developed countries; and lastly, the Group of Socialists countries.

The European Powers advocate fair, equitable and non-discriminatory treatment of transnational corporations while the Group of 77, at the moment, is agreeable only to equitable treatment.

Another point of difference among the various groups in the Commission is the matter of general treatment to be accorded to transnational corporations. G2 countries proposed that the treatment to be extended to transnational corporations should be no lesss favorable than the treatment granted to domestic enterprises. This proposal is not acceptable to the Group of 77. Hence, up to the present, there is an impasse on the matter.

All the groups in the United Nations Commission on Transnational Corporations recognize the power and the authority of every country to expropriate property, including properties represented by investments. Dispute arises, however, on the question of when compensation should be paid. Representatives of home governments insist on the prompt, effective and adequate payment for the expropriated property of foreign investors and transnational corporations. Most of the developing countries belonging to the Group of 77 cannot agree to prompt, effective, and adequate compensation because many of them do not have the economic resources foı the immediate remittance or repatriation of the proceeds of expropriation.

On the issue of settlement of disputes, the Group of 77 would like to insist on the resolution of investments disputes by national boards or tribunals while most of the members of G2 insist on some other modes, such as resort to the facilities of international machinery for disputes settlement including arbitration. A solution on this matter still has to be arrived at by the Commission on Transnational Corporations.

*Code of Conduct for Liner Conferences* [34]

One other possible international machinery for the settlement of disputes and the protection of foreign investments is that which may be found in the Code of Conduct for Liner Conferences.

During the third session of the United Nations Conference on Trade and Development held in 1972, the General Assembly of the United Nations was requested to convene a conference of plenipotenciaries to adopt a Code of Conduct for liner conferences. A draft code was prepared and subsequently adopted in the Convention of Geneva of April 1974.

It is to be noted that in the international transfer of goods and properties representing foreign investments, the same most often have to be transported through liners or shipping lines that form part of liner conferences.

The Code of Conduct fo Liner Conferences contain provisions to the effect that in case of disputes, the same shall be submitted to international mandatory conciliation. To be within its scope, the dispute must be between two or more liner conferences, between a liner conference and a shipping line, between two shipping lines of the same liner conference, or between a liner conference or shipping line member and an association of shippers or just plain representatives of shippers.

B. *Bilateral Treaties*

In view of the increase in the volume of international trade and investments, efforts are being taken by various nations of the world for the protection of investors.

Bilateral treaties are being resorted to for the purpose. At present, these treaties are generally of two types: 1) investment treaties; and, 2) tax treaties.

*Investment Treaties*

In the negotiation for the adoption of bilateral investment treaties, discussions usually center on the treatment to be afforded to foreign investors. Very often, host governments insist on the most-favored-nation treatment. Home governments generally insist on national treatment.

It is to be noted that if national treatment is to be accorded to foreign investments, the result is that there will be no marked difference

[34] Adopted by a conference of plenipotentiaries which met at Geneva from 12 November to 15 December 1973 and from 11 March to 6 April 1974 under the auspices of the United Nations Conference on Trade and Development in accordance with U.N. GEN. ASS. Res 3035 (XXVII) dated 19 December 1972. Open for signature from 1 July 1974 to 30 June 1975. For Text *see* TD/Code II/Rev. 1 & Corr. 1.

in the treatment of domestic investors on one hand and foreign investors on the other.

*Tax Treaties*

As a vehicle for the protection of foreign investments, tax treaties are concerned, generally, with the avoidance of double taxation and the prevention of fiscal evasion.

Foreign investments are usually taxed in the country of the host government. The concern of some foreign investors revolve on the belief that there should be less tax burden imposed upon them. The desirable situation in their view is that they should be subjected to tax in only one political jurisdiction so that if they are taxed by the host government they should not be taxed any more by the home government.

2. *Organic Laws*

The second source of protection for foreign investments are organic laws and constitutions. Many constitutions of the world contain provisions on due process, equal protection of laws, non-impairment of contracts, and expropriation clauses intended to grant protection not only to domestic but to foreign investors as well.

3. *State Legislation*

Statutes and other forms of state legislation constitute the third source of protection and incentives for foreign investments. Among such statutes are investment incentive laws, patent laws, trademark laws, anti-trust laws, statutes on unfair competition, laws on fraudulent advertising, and laws on the use of marked containers.

The physical protection of properties representing investments is likewise a concern not only of investors but also of governments. Consequently, penal laws on robbery, theft, swinlidng, and other similar acts are being enacted for their protection.

4. *International Arbitration and Conciliation Centers*

The existence and operations of international arbitration and conciliation centers have provided international legal machinery for the settlement of disputes, and, therefore, constitute another source of protection for foreign investments. Two of the more important arbitration authorities are the Court of Arbitration of the International Chamber of Commerce based in Paris and the American Arbitration Association based in New York. Both of these were established not by governments but by associations from the private sector. Their facilities are nevertheless used by

foreign investors whenever disputes arise in connection with their transactions.

*CONCLUSION*

With all the efforts being exerted by the United Nations and its specialized agencies, the governments of home and host countries, and the different non-governmental organizations for the improvement of international trade and investments, there is no doubt that legal protection is being extended to foreign investments by the international community. Perhaps, that should be the case if foreign investments are to be encouraged on a global scale.