CHAPTER 17

FROM GUNBOATS TO BITs:

The evolution of modern international investment law

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INTRODUCTION

In the Middle Ages, and even after the emergence of the modern nation State in the seventeenth century, an alien and his property were subject to abusive and discriminatory treatment, either at the hands, or with the implicit permission, of the local governing authority.[1] The remedy for mistreatment of an alien, to the extent one existed, was reprisal from the alien's home territory.[2] It was not until the middle of the eighteenth century that our notion of State responsibility for injuries to aliens began to emerge. The core of that notion was first stated by Emmerich Vattel in 1758: "Whoever uses a citizen ill, indirectly offends the State, which is bound to protect this citizen."[3]

This article will trace the development of that core notion as it has been applied to the property of aliens through four historical phases: (1) the nineteenth century (ending in 1914), during which European States and the United States maintained—by legal, diplomatic, and military means—the view that international law permits States to take the property of aliens only if they compensate the alien in an amount equal to the value of the property taken, and also during which resistance to this Euro-American view began to develop in Latin America; (2) the

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1. "The legal position of the alien has in the progress of time advanced from that of complete outlawry, in the days of early Rome and the Germanic tribes, to that of practical assimilation with nationals at the present time." Edwin Borchard, *Diplomatic protection of citizens abroad* (New York: Banks Law Publishing Co., 1915), at p. 33.

2. See, e.g., Evelyn Colbert, *Retaliation in international law* (New York: King's Crown Press, 1948), Ch. 1.

3. Emer de Vattel and Joseph Chitty, *The law of nations: Or, principles of the law of nature, applied to the conduct and affairs of nations and sovereigns* (Philadelphia: T. & J.W. Johnson, 1844), at p. 161.

inter-war period, during which the Euro-American consensus was disturbed by the Russian and Mexican Revolutions but nonetheless found uniform support in the period's few relevant judicial and arbitral decisions, some of which remain among the most important and frequently cited decisions that address the obligations of States with respect to the property of aliens; (3) what might be called the Cold War/post-colonial period, extending from the end of World War II to 1989 and including the important diplomatic initiatives of the late 1960s and 1970s known as Permanent Sovereignty over Natural Resources, the New International Economic Order, and the Charter of Economic Rights and Duties of States, all of which opposed the Euro-American view; and (4) the post-Cold-War period, extending from 1989 to the present, during which the relatively small number of treaties that embodied the Euro-American view—most commonly known as treaties of Friendship, Commerce, and Navigation—expanded exponentially into the truly global network of thousands of bilateral (and multilateral) investment treaties that we see today, virtually all of which adopt the Euro-American view and almost all of which provide a compulsory means of resolving investment disputes that permits (in some cases, requires) the investor's home State to remain uninvolved in the dispute.

The last twenty years have seen an enormous increase in the number of disputes between foreign investors and host States that are resolved by arbitral tribunals established under the provisions of bilateral investment treaties. This large number of arbitral decisions has drawn much attention to certain legal issues that previously either were unknown or were unimportant, and to the concerns expressed by some States, including the United States, that these decisions are stretching the agreed substantive rules in unhelpful—or at least unacceptable—directions. It is the authors' purpose to redirect attention from these subjects of current debate to the enormous progress that has been seen in this area of international law over the last 200 years, and to the forces that have brought us from a world in which a foreign-investment dispute might be a *casus belli,* to one in which most such disputes are not even the subjects of diplomatic correspondence between the relevant governments. In the current debates over the utility of bilateral investment treaties, it is important to keep in mind that perhaps their most important achievement has been largely to remove investment disputes from the bilateral diplomatic agendas of treaty countries.

A. THE NINETEENTH CENTURY: 1794–1914

The modern international law relating to the treatment of alien property has its roots in the State practice of the late eighteenth and nineteenth centuries. It was during this period that industrialization—primarily in Great Britain, but increasingly also in other Western European countries and the United States—began to generate the large capital surpluses that would fuel foreign investment on a scale not previously seen in world history. While the majority of this investment was financial in character, foreign direct investment also grew rapidly during this period, especially during the period from 1870 to 1914.[4] A significant proportion of these investment flows ran between colonizing powers and their overseas possessions. Such intra-imperial investments

4. See David Held et al., *Global transformations: Politics, economics, and culture* (Stanford: Stanford University Press, 1999), pp. 239–40. Foreign direct investment is estimated to have accounted for approximately 35 percent of the stock of long-term international investment by 1914. John H. Dunning, *Explaining international production* (London: Unwin Hyman, 1988), p. 72.

were effectively governed by the municipal law of the colonial power in question and accordingly have little bearing on the emergence of international law on the treatment of alien property.[5] But, especially in the later decades of the nineteenth century, international investment began to flow in increasing amounts from the Western powers to countries outside of the colonial system, in particular those of Central and South America that had relatively recently liberated themselves from Spanish rule.[6]

The State practice of this period, which was later to be invoked as evidence of established norms of customary international law, was driven by an inherent imbalance of power between the Western powers and the recipient countries. On the one hand, the internal weakness of many of the latter countries occasioned frequent insurrections and other mob violence in which alien interests were vulnerable to injury. On the other hand, the Western powers expected such injuries to be compensated and had the wherewithal to make life uncomfortable for the recipient States if they failed to provide such compensation. The Western viewpoint was expressed in two related propositions. First, these powers held that their nationals should not be subjected by their States of residence to a standard of treatment that fell below a certain international minimum, even if that minimum standard entailed treatment better than that guaranteed by the States of residence to their own nationals.[7] Second, the Western powers maintained that they had the right to afford protection to their nationals when these minimum standards were not met. Specifically, the principle of diplomatic protection advanced by the Western powers treated an injury to a foreign national caused by an act or omission of the host State as an international wrong against that national's home State, for which the home State was entitled—but not bound—to seek reparation in its own name.[8]

Throughout the nineteenth century and into the twentieth century prior to World War I, Great Britain, the United States, and other significant capital exporters, such as France and Germany, were aggressive in asserting their right to exercise diplomatic protection over their nationals in other countries.[9] On numerous occasions throughout this period, protection took the form of the threat or use of force by these States designed to ensure that the rights of injured nationals were fully vindicated.[10] Great Britain in particular was renowned for its readiness to resort to military intervention on behalf of its overseas nationals.

5. M. Sornarajah, *International law on foreign investment* (Cambridge: Cambridge University Press, 3rd ed., 2010), pp. 19–20.

6. Robert Grosse, *Multinationals in Latin America* (New York: Routledge, 1989), pp. 7–12; Sornarajah, *International law on foreign investment*, op. cit., at p. 19, n. 57.

7. See Borchard, *The diplomatic protection of citizens abroad*, op. cit., at pp. v–vi.

8. As later explained by the Permanent Court of International Justice: "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 whom they have been unable to obtain satisfaction through the ordinary channels." Mavrommatis Palestine Concessions Case (Jurisdiction) (Greece v. UK) 1924 P.C.I.J., Series A, No. 2, p. 12. See also Borchard, *The diplomatic protection of citizens abroad*, op. cit., at pp. v–vi.

9. See John R. Dugard, First Report on Diplomatic Protection, International Law Commission, 52nd Session, A/CN.4/506 (2000), p. 5 (observing that it was the "powerful Western States [. . .] that most readily intervened to protect their nationals who were not treated 'in accordance with the ordinary standards of civilisation' set by Western States.").

10. Dugard, First Report on Diplomatic Protection, op. cit., at p. 5 (commenting on the role of diplomatic protection in providing "a justification for military intervention or gunboat diplomacy.").

British "gunboat diplomacy" reached its apogee in the 1840s and 50s during the tenures as Foreign Secretary and Prime Minister of Lord Palmerston.[11] Palmerston famously defended his policy in Parliament during the so-called Don Pacifico Affair. This controversy arose in the wake of Palmerston's decision to dispatch a Royal Navy squadron to blockade the Athenian port of Piraeus following the Greek Government's refusal to compensate a British subject for injuries inflicted by a mob. Notwithstanding his jingoistic conclusion,[12] the key principle advanced by Palmerston in his speech to the House of Commons on June 25, 1850, was one to which the other Western powers would readily have subscribed during the period prior to 1914. Denouncing the position advanced by his parliamentary detractors that British nationals overseas should rely on the judicial remedies available in their countries of residence, Palmerston affirmed his alternative doctrine:

> [I]n the first instance, redress should be sought from the law courts of the country; but that in cases where redress cannot be so had—and those cases are many—to confine a British subject to that remedy only, would be to deprive him of the protection which he is entitled to receive.[13]

But Great Britain was not alone among the Western powers at this time in its readiness to deploy military force to protect overseas nationals and their investments. For example, as early as 1833, U.S. military forces were deployed in Buenos Aires to protect the interests of the United States and other countries during an insurrection in Argentina.[14] France landed troops at Vera Cruz in 1838 to recover debts owed to its nationals by the Mexican government.[15] Some 25 years later, Mexico's suspension of interest payments to foreign nationals prompted a joint military response by France, Spain, and Great Britain. France was to use that operation as a pretext for a full-scale invasion and its installation of Maximilian of Hapsburg as Emperor of Mexico in 1864.[16] By the turn of the twentieth century, joint military interventions by two or more of the Western powers to protect foreign interests were becoming commonplace.[17]

11. Jack Snyder, *Myths of empire: Domestic politics and international ambition* (Ithaca: Cornell University Press, 1991), pp. 156–57.

12. "[A]s the Roman, in days of old, held himself free from indignity, when he could say *Civis Romanus sum*; so also a British subject, in whatever land he may be, shall feel confident that the watchful eye and the strong arm of England, will protect him against injustice and wrong." *House of Commons Debates,* June 25, 1850, vol. 112 (3rd Ser.) c. 444 (statement of Lord Palmerston).

13. Palmerston, op. cit. c383.

14. Ellen C. Collier, Congressional Research Service, *Instances of use of United States forces abroad, 1798–1993* (October 1993), available at: http://www.history.navy.mil/wars/foabroad.htm (last visited April 19, 2011).

15. W.S. Robertson, "French intervention in Mexico in 1838," 24 *Hispanic American Historical Review* 222 (1944) pp. 222–252.

16. Maximilian was ultimately defeated by Mexican Republican forces and executed by firing squad in 1867. For a general history of this episode, see Kristine Ibsen, *Maximilian, Mexico and the invention of empire* (Nashville: Vanderbilt University Press, 2010).

17. In 1902, British and German naval forces jointly blockaded Venezuela to force the government of that country to pay debts owed to their respective nationals. Nancy Mitchell, *The danger of dreams: German and American imperialism in Latin America* (Chapel Hill: The University of North Carolina Press, 1999), pp. 64–107. The international force deployed to suppress the Boxer Rebellion threatening foreign interests in China in 1900–01 included contingents from Great Britain, Russia, Japan, the United States, France, Germany, Italy, and the Austro-Hungarian Empire. Victor Purcell, *The Boxer Uprising: A background study* (Cambridge: Cambridge University Press, 1963), pp. 249–62.

The threat or use of force by the Western powers on behalf of their nationals and their investments was rarely, if ever, an end in itself. The objective was typically to encourage an adjudication of the claims subject to diplomatic protection under standards that those powers would deem acceptable.[18] As the nineteenth century progressed, arbitration administered by mixed claims tribunals became the preferred means of achieving this objective. The archetype in the modern era for this means of dispute resolution was provided by the ad hoc tribunals established by Great Britain and the United States to resolve the claims of their respective nationals arising from the American War of Independence.[19] The claims at issue were remitted to boards of arbitration consisting of five commissioners: Two each appointed by Great Britain and the United States, with the fifth appointed by unanimous vote of the first four commissioners or by lot based on nominations by the party-appointed commissioners. This model, or variations upon it, was to become the standard for later mixed claims commissions, although, especially in the first half of the nineteenth century, it was not uncommon for a distinguished statesperson to sit as a sole arbitrator.[20]

Resort to such mixed commissions to resolve claims espoused by the home State of an injured foreign national became increasingly frequent in the latter part of the nineteenth century. According to Brownlie, "[i]n the century after 1840 some sixty mixed claims commissions were set up to deal with disputes arising from injury to the interests of aliens."[21] Great Britain or the United States were the claimants in many of these arbitrations; the respondent was often a Latin American country, most commonly Mexico or Venezuela.[22] Great Britain and the U.S. also arbitrated claims against each other, most famously in the *Alabama* Claims Arbitration held

18. In his defense of the Don Pacifico intervention, for example, Palmerston observed that the "demand was that the claim should be settled. An investigation might have been instituted, which those who acted for us were prepared to enter into, fairly, dispassionately, and justly." In the face of Greek inaction, "was there anything so uncourteous in sending, to back our demands, a force which should make it manifest to all the world that resistance was out of the question?" Palmerston, *House of Commons Debates,* June 25,1850, op. cit., cc. 396–97. The case was ultimately referred to arbitration, as a result of which Great Britain was awarded £150, on a claim amounting to some £21,295. See Jackson H. Ralston, *International arbitration from Athens to Locarno* (Stanford: Stanford University Press, 1929), p. 228.

19. See, e.g., Ralston, *International arbitration from Athens to Locarno*, op. cit., p.191 (observing that "[t]he modern era of arbitral or judicial settlement of international disputes, by common accord among all writers upon the subject, dates from the signing on November 19, 1794, of the Jay Treaty between Great Britain and the United States. Prior to this time arbitrations were irregular and spasmodic; from this time forward they assumed a certain regularity and system.").

The Jay Treaty established three arbitral commissions, one dealing with U.S./Canadian border issues and the other two charged with resolving, respectively, claims of British merchants for unpaid debts owed by U.S. nationals and claims brought by U.S. shipowners against Great Britain for the unlawful capture and condemnation of vessels. Ralston, *International arbitration from Athens to Locarno*, op. cit., pp. 191–93; Charles H. Brower II, "The functions and limits of arbitration and judicial settlement under private and public international law," 18 *Duke Journal of Comparative & International Law* 259 (2008), pp. 266–271.

20. For example, in 1839 Queen Victoria was appointed to arbitrate the dispute between France and Mexico that had triggered the French action against Vera Cruz and subsequent "Pastry War" the previous year. See William Evans Darby, *Modern pacific settlements involving the application of the principle of international arbitration* (London: The Peace Society, 1904), pp. 11–12.

21. Ian Brownlie, *Principles of public international law* (Oxford: Oxford University Press, 7th ed. 2008), p. 522.

22. As Brownlie notes, "[c]laims settlement conventions included conventions between Mexico and the United States of 1839, 1848, 1868, and 1923; the Venezuela arbitrations of 1903 involved claims of ten states against Venezuela; and conventions between Great Britain and the United States of 1853, 1871, and 1908." Brownlie, *Principles of public international law*, op. cit., p. 522 n.18.

in Geneva in 1871–72 to resolve U.S. claims for damage inflicted during the American Civil War by Confederate ships built in England in alleged violation of the international law of neutrality.[23]

The success of the *Alabama* arbitration in resolving a particularly emotional dispute between Great Britain and the U.S. has been credited with helping to fuel the subsequent movement to place international arbitration on a more permanent footing.[24] A particular milestone in that regard was the adoption at the 1899 Peace Conference at The Hague of the Convention for the Pacific Settlement of International Disputes.[25] The signatories to that treaty recognized arbitration as "the most effective, and at the same time the most equitable, means of settling disputes which diplomacy has failed to settle."[26] Chapters II and III of the treaty went on to establish, respectively, a Permanent Court of Arbitration at The Hague[27] and arbitral procedures to govern its operation.[28] In addition, Article 19 of the treaty provided for signatories to conclude general arbitration agreements among themselves, "with a view to extending obligatory arbitration to all cases which they may consider it possible to submit to it."[29] From 1900–1914, more than 120 such treaties were concluded bilaterally between States.[30]

By the turn of the twentieth century, Western commentators were extracting from the accumulated diplomatic and arbitral practice of the preceding century a rule governing the treatment of aliens and their property, which was said to be generally applicable under international law. As the former U.S. Secretary of State (and, before that, Secretary of War), Elihu Root, explained in an address to the American Society of International Law in 1910:

> There is a standard of justice, very simple, very fundamental, and of such general acceptance by all civilized countries as to form a part of the international law of the world. […] If any country's system of law and administration 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.[31]

23. See generally Tom Bingham, "The Alabama Claims arbitration," 54 *International & Comparative Law Quarterly* 1 (2005), pp. 1–25.

24. See Bingham, "The Alabama Claims arbitration," op. cit., p. 24. See also Manley O. Hudson, *International tribunals: Past and future* (Washington: Carnegie Endowment for International Peace and Brookings Institution, 1944), vol. 1, p. 5 (observing that "[t]he success of the *Alabama Claims arbitration* stimulated a remarkable activity in the field of international arbitration.").

25. Convention for the Pacific Settlement of International Disputes (1899), available at http://library2.lawschool.cornell.edu/pca/1899english.htm (last visited April 19, 2011) [hereinafter CPSID].

26. CPSID, op. cit., Art. 16.

27. CPSID, op. cit., Arts. 20–29.

28. CPSID, op. cit., Arts. 30–57.

29. CPSID, op. cit., Art. 19.

30. Hudson, *International tribunals: Past and future*, op. cit., p.7. See, e.g., Agreement Between the United Kingdom and France Providing for the Settlement by Arbitration of Certain Classes of Questions Which May Arise Between the Two Governments, (Oct. 14, 1903), 23 *Hertslet's Commercial Treaties,* p. 492.

31. Address of Hon. Elihu Root, President of the Society on "The basis of protection to citizens residing abroad," 4 *American Society of International Law Proceedings* 16 (1910), p. 21.

This rule was perhaps implicit in the refusal of the Western powers over the previous century to tolerate perceived injustices suffered by their nationals at the hands of the judicial and other authorities of capital-importing countries, and indeed Root quoted from Palmerston's *Don Pacifico* speech to illustrate its pedigree.[32]

The detailed content of the minimum standard remained, however, somewhat indeterminate. One component of the standard related to the obligation of host governments to use due diligence to prevent injuries to aliens at the hands of private individuals and, in the event such an injury occurred, to exercise reasonable efforts to bring the offenders to justice.[33] Other components of the standard tended to be lumped together under the amorphous concept of denial of justice. As Borchard explained in his classic work on diplomatic protection, "denial of justice" was understood to encompass both the narrow concept of judicial misconduct corresponding to the current understanding of the term, as well as a range of other injuries that would today be analyzed as expropriation or other discrete claims:

> The term […] is used in two senses. In its broader acceptation it signifies any arbitrary or wrongful conduct on the part of any one of the three departments of government—executive, legislative or judicial. The term includes every positive or negative act of an authority of the government, not redressed by the judiciary, which denies to the alien that protection and lawful treatment to which he is duly entitled. [. . .] For example, a wrongful expulsion, false imprisonment, confiscatory breach of contract, wanton pillage by officered government troops, confiscation of property by legislative act or government decree, failure to punish a criminal offense, all constitute different forms of denial of justice.
>
> In its narrow and more customary sense the term denotes some misconduct or inaction of the judicial branch of the government by which an alien is denied the benefits of due process of law.[34]

Whether or not labeled as expropriation, however, the pre-1914 arbitral case-law reflects an understanding that governments that expropriate property from foreign nationals must pay compensation. One of the earliest cases cited for this proposition is that arising from the decision of the Kingdom of Naples in July 1838 to grant a monopoly in the Sicilian sulphur trade to a French company. Confronted with threatened British naval action, the Neapolitan Government

32. The passage quoted by Root included Palmerston's colorful illustration of the general principle of a minimum standard of treatment for foreign nationals:

"We shall be told, perhaps, as we have already been told, that if the people of the country are liable to have heavy stones placed upon their breasts, and police officers to dance upon them; if they are liable to have their heads tied to their knees, and to be left for hours in that state; or to be swung like a pendulum and to be bastinadoed as they swing, foreigners have no right to be better treated than the natives, and have no business to complain if the same things are practised upon them. We may be told this, but that is not my opinion, nor do I believe it is the opinion of any reasonable man." Palmerston, *House of Commons Debates,* June 25, 1850, op. cit., c. 387.

33. See, e.g., Borchard, *The diplomatic protection of citizens abroad*. op. cit., p. 213.

34. See Borchard, *The diplomatic protection of citizens abroad*. op. cit., p. 330. See also Jan Paulsson, *Denial of justice in international law* (Cambridge: Cambridge University Press, 2005), p. 47: "[I]n ordinary cases of executive action which we would today instantly recognise as expropriatory, the sponsors of the claim, strenuously arguing that the acts of administrative organs of the state could give rise to international responsibility for denial of justice, were seeking to bring the claim within the scope of denial of justice because they did not know what other terms to use to justify the espousal of a claim by the mechanism of diplomatic protection."

backed down.[35] The contract at issue was rescinded by a decree of July 1840 and a Commission established "under a plan of arrangement proposed by the French government" to "liquidate the claims of British subjects against the Neapolitan Government, for losses sustained by them, in consequence of that contract."[36] In the *Delagoa Bay* arbitration, decided in 1891, Portugal conceded in the *compromis* agreed with the claimants, Great Britain and the United States, that the only issue to be decided by the tribunal was the amount of compensation due with respect to its annulment of a railroad concession and the seizure of the associated railroad.[37] In the *El Triunfo* case brought by the United States against El Salvador on behalf of U.S. shareholders in a port concession, the tribunal issued an award in 1902 holding that "the Salvador Commercial Company and the other nationals of the United States who were shareholders in El Triunfo Company [. . .] are entitled to compensation for the result of the destruction of the concession and for the appropriation of such property as belonged to that company."[38]

Finally, in its submission to the tribunal established to consider claims arising from the confiscation by Portugal in 1910 of all property belonging to the religious associations in that country (the *Portuguese Religious Properties* case), Great Britain observed:

> His Majesty's Government are of opinion that the Portuguese State in taking possession, as it has done, of property legally acquired by British nationals in conformity with the legislation of Portugal and under the cover and protection of its public and private law, has acted contrary to the principles of the law of nations which governs the relations between states.[39]

Great Britain's co-claimants, France and Spain, are reported to have made similar observations, and Portugal to have accepted the legal principle thus advanced.[40]

Notwithstanding the assertion of Root and others that the minimum standard of treatment for foreign nationals was now part of international law, the notion that foreign nationals might be entitled to more favorable treatment than that available to the nationals of their host States met strong resistance throughout this period, in particular from Latin American States. This resistance first found its voice in the writings of the Argentine jurist Carlos Calvo, in particular his *Derecho Internacional Teórico y Práctico* of 1868.[41] The so-called Calvo Doctrine asserted that foreign nationals were entitled to treatment no greater than that afforded to nationals under the laws of their countries of residence, located exclusive jurisdiction over investment disputes in the national courts of the host State, and denied the right of States to intervene militarily or even diplomatically in the affairs of other States in exercise of a claimed right of diplomatic

35. See Alexander Fachiri, "Expropriation and international law," 6 *British Yearbook of International Law* 159 (1925), pp. 163–64.

36. Letter of Viscount Palmerston to the British Commissioners, Foreign Office, Nov. 17, 1840, reproduced in *British and Foreign State Papers*, Vol. 30, (1841–42), p. 111.

37. The full text of the *compromis* and award in the original French can be found in H. La Fontaine, *Pasicrisie internationale: Histoire documentaire des arbitrages internationaux,* (Berne: Impr. Stämpfli, 1902), p. 397. The limited scope of the arbitral tribunal's mandate is set out in Article 1 of the *compromis*. *Fontaine, Pasicrisie Internationale*, op. cit., p. 398.

38. 15 *Reports of International Arbitral Awards* 467 (1902), p. 478.

39. As reported in Fachiri, "Expropriation and international law," op. cit., p. 168.

40. Fachiri, "Expropriation and international law," op. cit., pp. 168–69. The award in the Portuguese Religious Properties case is available in French at 1 *Reports of International Arbitral Awards* (1920), pp. 7–57.

41. Carlos Calvo, *Derecho internacional teórico y práctico*, (Paris: Amyot, 1868).

protection.[42] The Calvo Doctrine was incorporated into agreements between Central and South American countries and advanced on occasion in diplomatic correspondence with the United States and European countries. But the Latin American States were generally too weak during this period to withstand the demands of the Western powers that injuries to foreign nationals be remedied according to the Western conception of international law.[43]

The Central and Latin American countries were somewhat more successful in their efforts to discourage the use of military force by Western powers to ensure that public debts owed to their nationals were honored by regional governments. The so-called Drago Doctrine, enunciated by the Argentine Foreign Minister in 1902 following the Anglo-German blockade of Venezuela to enforce debts owed to their respective nationals, argued that such military interventions were an infringement on the sovereign equality of States.[44] A modified version of this proposition was adopted at the Second Hague Peace Conference in 1907 in the form of the Drago-Porter Convention, prohibiting the use of armed force for the recovery of State debts unless there was a refusal to submit the claim to arbitration.[45]

Modest though this caveat to Western practice in the period prior to 1914 may have been, it was—as the next part of this chapter will explain—the precursor to the broader-ranging resistance to Western orthodoxy mounted by Latin American countries after World War I.

B. THE INTER-WAR PERIOD

The period between the two World Wars was marked by two seemingly contradictory trends in the treatment of foreign nationals and their property. On the surface, there was the appearance of significant progress in the field. Revulsion at the carnage inflicted by World War I prompted renewed and intensified interest in arbitration as a means of pacific dispute settlement. A more consistent and coherent jurisprudence concerning the treatment of alien property began to emerge from the decisions of a variety of arbitral institutions. But alongside these developments, new realities were beginning to take form around the world. Revolutionary governments in Mexico and Russia and reforming regimes elsewhere embraced expropriation on a massive scale as a means of delivering social change. The Western powers discovered that their ability to

42. See Bernardo M. Cremades, "Resurgence of the Calvo doctrine in Latin America," 7 *Business Law International* 53 (2006), pp. 53–55; Christopher K. Dalrymple, Note, "Politics and foreign direct investment: The multilateral investment guarantee agency and the Calvo clause," 29 *Cornell International Law Journal* 161 (1996), pp. 164–66; Amos S. Hershey, "The Calvo and Drago doctrines," 1 *American Journal of International Law* 26 (1907).

43. See, e.g., Paulsson, *Denial of justice in international law*, op. cit., p. 21 (describing a note of 1873 from the Mexican Foreign Ministry to the U.S. Ambassador invoking Calvo and the Ambassador's response observing that "Dr. Calvo was a young lawyer whose theories had not been accepted internationally."); see also Dalrymple, "Politics and foreign direct investment: The multilateral investment guarantee agency and the Calvo clause," op. cit., p. 166.

44. Luis M. Drago, "State loans in their relation to international policy," 1 *American Journal of International Law* 692 (1907), p. 692.

45. Hague Convention No. II of October 18, 1907, Respecting the Limitation of the Employment of Force for the Recovery of Contract Debts, 36 Stat. 2241, T.S. No. 537; see also Hershey, "The Calvo and Drago doctrines," op. cit.; James Brown Scott, "The work of the second Hague peace conference," 2 *American Journal of International Law* 1 (1908).

enforce full compensation for their injured nationals was subject to new limitations in the changed world that emerged from the Great War.

1. ADVANCES IN THE INSTITUTIONS AND LAW OF INVESTMENT ARBITRATION

The end of World War I witnessed a resurgence of the enthusiasm for arbitration that in the twenty years prior to 1914 had helped spur the creation of the Permanent Court of Arbitration and the proliferation of bilateral arbitration treaties. The Treaty of Versailles of 1919, setting out the peace terms between Germany and the allied powers, contained several important provisions in this regard.[46] Article 304 of the treaty called for the establishment of Mixed Arbitral Tribunals between Germany and each of the allied powers to resolve outstanding disputes.[47] In addition to resolving purely private disputes between nationals of the respective parties, the Mixed Tribunals were charged with determining the compensation due under Article 297 of the treaty to nationals of the allied powers for wartime expropriations and other "exceptional war measures" taken by Germany that affected property rights.[48] Notwithstanding some noteworthy complaints about the fairness of these arrangements to Germany, the decision to entrust this significant category of claims to arbitration was itself an important statement about the role of arbitration in the postwar world order.[49] Still more significant, however, was Part I of the treaty, constituting the Covenant of the League of Nations and, in particular, Article 14 stipulating that the Council of that organization "shall formulate and submit to the Members of the League for adoption plans for the establishment of a Permanent Court of International Justice (PCIJ)".[50] The PCIJ held its inaugural session in the Peace Palace at The Hague in February 1922.[51]

In parallel with these developments facilitating arbitration of investor claims against States, the inter-war period also saw significant advances in the institutional framework for the arbitration of disputes between private parties. In 1923, the League of Nations adopted the Geneva Protocol on Arbitration Clauses, by which the contracting States agreed to recognize the validity of arbitration agreements between private parties.[52] In the Geneva Convention for the Execution of Foreign Arbitral Awards, which was adopted by the League of Nations in 1927, contracting States agreed to enforce arbitral awards made in conformity with the 1923 Protocol.[53]

46. Treaty of Versailles, June 28, 1919, 225 Consol. T.S. 189, 2 Bevans 43.

47. Treaty of Versailles, op. cit., Art. 304.

48. Treaty of Versailles, op. cit., Art. 297(e), pt. III § IV Annex 3.

49. See Karl Strupp, "The competence of the mixed arbitral courts of the Treaty of Versailles," 17 *American Journal of International Law* 661 (1923) (criticizing several decisions unfavorable to Germany, but observing that the treaty's commitment of disputes to international arbitration was "a real accomplishment, the fulfillment of wishes expressed even before the war").

50. Treaty of Versailles, op. cit., Art. 14.

51. See International Court of Justice, "History," available at http://www.icj-cij.org/court/index.php?p1=1&p2=1 (last visited May 10, 2011).

52. Protocol on Arbitration Clauses in Commercial Matters, September 24, 1923, (entered into force July 28, 1924), 20 *American Journal of International Law* 4 (1926) p. 194.

53. Geneva Convention on the Recognition and Enforcement of Foreign Arbitral Awards, September 26, 1927, 92 *League of Nations Treaty Series* 1 (1929) p. 302. The effectiveness of the Geneva Convention was limited by its requirement that an arbitral award become final in the state in which it was rendered before contracting third

The International Chamber of Commerce adopted rules of arbitration for the first time in 1922 and established its Court of Arbitration the following year.[54]

Over the course of the 1920s, a series of decisions addressing the treatment of alien property, and specifically the expropriation of such property, issued from the PCIJ,[55] from tribunals applying Article 297 of the Treaty of Versailles,[56] and from ad hoc tribunals formed pursuant to bilateral agreement between disputing States.[57] These decisions analyzed State responsibility for expropriation in more concrete terms than the pre-1914 rulings discussed above and appeared to indicate an emerging consensus around several key principles.

First, to the extent the issue arose, the decisions did not question a sovereign State's right to expropriate property for a public purpose. As the *Norwegian Shipowners* tribunal observed:

> [I]t can hardly be disputed that, provided that just compensation was duly assessed and paid as agreed without undue delay, the United States were entitled during the war to commandeer the yards and factories within American jurisdiction […] or that they had the right to expedite the construction of the ships for public use, even if the exercise of such a right necessitated the taking of these fifteen contracts for use for the time of the special war emergency.[58]

Second, the decisions agreed that—in the absence of a treaty undertaking to the contrary—a State expropriating the property of a foreign national in a lawful manner was obliged to pay compensation. The standard of compensation for lawful expropriations was variously described as "just" (*Norwegian Shipowners*, *Spanish Zone of Morocco*[59]), "fair" (*Chorzow Factory*,[60] *Administrative Decision No. III*[61]), or equitable (*Affaire Goldenberg*[62]), but on the facts of these cases, generally approximated the fair market value of the expropriated property.[63]

states were under any obligation to recognize and enforce the award themselves. Geneva Convention, op. cit., Art. 1(d). This limitation was removed in the New York Convention of 1958, which superseded both the Protocol of 1923 and the Geneva Convention. United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, Signed June 10, 1958, (entered into force June 7, 1959), 330 *United Nations Treaty Series* (1959) pg. 3.

54. United Nations Conference on Trade and Development, *Dispute settlement: International commercial arbitration* (2005), p. 21.

55. See, e.g., Certain German Interests in Polish Upper Silesia, 1926 PCIJ, ser. A, No. 7; Factory at Chorzów, 1928 PCIJ, ser. A, No. 17.

56. See, e.g., Administrative Decision No. III (U.S. v. Germ.), 7 *Reports of International Arbitral Awards* 64 (1923); Affaire Goldenberg (Germany v. Romania), 2 *Reports of International Arbitral Awards* 901 (1928).

57. See, e.g., Norwegian Shipowners' Claims (Norway v. U.S.), 1 *Reports of International Arbitral Awards* 307 (1922); Spanish Zone of Morocco (UK v. Spain), 2 *Reports of International Arbitral Awards* 615 (1925).

58. *Norwegian Shipowners' Claims*, op. cit., p. 337. See also *Affaire Goldenberg*, op. cit., p. 909 ("Military requisition is a *sui generis* form of expropriation for public use. It is an acknowledged derogation from the principle of respect for private property.").

59. *Spanish Zone of Morocco*, op. cit., p. 647.

60. *Factory at Chorzów*, op. cit., p. 46.

61. *Administrative Decision No. III*, op. cit., p. 65.

62. *Affaire Goldenberg*, op. cit., p. 909.

63. See, e.g., *Norwegian Shipowners' Claims*, op. cit., pp. 340–41 (fair market value plus interest); *Factory at Chorzów*, op. cit., p. 47 (the value of the undertaking at the moment of dispossession, plus interest to the day of payment).

Third, there was agreement that a higher measure of damages might be warranted in certain circumstances. For example, the tribunals in *Norwegian Shipowners* and—more ambiguously—*Spanish Zone of Morocco* both appeared to consider discrimination as an exacerbating factor meriting additional damages.[64] In *Chorzów Factory*, the PCIJ articulated the general rule that foreign nationals subjected to unlawful expropriation are entitled to restitution or, failing that, restitutionary damages, and not only the fair market value payable as compensation in the case of a lawful expropriation.[65]

In addition to this jurisprudential evolution, the inter-war period was also marked by jurisdictional innovations that foreshadowed, to some extent, developments later in the twentieth century. The jurisdictional rules of the PCIJ and the bilateral special agreements negotiated, for example, by Norway and the United States in *Norwegian Shipowners' Claims* respected the traditional model of inter-State arbitration based on a theory of diplomatic protection. Article 304 of the Treaty of Versailles, on the other hand, represented a significant break with that model, effectively giving nationals of the contracting States rights that could be directly enforced before the appropriate Mixed Arbitral Tribunal.[66] The Treaty of Versailles was not the first multilateral treaty to provide for individual standing before an international tribunal: Other examples include the International Prize Court provided for in the Hague Convention XII of 1907 and the Central American Court of Justice, which operated from 1908 to 1918.[67] But the volume of individual claims decided by the Article 304 tribunals give that provision far greater significance than its forerunners.[68]

The Treaty of Versailles helped promote the practice of individual standing in a less direct fashion as well. Under the framework for minority protection established by the treaty and its sister agreements, Germany and Poland concluded a convention in 1922 establishing an Arbitral

Whether or not the standard of compensation applied in these inter-war cases corresponded to the Hull Formula's requirement of "prompt, adequate and effective" compensation has been the subject of vigorous debate. Compare Oscar Schachter, "Compensation for expropriation," 78 *American Journal of International Law* 176 (1984) with Maurice. H. Mendelson, "What price expropriation? Compensation for expropriation: The case law," 79 *American Journal of International Law* 414 (1985).

64. See *Norwegian Shipowners' Claims*, op. cit., p. 336 ("[D]iscrimination against the claimants has not been sufficiently arbitrary to justify any special claim for damages by the Kingdom of Norway"); *Spanish Zone of Morocco*, op. cit., p. 647 (observing that it is all the more true that an alien should receive indemnity when expropriatory measures are aimed at predetermined persons, rather than the generality of similarly situated property owners).

65. *Factory at Chorzów*, op. cit., p. 47 ("Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it–such are the principles which should serve to determine the amount of compensation due for an act contrary to international law.").

66. See Mohsen Aghahosseini, *Claims of dual nationals and the development of customary international law: Issues before the Iran-United States claims tribunal* (Leiden: Martinus Nijhoff Publishers, 2007), p. 36 (drawing a parallel with the jurisdictional basis of the U.S.-Iran Claims Tribunal).

67. See Ian Brownlie, "The individual before tribunals exercising international jurisdiction," 11 *International & Comparative Law Quarterly* 701 (1962), p. 709.

68. By comparison, the International Prize Court never came into existence and the Central American Court of Justice dealt with only five cases brought by individuals. See Roberto Bruno, "Access of private parties to international dispute settlement: A comparative analysis," Jean Monnet Working Paper No. 13/97 (1997), available at: http://centers.law.nyu.edu/jeanmonnet/papers/97/97-13.html. Brownlie notes that the Article 304 tribunals were "[o]f greater practical importance" than the previous examples, although he views their significance as being limited because "[t]hey were part and parcel of dictated peace treaties and their decisions turned to a large extent on points of private law and the interpretation of the peace treaties." Brownlie, "The individual before tribunals exercising international jurisdiction," op. cit., pp. 709–10.

Tribunal of Upper Silesia.[69] The rules of procedure for the tribunal, set forth in the German-Polish Convention, permitted individuals to make claims against both their own government and that of the other contracting party and accorded full procedural capacity to such claimants. Indeed, the dispute between Germany and Poland that eventually gave rise to the PCIJ decision in *Chorzów Factory* started life as a claim for compensation brought against Poland by a German company in the Upper Silesia Tribunal.[70]

A further development tending in the same direction was the increasing use of arbitration provisions in concession agreements between States and private companies. This development gave rise to some of the earliest investor-State arbitrations.[71] Among the best known of these was *Lena Goldfields Limited v. USSR*, which resulted in 1930 in an award of £13 million to the British mining company claimant.[72]

2. THE EMERGENCE OF MASS EXPROPRIATION AS AN INSTRUMENT OF STATE POLICY

In addition to foreshadowing developments in investment dispute resolution later in the century, however, *Lena Goldfields* also represents a strong counter-trend in matters relating to protection of alien property during the inter-war period. The dispute in that arbitration had its roots in the sweeping nationalization of privately owned property implemented by the Bolsheviks after the October Revolution of 1917.[73] The comprehensive program of nationalization undertaken by the Bolsheviks was unprecedented and played a significant role in crystallizing expropriation as a distinct, and thorny, issue in international economic relations. As a 1963 survey of expropriation in the twentieth century prepared by the Library of Congress was to observe:

> A study of expropriation as an important problem in the 20th century may really begin with the Communist revolution in Russia in 1917. Confiscation of private property formed a fundamental

69. Convention Between Germany and Poland Concerning Upper Silesia, signed May 15, 1922, 9 *League of Nations Treaty Series* 466 (1922), p. 466.

70. See Case Concerning the Factory at Chorzów (Jurisdiction), 1927 PCIJ, ser. A, No. 9, p. 10.

71. But not the earliest; Newcombe and Paradell, for example, describe an investor-State arbitration of 1864 in which Napoleon III acted as the sole arbitrator. Newcombe and Paradell, *Law and practice of investment treaties: Standards of treatment*, op. cit., at p. 8 and n. 37 (citing Egypt v. Suez Canal Company (*award*, 1864)).

72. For historical accounts of the dispute and arbitration, see V.V. Veeder, "The Lena Goldfields arbitration: The historical roots of three ideas," 47 *International & Comparative Law Quarterly* 755 (1998); and A. Nussbaum, "The arbitration between the Lena Goldfields Ltd. and the Soviet Government," 36 *Cornell Law Quarterly* 31 (1950–51).

Other pre-World War II examples of investor-State arbitrations based on an arbitration provision in a concession agreement include Administration of Posts and Telegraphs of the Republic of Czechoslovakia v. Radio Corporation of America (1932). The text of the award in that arbitration is reprinted at 30 *American Journal of International Law* 523 (1936), p. 523.

73. Lena Goldfields Ltd., an English company, was dispossessed of its extensive mining interests in Russia in July 1918, as part of a comprehensive program of nationalization of private property by the Bolsheviks. The concession agreement at issue in the case was granted by the Soviet authorities in 1925 under the New Economic Policy, in return for Lena Goldfields' agreement to waive its claim for compensation. But when the New Economic Policy failed, to be replaced in 1929 by the first of the Five Year Plans that were to exemplify Soviet central planning, Lena came under renewed attack, effectively rendering the concession worthless. See generally Veeder, "The Lena Goldfields arbitration," op. cit.

> part of the revolution, and nationalizations were made on a vast scale to carry out the Marxist doctrine calling for the socialization of the means of production.[74]

The Soviet Union was not alone in expropriating foreign property during this period. Agrarian reform in Eastern Europe following the First World War triggered further disputes. For example, many residents of Transylvania who had opted to retain Hungarian nationality when that region was transferred to Romania under the 1920 Treaty of Trianon, found themselves dispossessed when the Romanian Government decided in July 1921 to extend to Transylvania a land-reform program already in effect in other regions of Romania. The resulting dispute between Hungary and Romania, which became known as the Optants Case, occupied the League of Nations for most of the 1920s.[75]

Agrarian reform also triggered a long-running dispute between foreign investors and Mexico during this period. Even before Russia's October Revolution had occurred, Mexico—undergoing a revolution of its own that had begun with the fall of Porfirio Diaz in 1910—had enacted an agrarian reform program that would dispossess large numbers of foreign landowners, who had bought property in the country under the investment-friendly Diaz regime.[76] Mexico's dispute with capital-exporting States broadened in 1938, when the government of President Cárdenas nationalized the oil industry, which had been in predominantly American and British hands.[77]

In each case, the expropriating State disclaimed any obligation to pay full compensation to the foreign nationals affected by their measures. The Soviet authorities initially declined to pay any compensation for seized alien property; subsequently the Soviet Union offered to entertain foreign claims only as part of a general settlement resolving its own claims against those States that had intervened in the civil war following the October Revolution in support of the Whites.[78] When Hungarian nationals who had lost property as a result of the Romanian agrarian reforms brought claims for full compensation before the Mixed Arbitral Tribunal established by the Treaty of Trianon, Romania denied the Tribunal's competence to consider the claims. When it subsequently appeared that its objection would be overruled by the majority of the Tribunal, Romania withdrew its member.[79] Mexico offered expropriated foreign landowners only the partial or deferred compensation available to its own citizens under applicable domestic law.[80]

74. Legislative Reference Service Report, "Expropriation of American-owned property by foreign governments in the twentieth century," 2 *International Legal Materials* 1066 (1963), p. 1077 [hereinafter Legislative Report]. See also Cecil J. Olmstead, "Nationalization of foreign property interests, particularly those subject to agreements with the state," 32 *New York University Law Review* 1122 (1957), p. 1124 ("In important respects, the Russian Communist takings were unique and marked a departure from earlier nationalizations.").

75. See Joseph Slabey Rouček, *Contemporary Roumania and her problems,* (New York: Arno Press, 1971), pp. 158–64 (describing the dispute between Hungary and Romania and its ultimate settlement). See generally Sarahelen Thompson, "Agrarian reform in Eastern Europe following World War I: Motives and outcomes," 75 *American Journal of Agricultural Economics* 840 (1993) p. 840 (for a survey of agrarian reform measures enacted by Eastern European countries during this period).

76. John M. Hart, "Agrarian Reform," in W. Dirk Raat and William H. Beezley, eds., *Twentieth century Mexico* (Lincoln: University of Nebraska Press, 1986), at p. 6.

77. Merrill Rippy, *Oil and the Mexican Revolution* (Leiden: Brill, 1972), at pp. 206–41.

78. See Legislative Report, op. cit., p. 9.

79. See Royall Tyler, "The eastern reparations settlement," 9 *Foreign Affairs* 106 (1930), pp. 112–13.

80. See Patrick Del Duca, "The rule of law: Mexico's approach to expropriation disputes in the face of investment globalization," 51 *UCLA Law Review* 35 (2003), pp. 62–65.

Mass uncompensated (or partially compensated) expropriation as a tool of government policy raised new questions, causing many commentators to question whether it was subject to the same rules as the sporadic and individualized expropriations addressed in the nineteenth-century arbitral case-law. It was apparent that the social problems invoked as a justification for the mass expropriations were real. It was equally apparent that it was beyond the financial means of the expropriating countries to pay full compensation for property taken from foreign owners in the course of such systematic reform programs. And the element of discrimination against aliens was missing when a foreign national lost property as a result of a generalized nationalization or land reform program. These distinctions resulted in what one author, writing in 1941, described as:

> [T]he great controversy as to whether general legislative reform measures interfering with rights in order to establish what is deemed to be a better social order in certain branches or the whole of national economy (measures of "socialization" or "nationalization" or "social reform") constitute measures of an extended police power, whether they fall under the traditional conception of expropriation for public utility, or whether they form a new kind of motivation which leads to new consequences.[81]

A similar debate was taking form during this period between the capital exporting States and certain of the capital importing States, led by Latin American countries espousing positions first advanced by Calvo in the previous century. The conflicting positions of these two camps crystallized in the course of efforts by the League of Nations to codify international law on "Responsibility of States for Damage Caused in Their Territory to the Person or Property of Foreigners." This subject had been identified by the League's Committee of Experts for the Progressive Codification of International Law as being "ripe for international agreement."[82] Positions quickly became polarized, however, after the publication in 1926 of the report of the Commission's subcommittee on the subject led by Gustavo Guerrero of El Salvador, which aggressively advanced a Latin American perspective.[83] While the Guerrero Report touched only incidentally on the question of compensation for expropriation, its emphasis on domestic remedies implied that an alien's entitlement to compensation could not exceed that available under

81. John H. Herz, "Expropriation of foreign property," 35 *American Journal of International Law* 243 (1941), p. 252. See also, e.g., John Fischer Williams, "International law and the property of aliens," 9 *British Yearbook of International Law* 1 (1928) (questioning whether there is a rule of full compensation when "measures of expropriation appl[y] indiscriminately to national and aliens."); Francesco Francioni, "Compensation for nationalization of foreign property: The borderland between law and equity," 24 *International & Comparative Law Quarterly* 255 (1975) p. 267, (observing that following the Soviet nationalization, "[i]t was especially in the British, French and Italian legal literature that the view according to which no compensation is due to the dispossessed foreign owner outside a treaty then found its way as a drastic alternative to the classical pattern.").

82. United Nations, *The work of the International Law Commission* (7th ed., vol. 1, 2007), at p. 3.

83. League of Nations Committee for the Progressive Codification of International Law, "Report of the Sub-Committee," reprinted at 20 *American Journal of International Law Special Supplement* 177 (1926) p. 177.

municipal law.[84] When the full Commission of 42 States met at The Hague in 1930, it quickly became apparent that there would be no agreement on the desired convention.[85]

Debate over the standard of compensation for expropriated property was unambiguously and famously joined later in the 1930s, in the correspondence between the Mexican Minister of Foreign Affairs and U.S. Secretary of State Cordell Hull relating to outstanding claims of U.S. nationals for expropriated land. The Mexican position, as stated in a note of August 3, 1938, emphasized the non-discriminatory nature of that country's agrarian reforms and asserted that:

> [T]here does not exist in international law any principle universally accepted by countries, nor by the writers of treatises on this subject, that would render obligatory the giving of adequate compensation for expropriations of a general and impersonal character. Nevertheless Mexico admits, in obedience to her own laws, that she is indeed under obligation to indemnify in an adequate manner; but the doctrine which she maintains of the subject […] is that the time and manner of such payment must be determined by her own laws.[86]

Hull responded, in a note of August 22, 1938, with his classic formulation of what has since become known as the Hull Doctrine:

> The Government of the United States merely adverts to a self-evident fact when it notes that the applicable precedents and recognized authorities on international law support its declaration that, under every rule of law and equity, no government is entitled to expropriate private property, for whatever purpose without provision for prompt, adequate, and effective payment therefor.[87]

Perhaps more telling than this diplomatic posturing, however, are the outcomes that the respective sides of these debates were eventually obliged to accept. As we have seen, in the period prior to 1914 the Western powers had invariably been able to get their way by a combination of gunboat diplomacy and its more subtle diplomatic and economic variants. In the inter-war period, those powers were subject to a variety of constraints that limited their options for applying pressure to recalcitrant capital importing States. Public disenchantment with the use of force as a means of dispute settlement following the carnage of the Great War significantly raised the

84. The report acknowledged that "the loss of property for reasons of public utility [. . .] constitutes an undoubted title to compensation," but did not specify a standard of compensation. More generally, the report concluded that "[t]he duty of the State as regards legal protection must be held to held to have been fulfilled if it has allowed foreigners access to the national courts and freedom to institute the necessary proceedings whenever they need to defend their rights." League of Nations Committee for the Progressive Codification of International Law, *Report of the Sub-Committee*, op. cit., pp. 195, 202.

85. For an account of the Commission's deliberations, written from the perspective of a U.S. delegate, see Edwin M. Borchard, "'Responsibility of states,' at the Hague Codification Conference," 24 *American Journal of International Law* 517 (1930) p. 517.

86. G. Hackworth, *Digest of international law,* Vol. 3, (Washington: United States Government Printing Office, 1942) pp. 655, 658.

87. Hackworth, *Digest of international law*, op. cit., p. 659.

threshold for deploying, or even threatening, military force to protect overseas investments.[88] As tensions mounted in the 1930s over German remilitarization and Japanese aggression in Asia, the UK and U.S.—still the world's two largest capital exporters—also had strong, pragmatic reasons for avoiding unnecessary military entanglements. On the other hand, the importance attached to diplomatic recognition by the new regimes brought into power by the revolutions in Russia and Mexico meant that the Western powers retained significant diplomatic leverage with them, initially at least. That leverage was increased to the extent that the new regimes desired to attract fresh foreign investments. The interplay of the foregoing factors largely explains the differing ways in which alien claims were ultimately resolved in these three early examples of mass expropriation.

For example, the Soviet Union significantly moderated its position concerning compensation for the Bolshevik expropriation of foreign property during the period of the New Economic Policy in the early 1920s. The Soviet authorities were anxious at that time to secure international recognition and to attract foreign capital back into the country. In a General Treaty concluded with Great Britain in August 1924, for example the Soviet Union recognized its "responsibility to settle the claims of [British] bondholders, petty losers, and expropriated private owners."[89] While the claims negotiations themselves were put off for a later date, the Soviet authorities proceeded to conclude concession agreements with some of the larger British concerns dispossessed during the revolution, including Lena Goldfields Ltd.

By the end of the 1920s, however, the Soviet position had hardened considerably. Recognition had already been granted by Great Britain and other significant European powers, weakening the diplomatic incentive to negotiate. Moreover, Soviet interest in attracting foreign investment had all but vanished with the end of the New Economic Policy and the advent under Stalin's leadership of central planning. Although British-Soviet negotiations resumed in 1929 and continued into the 1930s, there was no agreement on claims for expropriation. Meanwhile, the British (and other foreign concessions) granted under the New Economic Policy were snuffed out one by one. By the time the United States was ready to negotiate with the Soviet Union under the Roosevelt administration, the most that could be achieved on behalf of expropriated nationals was to trade diplomatic recognition for partial compensation funded out of the proceeds of previously seized Soviet property.[90]

By contrast, Hungary found itself ill placed to exert pressure on Romania over the expropriation of its nationals in the Optants Case. As a recently defeated nation, still coming to terms with the transfer of territory formerly under the sovereignty of the Austro-Hungarian Empire under the peace terms dictated in the Treaty of Trianon, Hungary was in no position to respond militarily to the Romanian land-reform measures in Transylvania.[91] Hungary chose instead to make its case by diplomatic means, calling on the League of Nations to enforce the Treaty of Trianon's requirement that any liquidation of Hungarian-owned property in the transferred territory be accompanied by full compensation. The dispute was eventually resolved in 1930 at the

88. See, e.g., Evan Andrew Huelfer, *The "casualty issue" in American military practice: The impact of World War I* (Westport, Conn: Praeger, 2003); Frank McDonough, *Neville Chamberlain, appeasement, and the British road to war* (Manchester: Manchester University Press, 1998) p. 33.

89. Louis Fischer, "British labor and the Soviets," 8 *Foreign Affairs* 260 (1930), pp. 271–72.

90. Philip C. Jessup, "The Litvinoff assignment and the Belmont Case," 31 *American Journal of International Law* 481 (1937), p. 481.

91. See generally Francis Deák, *The Hungarian-Rumanian land dispute: A study of Hungarian property rights in Transylvania under the Treaty of Trianon* (New York: Columbia University Press, 1928).

Hague Conference on Reparations by means of a complex arrangement under which, among other things, Hungary traded its remaining reparations obligations for a commitment to pay an annuity into a fund from which compensation awards to expropriated Optants would be financed.[92]

In Mexico, early progress towards the settlement of claims was driven by the desire of a new regime (that of General Obregón, who seized power in 1920) for diplomatic recognition. In 1923, Mexico and the United States agreed to the establishment of two Mixed Claims Commissions, hard on the heels of the U.S. according the desired recognition.[93] A Special Claims Commission was established to consider the claims of U.S. nationals against Mexico for injuries suffered as a result of the disorder in the country during the revolutionary period. A General Claims Commission was set up to consider all other claims against both States by nationals of the other, including claims by U.S. nationals for land expropriated as part of Mexico's agrarian reform program.[94] Mexico subsequently established claims commissions with a number of European nations, with jurisdiction similar to that of the U.S./Mexico Special Claims Commission.[95]

The U.S./Mexican agreement of 1923 was, however, just the beginning of a long and contentious process. The Special Claims Commission made little progress and was eventually disbanded in 1930, to be superseded in 1934 by a lump-sum settlement agreement between the U.S. and Mexico with regard to claims within its jurisdiction.[96] The General Claims Commission decided only a small fraction of the claims before it, despite repeated extensions to its initial three-year lifespan. The Mexican authorities failed to make any payments to U.S. beneficiaries of those Commission awards prior to 1942.[97] Moreover, under President Cárdenas, the incidence of fresh expropriations of U.S. landowners increased exponentially and, in 1938, the government announced the nationalization of the U.S.- and UK-dominated oil industry.[98] The mutual frustration with this process provides the backdrop to the enunciation of the Hull Doctrine in the inter-governmental correspondence quoted earlier in this section. More notable to contemporaries, however, was the United States' decision to abide by the "Good Neighbor Policy" enunciated by the Roosevelt administration earlier in the decade, staying its hand militarily in the face of Mexico's provocations.[99]

92. See generally Tyler, *The eastern reparations settlement*, op. cit.

93. See A.H. Feller, *The Mexican claims commissions 1923–1934* (New York: Macmillan, 1935), p. 23.

94. See Feller, *The Mexican claims commissions 1923–1934*, op. cit., p. 29.

95. See Feller, *The Mexican claims commissions 1923–1934*, op. cit., pp. 23–28.

96. See Louis McKernan, "Special Mexican claims," 32 *American Journal of International Law* 457 (1938), pp. 460–61.

97. See Herbert Briggs, "The Settlement of Mexican Claims Act of 1942," 37 *American Journal of International Law* 222 (1943), p. 223.

98. See John Joseph Dwyer, *The agrarian dispute: The expropriation of American-owned land in postrevolutionary Mexico* (Durham: Duke University Press 2008), pp. 159–62.

99. Leon Trotsky, by then in exile in Mexico, commented on the absence of UK or U.S. military retaliation for the oil expropriation in an article published in January 1939. Leon Trotsky, *Clarity or Confusion?* (January 1939), available at: http://www.marxists.org/archive/Trotsky/1939/02/clarity.htm (last visited May 10, 2011). Trotsky explained the Good Neighbor Policy as the product of "the profound crisis of North American capitalism and the growth of radical tendencies in the working class" before observing: "[T]his international political relationship has made possible the expropriation of petroleum in Mexico without military intervention or an economic blockade. In other words, a peaceful step on the road to economic emancipation was possible thanks to a more active and aggressive policy on the part of large layers of the North American proletariat."

The approach of World War II, however, transformed the negotiating dynamic. Worried at the prospect of Mexican oil sales to Nazi Germany, the Roosevelt administration entered into a broad-ranging agreement with Mexico in November 1941, combining lump-sum compensation by Mexico for agrarian and oil expropriations with significant U.S. financial support for Mexico. As described by a contemporary writer:

> By the Claims Convention of November 19, 1941, Mexico obligated herself to pay $40,000,000 to the United States at the rate of $2,500,000 a year. By an agreement reached the same day, the Mexican government agreed to make a conditional payment of $9,000,000, on account, as compensation for expropriated petroleum properties of American nationals. At the same time the United States obligated itself to set up a $40,000,000 fund to stabilize the Mexican peso; to establish a preliminary $30,000,000 credit through the Export-Import Bank to finance Mexican highway construction; and to purchase each month at an artificially high price some millions of ounces of newly mined Mexican silver. While it might thus appear that the United States government is financing the payment of claims by Mexico, the international responsibility of Mexico to pay for damage to American nationals has been accepted […].[100]

The ambiguous arrangements by which the great takings of the inter-war years were ultimately resolved stand in marked contrast to the growing clarity with which tribunals of the period were stating the rule that expropriation entails an obligation to pay full compensation. As the next section will explain, the tension between practice and theory that was just starting to emerge between 1918 and 1941 matured into full-blown deadlock after World War II.

C. 1945–1989: THE COLD WAR ERA

The late Judge Richard Baxter observed that, by the 1920s, the number of adjudicated cases and amicable settlements reflecting a common understanding of the law had become so substantial that "no topic could have appeared more ripe for codification than the law of State responsibility."[101] The previous discussion has described the reasons why, however "ripe" the topic then might have seemed, events of the inter-war period frustrated any hopes for codification. Judge Baxter went on to observe in the same article—written in 1965—that

> thirty lean years cast doubt on all that went before. Relatively few cases have been decided by the few tribunals […] which have been established. The most outrageous and offensive conduct toward aliens goes unaddressed.[102]

100. Briggs, "The Settlement of Mexican Claims Act of 1942," op. cit., p. 232.

101. R.R. Baxter, "Reflections on codification in light of the international law of state responsibility for injuries to aliens," 16 *Syracuse Law Review* 745 (1965), at p. 756. "No contention could have been made that the law should be allowed to work itself out through the cases before codification should be attempted; the cases were already there." *Id.* Even in 1948, Judge Jessup could write that "[t]he international law governing responsibility of states for injuries to aliens is one of the most highly developed branches of that law." Philip C. Jessup, *A modern law of nations* (New York: Macmillan, 1948), p. 94.

102. Jessup, *A modern law of nations*, op. cit., at p. 757

Had Judge Baxter been writing in 1980, instead of 1965, he would have needed to change nothing, other than to replace "thirty lean years" with "forty-five lean years." There were, to be sure, a few important investment arbitrations between 1945 and 1980, all conducted under arbitral clauses in concession contracts. But it was not until the early 1980s, when the Iran-U.S. Claims Tribunal[103] began its work, that there again was a steady flow of arbitral decisions addressing the obligations of States with respect to the property of aliens. This tribunal, however, dealt only with claims of U.S. nationals against one country, Iran, arising out of that country's Islamic Revolution.[104] The first twenty years of the Cold War era produced many far more sweeping nationalization programs than that of Iran,[105] and the last twenty saw both increases in foreign investment that would have been difficult to imagine even in the 1950s, and an enormous increase in takings of alien-owned property by developing countries in the late 1960s and 1970s.[106] Nonetheless, investment disputes went unaddressed to a degree that would have been inconceivable in the nineteenth or early twentieth centuries. To the extent investment claims were settled at all in the Cold War period, they very largely were settled in negotiated, and modest, lump-sum agreements.[107]

Yet no one considering the development of the law of State responsibility would view the years between the fall of Berlin and the fall of the Berlin Wall as uneventful. The deterioration of the European-American consensus that began with the Russian and Mexican Revolutions resumed after World War II and, by the 1970s, had become a full diplomatic attack on that consensus by the world's communist and developing countries. At the same time, the traditional consensus was uniformly endorsed—and, indeed, strengthened—in the era's few arbitral decisions, especially those of its only true mixed claims commission, the Iran-U.S. Claims Tribunal. This period also saw the formulation of modern treaty-based investment-protection standards in new treaties of Friendship, Commerce, and Navigation ("FCN" treaties) and, most importantly, ended with a conceptual breakthrough, the importance of which could only have been imagined at the time: The addition to the modern FCN treaty of a consent by each State to arbitrate disputes arising under the treaty not just with the other State, but also with aggrieved investors of the other State. This section will attempt to shed some light on why a period that began with massive nationalization programs by new communist States and saw ever-broadening dissent from the old consensus as large numbers of new States emerged from colonialism ended by sowing the seeds of today's global treaty-based system of resolving investor-State disputes through arbitrations that apply rules based on the old consensus.

103. See generally Wayne Mapp, *The Iran-United State Claims Tribunal: The first ten years*, (Manchester: Melland Schill Monographs in International Law, 1993).

104. Mapp, *The Iran-United State Claims Tribunal: The first ten years*, op. cit., at pp. 21–28. And all of the important decisions of this Tribunal relied heavily on the 1955 Treaty of Amity and Economic Relations between the United States and Iran (a modern FCN treaty by another name).

105. See Samuel Herman, "War damage and nationalization in Eastern Europe," 16 *Law & Contemporary Problems* 498 (1951) p. 500; Kenneth J. Vandevelde, "A brief history of international investment agreements," 12 *U.C. Davis Journal International Law & Policy* 157 (2005), at p. 167.

106. David Held et al., *Global transformations: Politics, economics, and culture* (Stanford: Stanford University Press, 1999), pp. 201–35, 242–82; Jeswald W. Salacuse and Nicholas P. Sullivan, "Do BITs really work? An evaluation of bilateral investment treaties and their grand bargain," 46 *Harvard International Law Journal* 67 (2005), at p. 71.

107. Richard B. Lillich and Burns H. Weston, "Lump sum agreements: Their continuing contribution to the law of international claims," 82 *American Journal of International Law* 69 (1988), at p. 69.

1. THE EVENTS AND CONDITIONS OF THE PERIOD

The defining event of the period under consideration was the Cold War—the military, diplomatic, and economic contest between the community of liberal, developed States that viewed the protection of private property as a core societal value and the community of communist States that expanded rapidly in the years immediately following World War II and that viewed private property as a core societal problem. Communism's distaste for private property did not present a serious challenge to the Euro-American consensus in the inter-war years because, in that time, only one State—the Soviet Union—had adopted this ideology, and, for most of the inter-war period, the Soviet Union was very much feeling its way, in terms of both its internal economic policy and its foreign policy.[108] By the end of World War II, however, these uncertainties had been resolved. Poland, eastern Germany, and almost all of the old Austro-Hungarian Empire were under Russian military occupation. By 1948, all of this territory, except for Austria, was under the control of Communist national governments.[109] By 1949, China was under the control of a communist government. All of these governments soon embarked on broad nationalization programs that swept up virtually all alien-owned property.

During these critical first postwar years, the world also saw the beginning of the end of European (and American) colonialism. In 1946, the Philippines became independent of the United States. In 1947, India and Pakistan became independent of Britain. In 1949, Indonesia became independent of The Netherlands. In that same year, South Vietnam became independent of France, with independence coming to the north five years later. All of these new States, and the many that followed in the 1950s and 1960s, would struggle with the legacies of colonialism in their own ways, and almost all would come to question, if not reject, the Euro-American consensus concerning the customary international law of State responsibility. The States of Latin America, for the most part, already had rejected that consensus.[110]

Finally, the postwar period through 1949 saw the formation of the United Nations and the principal modern international economic institutions: The International Monetary Fund, the International Bank for Reconstruction and Development (now the World Bank), and the General Agreement of Tariffs and Trade (the "GATT," succeeded by today's World Trade Organization). The new rules of international behavior found in the United Nations Charter partially explain the relative lack of arbitrations between 1945 and 1989. The liberalized postwar international economic system has had much to do with creating the huge increase in foreign investment that began toward the end of the Cold War period and that to a great extent coincided with the development of the modern BIT system.

108. See Alexander Dallin, "Soviet foreign policy and domestic politics: A framework for analysis," in Erik P. Hoffman and Frederic J. Fleron, Jr., eds., *The conduct of Soviet foreign policy* (New York: Aldine Publishing Company, 1980), pp. 36, 41 ("Indeed throughout the interwar period Soviet policy generally avoided foreign adventures and involvement in violent conflict abroad. More than once the response of the Soviet regime to potential foreign threats was one of reluctant accommodation, retrenchment, and even appeasement [. . .]."). In the investment dispute context, the best example of this hesitancy is the Soviet Union's inconsistent, haphazard approach to the *Lena Goldfields* arbitration, discussed in Part B of this chapter. See notes *supra* 75–77.

109. Ronnie D. Lipchutz, *Cold War fantasies: Film, fiction, and foreign policy* (Lanham: Rowman & Littlefield, 2001), p. 19.

110. Cremades, "Resurgence of the Calvo Doctrine in Latin America," op. cit., pp. 55–58; see generally notes 34–36 and accompanying text, *supra*.

The realignment of much of the world into the two Cold War blocs and the emergence from colonialism of the rest of the world (save long-independent Latin America) go far toward explaining the development of the law of State responsibility during this period.

2. LUMP-SUM SETTLEMENTS

Perhaps the most noteworthy legal development in this period has more to do with process than with the law itself, and that is the observation of Judge Baxter with which this section began: "Relatively few cases have been decided by the few tribunals [. . .] which have been established. The most outrageous and offensive conduct toward aliens goes unaddressed." [111] The basic facts are familiar and need not be rehearsed here at great length.

a. Lump-Sum Settlements: The Takings of the Postwar Communist States

Few, if any, of the massive postwar expropriations by the new communist States ever became the subject of an international arbitration.[112] Instead, they were the subjects of many lump-sum settlement agreements negotiated by the governments of various developed Western countries,[113] the proceeds of which then generally were distributed by national claims-settlement commissions.[114] In some cases, claims have been adjudicated by national commissions in advance of a settlement agreement.[115] These national claims-settlement commissions usually applied principles of international law that reflected the Euro-American consensus and are an

111. R.R. Baxter, "Reflections on codification in light of the international law of state responsibility for injuries to aliens," op. cit., p. 756.

112. See Richard Lillich and Burns Weston, *International claims: Their settlement by lump-sum agreements* (Charlottesville: University of Virginia Press, 1975), pp. 30–31.

113. From 1945 to 1970, The United States entered into nine lump-sum settlement agreements. Of these, six related to expropriations of U.S.-owned property by foreign States, and five of these related to takings by States that became governed by communist regimes in the wake of World War II (Poland, Rumania, Bulgaria, and two agreements (in 1948 and 1964) with Yugoslavia. (The sixth agreement, with Panama, settled largely intergovernmental claims and one claim related to the taking of private property.) See Lillich and Weston, *International claims: Their settlement by lump-sum agreements,* op. cit. Part II. The large majority of Western countries entered into a comparable number of lump-sum agreements over the same period, almost all of which settled either claims against Austria, Germany, Italy, or Japan growing out of the war and/or the post-war occupation, or claims against communist States relating to expropriations. See *Id.* From 1970 to 1995, expropriations by other communist States were the subjects of 31 additional lump-sum agreements. See B. Weston, R. Lillich, and D.J. Bederman, *International Claims: Their settlement by lump-sum agreements, 1975–1995* (Ardsley, N.Y.: Transnational Publishers, 1999).

114. See Lillich and Weston, "Lump sum agreements: Their continuing contribution to the law of international claims," op. cit., pp. 69–70.

115. For example, this has been done with respect to the claims of U.S. investors against Cuba, with which the United States has yet to reach a claims-settlement agreement, and was the case with respect to the claims of U.S. investors against Bulgaria and Czechoslovakia. Claims against the latter two countries were adjudicated by the United States Foreign Claims Settlement Commission in the early 1950s, in the case of Bulgaria, and from 1958 to 1962, in the case of Czechoslovakia. Claims Settlement Agreements were not entered into with these countries until 1963 and 1982, respectively. See Legislative Report, op. cit., at pp. 14–15; Lillich, Weston, and Bederman, *International claims: Their settlement by lump-sum agreements, 1975–1995,* op. cit. at p. 271; Lillich & Weston, *International claims: Their settlement by lump-sum agreements,* op. cit., Part II, p. 266.

under-appreciated source of jurisprudence concerning the fundamental principles of the law of State responsibility.[116] But the fact remains that the most sweeping takings of alien property in history (certainly if one includes the pre-war takings by the Soviet Union) have gone almost completely unaddressed by international tribunals. One need not long ponder the reason why these claims were not submitted to arbitration: None of the communist States was subject to the compulsory jurisdiction of the ICJ; none of the claims arose under international agreements that contained a specific consent to ICJ or other third-party jurisdiction; few arose under contracts between the expropriating State and the alien that provided for arbitration;[117] and, most importantly, because the States involved in these settlements, by and large, held diametrically opposing views concerning the importance of property rights and the obligations of a sovereign with respect to alien-owned property, there was no interest on the part of the host States in allowing third-parties to judge their acts, particularly when there was good reason to believe that almost any plausible third party would find the host State's actions objectionable.[118] Moreover, even apart from the UN Charter's proscription against using force except in self-defense, the Cold War did not get its name for nothing. Application of nineteenth-century military pressure to encourage a member of the Warsaw Pact to agree to arbitrate claims asserted by a member of NATO simply was not an option. In short, socialist postwar nationalization programs were not the subjects of arbitral awards because there was no pre-existing basis for arbitral jurisdiction and no desire to create such jurisdiction after the fact.[119]

There being no willingness on the part of respondent States to create arbitral jurisdiction, and no real ability on the part of claimant States to foster such willingness, why were there any settlements at all? In the case of the postwar settlements with communist States, the answer is found in the timing of those lump-sum agreements and, often, in the blocking of host State assets by the investor's State. For example, the first postwar lump-sum agreement between the United States and a new communist government was with Yugoslavia in 1948, the year in which Yugoslavia decisively split from the Soviet Union and the United States began to provide it

116. The decisions of these national claims commissions "constitute at least 95 percent of postwar claims practice." Richard B. Lillich, *International claims: Postwar British practice* (Syracuse: Syracuse University Press, 1967), p. xi. For a concise discussion of U.S. practice, see Ronald Bettauer, "International claims: Their settlement by lump-sum agreements, 1975–1995" (Review), 94 *American Journal of International Law* 810 (2000), p. 810.

117. The exception that proves this general rule is the Lena Goldfields case, which was one of the rare instances in which an expropriation took place in the context of a concession contract that provided for arbitration. Nonetheless the Soviet government refused to participate in the arbitral proceedings and never compensated the company. See note 77, *supra*.

118. The extensive jurisprudence of the nineteenth century and the first 39 years of the twentieth century, discussed above, certainly would have given any socialist State reason to hesitate before agreeing to submit its postwar nationalizations to third-party judgment. One should not assume, however, that Western States did not see some advantage in negotiating lump-sum settlements with communist States, rather than establishing mixed claims commissions to arbitrate every expropriation claim. As is explained in Part B of this chapter, both of the inter-war Mexico-U.S. claims commissions produced unsatisfactory results and both eventually were superseded by lump-sum settlements. See text accompanying notes 108–115, *supra*.

119. Of course, communist States were not the only ones to engage in rather extensive nationalization programs in the wake of World War II. Western democratic countries also chose to increase the role of the State in their economies. But these takings did not produce international disputes, at least not of any consequence, because the host States typically paid more-or-less adequate compensation. See, e.g., Burns Weston, *International claims: Postwar French practice* (Syracuse: Syracuse University Press 1971), at p. 13 (noting that "French interests, deprived by postwar British nationalization measures, accepted virtually without discussion the indemnity proposed by London").

with aid.[120] No further agreements were concluded until 1960, with Poland and Romania, and 1963, with Bulgaria. The Romanian and Bulgarian agreements allowed the United States to vest blocked assets and use them to pay claimants (to which each State added a modest additional amount of cash).[121] These agreements, like the agreement with Yugoslavia, came at a time when each country's respective dictator was engaged in a risky attempt to increase its independence from the Soviet Union and was thus reaching out to the U.S. on a number of economic and national security issues.[122] The much later agreements with China and Vietnam were directly tied to the resumption of normal diplomatic relations.[123]

The unsatisfied expropriation claims of its nationals, even if not very substantial, are difficult for the government of a liberal democracy to ignore in its relations with the expropriating State.[124] In the case of the United States, legislation made it difficult, if not impossible, to provide direct aid to expropriating States that did not compensate dispossessed U.S. investors.[125] Usually, there would have been a range of matters on the diplomatic agenda of the United States with most socialist States that were far more important than the outstanding claims of U.S. citizens.[126] Yet the expropriation claims of U.S. citizens, until resolved, persisted as a complicating factor.

120. See Lorraine M. Lees, "The American decision to assist Tito, 1948–1949," 2 *Diplomatic History* 407 (1978), pp. 408–09. The United States held US$46,800,000 worth of gold that had been transferred by Yugoslavia to Federal Reserve banks during the German occupation and that had been frozen by the United States. Although the claims of U.S. nationals against Yugoslavia for postwar takings were estimated at US$150 million, the United States settled those claims, and released the frozen gold to Yugoslavia, for US$17 million, payable by means of a partial liquidation of the Yugoslav gold. Frank G. Dawson and Burns H. Weston, "'Prompt, adequate and effective': A universal standard of compensation?," 30 *Fordham Law Review* 727 (1961–1962), pp. 743–44.

It is difficult to explain the release of so much of the blocked gold to Yugoslavia in the face of unsatisfied claims without considering the desire of the United States to support Yugoslavia in its efforts to distance itself from the Soviet Union, which began in the year of the settlement.

121. Dawson and Weston, "'Prompt, adequate and effective': A universal standard of compensation?" op. cit. at p. 743. Note that in the cases of Hungary and Czechoslovakia, the United States vested blocked assets and used them to partially compensate U.S. claimants without benefit of a claims-settlement agreement. Legislative Report, op. cit.

122. See Piotr Stefan Wandycz, *The United States and Poland* (Cambridge, Mass.: Harvard University Press, 1980) pp. 359–80; Johanna Granville, "Deja-Vu: Early roots of Romania's independence," 42 *East European Quarterly* 365 (2009), pp. 366–67.

123. Agreement Between the Government of the United States of America and the Government of the People's Republic of China Concerning the Settlement of Claims (1979), 6 U.S.T. 5596; T.I.A.S. No. 9675; Agreement Between the United States of America and the Government of the Socialist Republic of Vietnam Concerning the Settlement of Certain Property Claims [1995], T.I.A.S. 12602. The preamble to the China Agreement reads, in part, as follows: "In order to develop bilateral economic and trade relations and to complete the process of normalization of relations [. . .]." The preamble to the Vietnam Agreement reads, in part, as follows: [The Parties], with a firm desire to reach an early settlement of property claims in order to develop bilateral economic and trade relations and in the context of the process of normalization of relations [. . .]."

124. Lillich and Weston cite as an important motivating factor in lump-sum agreements the "need for the restoration of previously cordial relations that comes from, or is facilitated by, the settlement of large numbers of claims on a once-and-for-all basis [. . .]." Lillich and Weston, *International claims: Their settlement by lump-sum agreements*, op. cit., at p. 13.

125. Section 620(e)(1) of the Foreign Assistance Act of 1961, as amended (22 U.S.C. 2370(e)(1)), commonly referred to as the "Hickenlooper Amendment," requires the suspension of assistance to any country that expropriates property owned by U.S. nationals [and] does not take steps to pay prompt, adequate, and effective compensation. A single unresolved expropriation is enough to block aid under the Hickenlooper Amendment.

126. Usually having to do with fostering greater independence of socialist States from the Soviet Union and easing Cold War tensions. See text accompanying notes 113–115.

Clearing that complication away so that more important matters could be dealt with more effectively required no small amount of diplomatic effort.[127]

b. Lump-Sum Settlements: The Postwar Takings of Developing States

The new postwar communist States were hardly the only States intent on confiscating alien-owned property. Although neither the newly independent States of Africa and Asia nor the Latin American States (save Cuba) engaged in sweeping nationalizations on the model of the early postwar communist States, they took actions against alien-owned property that gave rise to a large number of expropriation claims.[128] Some of these claims were resolved in lump-sum settlements, as was the case with all of the early postwar claims.[129] Apart from claims against Iran that were resolved by the Iran-U.S. Claims Tribunal, only a small handful were resolved by arbitration. Most, no doubt, were not addressed by any formal action of an international character.[130]

The reasons why relatively few expropriation claims against developing countries found their way to arbitration are similar to those discussed above with respect to communist countries. Few newly independent, or Latin American, States have ever accepted the compulsory jurisdiction of the ICJ.[131] Although most postwar FCN treaties contained clauses providing for

127. There are countless examples of the length of, and diplomatic challenges posed by, bilateral investment dispute negotiations. The final round of negotiations that produced the settlement between the United States and Bulgaria consumed only two and a half years, but was preceded by fourteen years of wrangling over whether Bulgaria would fulfill its compensation commitments under a post-World War II peace treaty. Richard B. Lillich, "The United States-Bulgarian Claims Agreement of 1963," 58 *American Journal of International Law* 686 (1964), pp. 686–87. Moreover, the disagreement over expropriation claims was one of several thorny diplomatic issues that destroyed the U.S.-Bulgarian relationship and led to a formal suspension of diplomatic relations that lasted nine years. *Id*. at p. 687. The dispute between the United States and China over myriad expropriation claims by both countries required approximately thirty years to resolve. Lihai Zhao, "The main legal problems in the bilateral relations between China and the United States," 16 *New York University Journal of International Law and Politics* 544 (1984), p. 544.

Talks between the United States and Czechoslovakia began in 1948, resumed in 1955, continued episodically thereafter, and did not produce an agreement until 1982. Legislative Report, op. cit. at p. 14. Negotiations between the United States and Poland began in late 1946, failed in 1947, resumed in 1957, and resulted in an agreement only after three more years of negotiations. *Id*. at pp. 13–14. It took the United States two decades to obtain compensation from Vietnam for diplomatic and private American property expropriated when North Vietnam conquered South Vietnam in 1975. Thomas J. Lang, Note, "Satisfaction of claims against Vietnam for the expropriation of U.S. citizens' property in South Vietnam in 1975," 28 *Cornell International Law Journal* 265 (1995), p. 299.

128. A U.S. State Department study said that there were "at least 87 instances of expropriation or [. . .] concession cancellation or renegotiation, and coerced sale" from July 1, 1971, to July 1, 1973. See David A. Gantz, "The Marcona settlement: New forms of negotiation and compensation for nationalized property," 71 *American Journal of International Law* 474 (1977) n. 2.

129. Lillich and Weston, "Lump sum agreements: Their continuing contribution to the law of international claims," op. cit., at p. 69.

130. Salacuse and Sullivan, "Do BITs really work? An evaluation of bilateral investment treaties and their grand bargain," op. cit., pp. 69–70, 75.

131. Between 1945 and 1989, the United States entered into a claims-settlement agreement with only one State that was subject to the compulsory jurisdiction of the ICJ at the relevant time, and that was with Egypt in 1976, shortly after the United States brokered the mutual disengagement of Israeli and Egyptian forces following the 1973 Yom Kippur War. (Another example of a claims settlement coinciding with developments affecting larger issues.) See Richard Lillich and Burns and Weston, *International claims: Their settlement by lump-sum agreements*,

compulsory resolution of disputes between the State parties, between 1945 and 1989 the United States relied on its FCN rights to resolve only one investment dispute, and that was a dispute with Italy.[132] Latin American States had long rejected the Euro-American consensus concerning a State's obligations with respect to alien-owned property, as did the newly independent States, if gradually. These States therefore shared the reluctance of communist States to create arbitral jurisdiction over investment disputes after the fact; in the case of the Latin American States, their attachment to the Calvo Doctrine gave their rejection of third-party dispute resolution a long-standing basis in principle that other countries in time found congenial.[133] Finally, while the application of force by Western countries to resolve investment disputes with members of the Warsaw Pact may have faced practical obstacles not present in other disputes, the UN Charter made the use force for any purpose other than self-defense illegal everywhere.[134] At least as a partial result, the only *direct* use of force that was in any way related to an investment dispute during this period was the ill-fated military intervention of Britain and France in Egypt immediately following the nationalization of the Suez Canal.[135] During the period under consideration, the United States entered into five lump-sum agreements with developing countries that

op. cit. Part II, p. xxvi; Lillich, Weston and Bederman, *International claims: Their settlement by lump-sum agreements, 1975–1995,* op. cit., pp. 108–09. Egypt accepted the ICJ's compulsory jurisdiction in 1957. See International Court of Justice, "Jurisdiction," available at: www.icj-cij.org/jurisdiction/index.php, (last visited May 10, 2011). One might engage in interesting speculation concerning the reasons why the United States did not bring its claims against Egypt to the ICJ (the entire relevant period predated the United States' withdrawal of its consent to the Court's jurisdiction). No doubt the sensitiveness of America's relationship with Egypt, in the context of both the Arab-Israeli conflict and the Cold War, and Western (particularly U.S.) distrust of the ICJ played a role. See Martin A. Rogoff, "International politics and the rule of law: The United States and the International Court of Justice," 7 *B.U. International Law Journal* 267 (1989), pp. 293–99.

Four cases related to foreign investment have been brought before the ICJ in the period under consideration, but only one has been brought by a Western developed State against a developing State, Anglo-Iranian Co. (UK v. Iran) (1951) *ICJ Report* 93, and in that case the Court found that it lacked jurisdiction. The other three cases all involved claims by one Western developed State against another (Barcelona Traction (Belgium v. Spain) (1970) *ICJ Report* 4, Case of Certain Norwegian Loans (France v. Norway) (1957) *ICJ Report* 9, Ellettronica Sicula S.p.A. (ELSI) (U.S. v. Italy) (1989) *ICJ Report* 15). Of these three cases, the Court found that it had jurisdiction only in the ELSI case, a case brought under the U.S.-Italy FCN of 1948. The court found in favor of the respondent, Italy.

132. Ellettronica Sicula S.p.A., op. cit. The claims of Americans against Iran were referred to the Iran-U.S. Claims Tribunal pursuant to a special agreement, not pursuant to the Iran-U.S. FCN.

133. See discussion of the New International Economic Order and the Charter of Rights and Duties of States in Part C. 4., *infra.*

134. "Since states against whom claims are pressed now no longer need contemplate the possibility of being subjected to coercive measures at the end of the diplomatic protection continuum, they naturally have less incentive than in the past to agree to submit such claims to third-party adjudication." Richard B. Lillich, *International law of responsibility for injuries to aliens,* (Charlottesville: University of Virginia Press, 1983), p. 8.

135. John Lewis Gaddis, *The Cold War: A new history* (New York: Penguin Books, 2005), at pp. 127–28. The authors use the term "direct use of force" in recognition of the complex motives behind the now well-known but then clandestine interventions by the United States and Britain in Iran following the nationalization of the Anglo-Iranian Oil Company (1951), see Ervand Abrahamian, "The 1953 coup in Iran," 65 *Science & Society* 182 (2001), by the United States in Guatemala following the Guatemalan government's interference with the United Fruit Company (1953–54); Richard H. Immerman, *The CIA in Guatemala: The foreign policy of intervention* (Austin: University of Texas Press, 1982), and by the United States in Chile following the expropriation of U.S.-owned copper mining companies in that country; Mark B. Baker, "Private codes of corporate conduct: Should the fox guard the henhouse?" 24 *University of Miami Inter-American Law Review* 399 (1993), p. 403 n. 25.

settled investment claims,[136] and one agreement that created a mixed claims commission (the Iran-U.S. Claims Tribunal).

It is impossible to know how many expropriations of alien-owned property simply never became the subject of government action that resulted in an agreement between the investor's State and the expropriating State. A 1974 UN study concluded that there were 875 expropriations occurring in 62 countries between 1960 and 1974, with ten countries accounting for two-thirds of this number.[137] Since no State had entered into a claims-settlement agreement with nine of these ten States by 1995,[138] it seems fair to conclude that the large majority of expropriations that have occurred since the early postwar takings by communist States have not been the subject of any governmental settlement. No doubt many of the victims of these takings have worked out some sort of arrangement directly with the host government, including arrangements that allow the victim to continue operating in the country, if under less favorable conditions. This should not be surprising. Unless the investor's State is dealing with sweeping expropriations that affect a large number of its citizens, it is difficult for the State to justify, as a matter of resource allocation, doing more for the claimant than making informal representations to the host government. Discussing the negotiation of the 1974 agreement between the United States and Peru that settled claims of 12 U.S. companies, a State Department participant in those negotiations wrote:

> [Despite the success of these negotiations], government-to-government settlements of expropriation claims will probably remain the exception rather than the rule. Given […] the problem the United States faces in seeking to verify the validity of a claim and the amounts involved, and the time and expertise which would be required of United States officials if such settlements were to become the rule, the traditional United States company-to-host-government approach is likely to remain predominant.[139]

There is no point in discussing at any length whether postwar lump-sum agreements provided claimants with full compensation for their losses, in accordance with the Euro-American consensus. They did not. As Garcia-Amador explained, "lump-sum agreements, far from envisaging 'just' or 'adequate' compensation, provide for 'partial' indemnification, the amount of which varies appreciably depending on the case and the circumstances."[140] States enter into these

136. Ethiopia, the Philippines, Egypt, and two agreements with Peru. See Lillich, Weston, and Bederman, *International claims: Their settlement by lump-sum agreements, 1975–1995,* op. cit., pp. 108–09. In addition, the United States entered into agreements with Cambodia in 1994 and with Albania and Vietnam in 1995. See *Id.*

137. Permanent Sovereignty Over Natural Resources Report of the Secretary General, UN Doc. A/9716 (1974).

138. The ten States were: Algeria, Chile, Egypt, India, Indonesia, Sri Lanka, Sudan, Uganda, and Tanzania. The United States and a few other countries entered into claims-settlement agreements with Egypt. As of 1995, no State had had entered into a settlement agreement with any other of these States. See Lillich, Weston, and Bederman, *International claims: Their settlement by lump-sum agreements, 1975–1995,* op. cit., pp. 105–09. A 1974 State Department study reported that there were "at least" 87 instances of expropriation of U.S.-owned property between July 1, 1971 and July 31, 1973. See Gantz, "The Marcona settlement," op. cit., pp. 474, n. 2.

139. David A. Gantz, "The United States-Peruvian Claims Agreement of February 19, 1974," 10 *International Lawyer* 389 (1976), pp. 392, 396.

140. International Law Commission, Fourth report on International Responsibility, U.N.G.A. Off. Rec. 11th Sess., at 58 (A/CN.4/119) (1959).

agreements for a variety of reasons, and, as noted previously, simply putting the claims issue behind them often may be a key driving force.[141]

Many negotiated claims settlements, of course, are for substantial amounts and greatly improve the lot of the injured aliens, even if they do not provide full indemnification. The two lump-sum agreements between the United States and Peru, concluded in 1974 and 1976, are good examples. The 1976 agreement settled the claims of a single American claimant, the Marcona Mining Company, for a value of close to US$100 million (combining cash and ongoing business opportunities).[142] The 1974 agreement provided for compensation of US$76 million (plus US$74 million in direct remittances previously owed by the Peruvian government to certain claimants) to be shared among 12 claimants, with five accounting for almost 90 percent of the total compensation.[143] But, like the lump-sum agreements discussed previously, even these substantial settlements also served other, broader, interests. After noting the applicability to the Marcona-Peru situation of the Hickenlooper Amendment (barring foreign assistance to countries that expropriate U.S. property without paying proper compensation),[144] the Gonzalez Amendment (requiring the United States to oppose loans to such countries by the World Bank and the Inter-American Development Bank),[145] and Section 502(b)(4) of the Trade Act of 1974 (requiring the suspension of generalized tariff preferences for such countries),[146] a participant in these negotiations observes that

> [t]hese laws mean not only that the U.S. bilateral relations may be severely damaged by an expropriation, but that, in the case of a country that enjoys a world or Third World leadership role, the spill-over effect will impinge upon our multilateral relations as, for example, in the Organization of American States.[147]

3. TREATIES OF FRIENDSHIP, COMMERCE, AND NAVIGATION

The United States entered into its first FCN treaties during and immediately after its War of Independence and continued to conclude them episodically until 1966. As their name implies, the focus of these treaties was trade, not the protection of U.S. investments. Nonetheless, from the 1920s, these treaties usually have prohibited the expropriation of property without payment of compensation.[148]

141. In the case of claims against developing countries, the reason to enter into a claims settlement often is aid, which the respondent State wants to receive for obvious reasons and the claimant State wants to give, perhaps to increase its influence with the recipient or for other reasons, often including a desire simply to help the recipient country. See text accompanying notes 159–162, below.

142. Gantz, "The Marcona settlement," op. cit., pp. 488.

143. Gantz, "The United States-Peruvian Claims Agreement of February 19, 1974," op. cit, pp. 392, 396.

144. Section 620(e)(1) of the Foreign Assistance Act of 1961, as amended (22 U.S.C. 2370(e)(1)).

145. Section 21 of the Inter-American Development Bank Act, as amended, 86 Stat 59 (1972).

146. Section 502(b)(4) of the Trade Act of 1974 (88 Stat. 2067).

147. Gantz, "The Marcona settlement," op. cit., p. 491.

148. See Robert R. Wilson, *United States commercial treaties and international law,* (New Orleans: The Hauser Press, 1960). pp. 113–118. The 1923 FCN treaty between the United States and Germany contains the following language: The nationals of each High Contracting Party shall receive within the territories of the other [. . .] the most constant protection of their persons and property, and shall enjoy in this respect that degree of protection

Over time, the investment-protection elements of FCN treaties were expanded and strengthened. In the twenty years from 1946 to 1966, the United States and other developed countries entered into FCN treaties almost all of which contained investment-protection provisions that are hard to distinguish from those found in today's BITs.[149] For example, the 1955 Treaty of Amity, Economic Relations, and Consular Rights between Iran and the United States[150] contains: "constant protection and security" clauses (Article II (nationals) and Article IV.1 (property)); a "fair and equitable treatment" clause, applicable to "nationals and companies" of the parties "and to their property and enterprises" (Article IV.2); and an MFN clause (Article IV.4). Article IV.2 also provides that property of nationals or companies of the other party "shall not be taken except for a public purpose, nor shall it be taken without the prompt payment of just compensation [. . .] [which] shall be in an effectively realizable form and shall represent the full equivalent of the property taken." Most modern BITs do not contain a lot more in the way of investment-protection.[151]

As one might expect, given their attention to trade, consular relations, and other matters in addition to the protection of property, FCN treaties at all times were concluded with both developed and less-developed States. Indeed, of the 21 postwar FCN treaties concluded by the United States, at least ten were with countries that even at the time of signature were First World countries.[152] The postwar treaties came in two rather obvious waves. The first wave began immediately following the end of the war and consisted very largely of treaties with former Axis States or with European and a few other States that plainly required some shoring-up in the face of

that is required by international law. Their property shall not be taken without due process of law and without payment of just compensation. Dec. 8, 1923, 44 Stat. 2132; TS 725. The same language appears in treaties negotiated with 11 countries between 1923 and 1938, most with European countries. See Wilson, *United States commercial treaties and international law,* op. cit., p. 113.

149. In addition to the United States, which entered into 21 postwar FCN treaties, the UK, France, Germany, Switzerland, and Japan, also entered into FCN-type treaties with investment-protection provisions on the U.S. model. See Francesco Francioni, "Compensation for nationalisation of foreign property: The borderland between law and equity," op. cit., 264; Newcombe and Paradell, *Law and practice of investment treaties: Standards of treatment,* op. cit. p. 22.

150. Signed August 15, 1955, 284 *United Nations Treaty Series* 93 (1957) pg. 93. Treaties included in the general category labeled "FCN treaties" often are not called treaties of "Friendship, Commerce, and Navigation." The 1955 treaty between the United States and Iran falls into this category. While it is essentially identical with most postwar American FCN treaties, its title is "Treaty of Amity, Economic Relations, and Consular Rights."

151. An exception to this statement would be the so-called "umbrella clause" that is found in many BITs, which explicitly obliges states to comply with their obligations under contracts they may have entered into with investors.

152. See Don C. Piper, "New directions in the protection of American-owned property abroad," 4 *International Trade Law Journal* 315 (1978–1979), 332–34.

communist or other threats.[153] The second wave, beginning in 1955, consisted almost entirely of treaties with developing States.[154]

The significance of FCN treaties, at least for purposes of this article, is that there is a long-standing and extensive treaty practice predating BITs that rather consistently reflected the Euro-American consensus concerning a sovereign's obligations with respect to alien-owned property. Indeed, postwar FCN treaties anticipated the majority of the investment-protection provisions found in BITs today. It has become commonplace to observe that the first treaty to be labeled a bilateral investment treaty was the 1959 treaty between Germany and Pakistan.[155] It is seldom, if ever, noted that the United States entered into an FCN treaty with Pakistan that same year.[156] A comparison of the two treaties reveals that: (1) the German treaty is shorter, because it deals only with investment-protection,[157] (2) the investment-protection provisions of the two treaties are almost identical,[158] and (3) neither provides for third-party resolution of disputes between investors and the host State; only disputes between the State parties are subject to third-party

153. The first postwar treaties were signed with China's nationalist Government (1946), while it struggled to hold back Mao's communist rebels, see Gaddis, *The Cold War: A new history*, op. cit., pp. 36–38, with Italy (1948), immediately following its 1947 peace treaty and just months before its high-profile 1948 election that the Communist Party almost won, *Id*. at 162–63; with Greece (1951), two years after the end of its communist insurgency, see István Deák, "Post World War II political justice in a historical perspective," 149 *Milwaukee Law Review* 137 (1995), p. 142; with Israel (1951), which was newly independent, unaligned, and occupying a strategic position that would be crucial in any Anglo-American conflict with the Soviets, see Michael Joseph Cohen, *Truman and Israel* (Berkeley: University of California Press, 1990), pp. 257–74; and with Japan (1953), one year after its peace treaty came into force, just as the United States was attempting to cultivate Japan as a counterweight to Asia's communist powers, see Richard B. Finn, *Winners in peace: MacArthur, Yoshida, and postwar Japan* (Berkeley: University of California Press, 1992). As exceptions to this general observation, treaties also were concluded in this first period with Ireland (1950) and Denmark (1951). See Piper, "New Directions in the Protection of American-Owned Property Abroad," op. cit., p. 332.

154. The second wave consisted of treaties with Iran (1955), Republic of Korea (1956, certainly a developing country at that time), Nicaragua (1956), Muscat and Oman (1958), Pakistan (1959), Togo (1966), and Thailand (1966). The exceptions in this period were the treaties with Belgium (1961) and France (1959). *Id*. See generally Aaron Forsberg, *America and the Japanese miracle: The Cold War context of Japan's postwar economic revival 1950–1960,* (Chapel Hill: University of North Carolina Press, 2000) p. 178 (noting that in the mid-1950's "the Eisenhower Administration was expanding the scope of its economic policy to meet competition with the Soviet Union for influence in the Third World and the promotion of economic development there").

155. See, e.g., Jeswald W. Salacuse, "BIT by BIT: The growth of bilateral investment treaties and their impact on foreign investment in developing countries," 24 *International Lawyer* 655 (1990), p. 655.

156. Treaty of Friendship and Commerce, Nov. 12, 1959, United States-Pakistan, 12 U.S.T. 110, T.I.A.S. No. 4683.

157. The German treaty is approximately 2,000 words long, while the American treaty is well-over 5,000. Compare Treaty for the Protection of Investment, Signed Nov. 25, 1959, West Germany-Pakistan, 457 *United Nations Treaty Series* (1963), pg. 23 with Treaty of Friendship and Commerce, Nov. 12, 1959, United States-Pakistan, 12 U.S.T. 110, T.I.A.S. No. 4683.

158. Compare Treaty for the Protection of Investment, West Germany-Pakistan, op. cit., Art. 3, ("Nationals or companies of either Party shall not be subjected to expropriation of their investments in the territory of the other Party except for public benefit against compensation, which shall represent the equivalent of the investments affected. Such compensation shall be actually realizable and freely transferable in the currency of the other Party without undue delay. Adequate provision shall be made at or prior to the time of expropriation for the determination and the grant of such compensation.") with Treaty of Friendship and Commerce, United States-Pakistan, op. cit., Art. VI, ("Property of nationals and companies of either Party shall not be taken within the territories of the other Party except for a public purpose, nor shall it be taken without the prompt payment of just compensation. Such compensation shall be in an effectively realizable form and shall represent the full equivalent of the

resolution.[159] Although many European States entered into BITs on the early German model through the early 1960s, their investment-protection provisions did not differ materially from those of the postwar FCNs. It was not until the mid-1960s, following the conclusion in 1965 of the Washington Convention[160] that established the International Center for the Settlement of Investment Disputes ("ICSID"), that BITs began to include what has turned out to be their primary—indeed, their only truly important—difference from modern FCN treaties, and that is their provision for compulsory arbitral jurisdiction over disputes between investors and host States, available to the investor without any intervention on the part of his government.[161]

In short, treaty-based protection of foreign investment that reflects the Euro-American consensus is very old news. What is new is not the investment-protection provisions of BITs, it is their dispute-resolution provisions and, more importantly, their almost global geographic coverage. It is not possible to arrive at a precise estimate of the number of FCN treaties in the world that contain something approaching modern investment-protection provisions, but they probably number in the low hundreds, at most. The United States, the most active negotiator of these treaties in the last century,[162] is a party to only 32 FCN treaties that contain significant investor-protection provisions, and most of those are with developed countries with which there never was a disagreement over the host State's legal responsibilities, and with which serious investment disputes were unlikely in any event. The reasons for this new global willingness to accept in treaties investment-protection rules that countries would not, and often still will not, accept as part of customary international law will be considered at the end of this chapter.

4. THE CHALLENGE TO THE EURO-AMERICAN CONSENSUS CRYSTALLIZES: PERMANENT SOVEREIGNTY, THE NEW INTERNATIONAL ECONOMIC ORDER, AND THE CHARTER OF ECONOMIC RIGHTS AND DUTIES OF STATES

Prior to Word War II, the independent less-developed States of the world were found largely in Latin America. Almost all of today's independent States of Africa, South Asia, Southeast Asia, and the Middle East emerged from colonialism, or otherwise became fully independent, in the 25 years from 1945 to 1970. For reasons that are beyond the scope of this article, but that certainly include the postwar example and encouragement of the Soviet Union and other communist States, these new States, together with much of Latin America, held the view that their best course to economic development would require heavy involvement of the State. They did not particularly want any new foreign investment, and the foreign investment that was already present was viewed as a source of exploitation by the developed world, often by the former

property taken; and adequate provision shall have been made at or prior to the time of taking for the determination and payment thereof.").

159. See Treaty for the Protection of Investment, West Germany-Pakistan, op. cit., Art. 11; Treaty of Friendship and Commerce, United States-Pakistan, op. cit., Art. XXIII.

160. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, March 18, 1965, 17 U.S.T. 1270, T.I.A.S. No. 6090.

161. See Vandevelde, "A brief history of international investment agreements," op. cit., pp. 174–75.

162. See Robert R. Wilson, "A decade of new commercial treaties," 50 *American Journal of International Law* 927 (1956), p. 928.

colonial master.[163] This attitude no doubt explains most of the expropriations carried out by some developing countries in the first decades of the post-colonial period.[164] It also must go far toward explaining the formal challenges to the Euro-American view that occurred in the United Nations in 1974, one year after the 1973 Yom Kippur War, the ensuing oil embargo, and the first oil price shock.[165]

The story of the 1974 UN resolutions begins in 1962, with General Assembly Resolution 1803, entitled "Permanent Sovereignty over Natural Resources."[166] This resolution recognized the right of the State to expropriate privately held interests in its natural resources and provided that "[i]n such cases the owner shall be paid appropriate compensation, in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law."[167] Resolution 1803 was approved by a vote of 87 to 2, with 12 abstentions.[168] The United States proposed that "appropriate compensation" be defined to mean "prompt, adequate and effective compensation." The Soviet Union proposed an amendment to the effect that compensation would be determined by national law. The United States withdrew its amendment, stating in committee that it "was confident that the expression 'appropriate compensation' [. . .] would be interpreted as meaning under international law, prompt adequate and effective compensation."[169] The Soviet amendment was voted down by a vote of 48 to 34, with 21 abstentions.[170] At the time, this resolution was recognized by the United States as representing "a consensus of the economically developed and less developed countries."[171] Plainly, it did not reflect a consensus as to the meaning of "appropriate compensation." If Resolution 1803 reflected a useful consensus with respect to compensation, it was that customary international law required the payment of compensation in some amount.

Twelve years later, in 1974, even the ambiguous consensus represented by Resolution 1803 came under attack. Resolution 3201 (S-VI), the Declaration on the Establishment of a New International Economic Order, approved by the General Assembly on May 1, 1974, restated the notion that States enjoyed "permanent sovereignty" over their natural resources, "including the right to nationalization or transfer of ownership to its nationals," but went two steps further than had Resolution 1803 in 1962: Resolution 3201 held that "[n]o State may be subjected to economic,

163. Vandevelde, "A brief history of international investment agreements," op. cit., p. 166.

164. See text accompanying notes 44–45, *supra,* to effect that 875 expropriations occurred from 1960 to 1975, two-thirds by ten developing countries.

165. From late 1973 to the middle of 1974, the price of crude oil more than tripled. James L. Smith, "World oil: Market or mayhem?," 23 *Journal of Economic Perspectives* 145 (2009), p. 145.

166. G.A. Res. 1803 (XVII), reprinted in 2 *International Legal Materials* 223 (1963).

167. *Id.*, para. 4.

168. Stephen M. Schwebel, "The story of the UN's Declaration on Permanent Sovereignty over Natural Resources," 49 *American Bar Association Journal* 463 (1963), p. 466.

169. A./C.2/SR 850, p. 7, quoted in Schwebel, "The story of the UN's Declaration on Permanent Sovereignty over Natural Resources," op. cit., p. 466.

170. Schwebel, "The story of the UN's Declaration on Permanent Sovereignty over Natural Resources," op. cit.

171. Schwebel, "The story of the UN's Declaration on Permanent Sovereignty over Natural Resources," op. cit., p. 469. Fifteen years later, the sole arbitrator in one of the Libyan nationalization cases would find that Resolution 1803 was declaratory of existing customary international law. Texas Overseas Petroleum Co. & California Asiatic Oil Co. v. Libyan Arab Republic, 17 *International Legal Materials* 1 (1978), p. 30 (Dupuy, sole arb.) [hereinafter: TOPCO];

political, or any other type of coercion to prevent the free and full exercise of this inalienable right;"[172] and the resolution was silent on the issue of compensation.

Seven months later, that silence was broken. On December 12, 1974, by a vote of 120–6, with 10 abstentions, the General Assembly approved the Charter of Economic Rights and Duties of States,[173] Article 2.2(c) of which affirmed the right of each State

> [t]o nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent.

Thus, under the Charter, the obligations of a State that expropriates the property of an alien is, in the end, defined solely by the law of that State. And, under Resolution 3201, the State of the alien may not exert any economic, political, or other pressure on the taking State to obtain redress for its national.

Writing in 1983, Professor Lillich expressed what then was a common view:

> It can be argued that the attitude manifested in the [1974] resolutions is merely a response to the abuses of the past or is attributable only to misguided notions of state sovereignty. Whatever its cause, it nevertheless shows that a good many states today simply are unwilling to accept an international regime to resolve taking of property disputes […].[174]

One also might have concluded that, after 1974, the Euro-American consensus could not pretend to be a principle of customary international law. Post-1974 arbitrations, however, would indicate that the Euro-American view retained noteworthy strength,[175] and the development of the global BIT regime, in time, would prove that Professor Lillich's concern regarding the use of "international regimes" to resolve investment disputes was misplaced. The 1974 UN Resolutions are a source of almost no current concern. They should, however, give one pause before abandoning the relatively clear obligations of an investment treaty in favor of reliance on customary international law.

5. POSTWAR ARBITRATION DECISIONS

There were two sets of important arbitral decisions in this period: (1) arbitrations between investors and host States that arose from the termination or forced renegotiation of oil concessions by certain Middle Eastern States; and (2) arbitrations between U.S. investors and Iran in the Iran-U.S. Claims Tribunal, all of which arose from the treatment of U.S. investments in the wake of Iran's 1979 Islamic Revolution. Arbitral jurisdiction in all of the cases in the first group was

172. para. 4(e).

173. G.A. Res. 3281, U.N. GAOR, 29th Sess., Supp. No. 31, at 50, UN Doc. A/9631 (Jan. 15, 1974), reprinted in 14 I.L.M. 251 (1975).

174. Richard B. Lillich, *International Law of State Responsibility for Injuries to Aliens* (Charlottesville: University of Virginia Press, 1983), p. 16.

175. As is explained in the next section, this largely was because the 1974 resolutions were found not to reflect a legally- significant consensus of developed as well as developing States. See text accompanying notes 197–198.

based on contractual arbitration clauses. Jurisdiction in the second group was based on an agreement between the United States and Iran pursuant to which Iran consented to the jurisdiction of a special tribunal to hear claims of U.S. nationals.[176]

a. The Concession Cases

Much has been written about these cases, making it unnecessary to write much more about them here.[177] These cases came in three waves. The first wave consisted of four cases that extended from 1951 to 1963, all of which related to the efforts of certain Middle-Eastern States to terminate or renegotiate oil concession agreements.[178] The second wave consisted of three cases decided from 1973 to 1981, all of which related to Libya's nationalization of the rights and interests of foreign oil companies under long-term concession agreements.[179] The final wave consisted of a single case arising from Kuwait's 1977 termination of a foreign oil concession.[180] For present purposes, the significance of all of these cases is the following: (1) they all arose under contracts, and arbitral jurisdiction in all cases was based on a contractual arbitration clause, not on any agreement involving the investor's home State; (2) they all in some form applied customary international law or "general principles of law;"[181] (3) they all held the host State to the terms of the concession or awarded damages for breach based on the full value of what the investor had lost.; and (4) the Libyan cases that came after the UN resolutions just discussed, and the

176. Declaration of the Government of the Democratic and Popular Republic of Algeria Concerning the Settlement of Claims by the Government of the United States of America and the Government of the Islamic republic of Iran, 1 *Iran-US Claims Tribunal Report* 9, (1981). This "Declaration" was a part of the so-called "Algiers Accords," which also produced the release of the U.S. diplomatic hostages in Iran. In addition to establishing the jurisdiction of the Iran-U.S. Claims Tribunal to decide claims of U.S. citizens against Iran arising out of "expropriations or other measures affecting property rights," the Claims-Settlement Declaration also provided that US$1 billion of blocked Iranian assets would be used to fund a "security fund" from which awards of this tribunal would be paid in full, and required that Iran replenish the fund whenever it fell below US$500 million (*Id.*), an obligation with which Iran has complied.

177. For an excellent summary of these cases, see Patrick Norton, "A law of the future or a law of the past? Modern tribunals and the international law of expropriation," 85 *American Journal of International Law* 474 (1991), pp. 477–82.

178. Petroleum Dev. Ltd. v. Sheikh of Abu Dhabi, 18 *International Law Reports* 144 (1951); Ruler of Qatar v. International Marine Oil Co., 20 I.L.R. 534 (1953); Saudi Arabia v. Arabian American Oil Co., 27 *International Law Reports* 117 (1958) (Sauser-Hall, Badawi/Hassan, Habachy arbs.); Sapphire International Petroleum Ltd. v. National Iranian Oil Co., 35 *International Law Reports* 136 (1963) (Cavin, sole arb.).

179. British Petroleum Exploration Co. v. Libyan Arab Republic, 53 *International Law Reports* 297 (1973) (Lagergren, sole arb.); TOPCO, op. cit.; Libyan American Oil Co. v. Libyan Arab Republic, 20 *International Legal Materials* 1 (1981) (Mahmassani, sole arb.) [hereinafter: LIAMCO].

180. Kuwait and American Independent Oil Co., 21 *International Legal Materials* 976 (1982) (Reuter, Sultan & Fitzmaurice, arbs.) [hereinafter: AMINOIL].

181. The cases in the first wave all involved concessions that lacked clear governing law clauses. Thus, for example, the tribunal in the Abu Dhabi case applied "principles rooted in the good sense and common practice of the generality of civilized nations." 18 *International Law Reports* at p. 545. The cases in the second wave all involved contracts that identified as their governing law "the principles of law of Libya common to the principles of international law and in the absence of such common principles then [. . .] the general principles of law, including such of those principles as may have been applied by international tribunals." Quoted in Robert B. von Mehren and P. Nicholas Kourides, "International arbitration between states and foreign private parties: The Libyan nationalization cases," 75 *American Journal of International Law* 476 (1981), pp. 481–81.

AMINOIL case, either rejected everything that followed Resolution 1803 (Permanent Sovereignty over Natural Resources) as not reflecting a legally significant consensus,[182] or took the view that those resolutions indicated that international law was unsettled with respect to the measure of compensation due in oil nationalization case.[183]

b. The Iran-U.S. Claims Tribunal

The Iran-U.S. Claims Tribunal has produced the most important body of case-law in the area of State responsibility certainly in the last hundred years. Its decisions are cited in the memorials and decisions of most BIT arbitrations for one proposition or another. There are several reasons for the continuing significance of these decisions: (1) The Tribunal's jurisprudence is extensive, containing at least twenty decisions of continuing importance; (2) the make-up of the Tribunal has included prominent figures in the field of international arbitration of many nationalities and has changed over time, thus lending the consistency of its decisions greater authority; (3) almost all of its important decisions required it to construe provisions of the 1955 FCN treaty between Iran and the United States that are very similar to the important investment-protection provisions of almost all BITs; and (4) almost all of these same decisions consider the key issues both as questions of customary international law and as questions requiring construction of the treaty.[184] Because the large majority of the Tribunal's important decisions were rendered before, or very shortly after, 1989, and because they all were rendered after the events of 1974 just described, they provide the best available insight into the jurisprudential effects of those events and into the law of responsibility of States as it existed at the end of the Cold War.

The jurisprudential effect of the 1974 UN resolutions, at least within the Iran-U.S. Claims Tribunal, may be summarized briefly: They had no effect; they were considered and rejected, much as the tribunal did in the TOPCO case mentioned in the prior section.[185] Typical is the majority opinion in *Ebrahimi v. Islamic Republic of Iran*, which dismissed the resolutions in a footnote simply by noting that the they "make[] no reference to 'international law,' as a result of which the Charter was not accepted by most Western countries" and that therefore "the 'appropriate' compensation standard stated in the [resolutions] could not be held to express a general principle of international law."[186]

The Iran-U.S. Claims Tribunal not only ignored the 1974 UN resolutions, it consistently held that nationalizations of alien-owned property required payment of full compensation, under the treaty, and under international law generally. Thus, for example, the majority in the *AIG* case ruled that "it is a general principle of public international law that even in a case of lawful

182. See TOPCO, op. cit., at p.30; AMINOIL, op. cit., at 601.

183. The sole arbitrator in the LIAMCO case, Dr. Mahmassani, stated that the UN General Assembly's resolutions relating to the New International Economic Order represented "the recent dominant trend of international opinion." LIAMCO, op. cit., at p. 53. Dr. Mahmassani nonetheless went on to award damages based largely on claimant's lost profits. *Id*. at 81.

184. Whether the treaty had survived the 1979 break in relations between the two countries was a continuing legal and political issue. The Tribunal therefore often thought it prudent also to consider the case as a matter of customary international law. See, e.g. SEDCO, Inc. v. National Iranian Oil Co., 10 *Iran-U.S. Claims Tribunal Report* 180 (1986) (interlocutory award).

185. See text accompanying n. 175, *supra.*

186. Ebrahimi v. Islamic Republic of Iran, Award No. 560-44/46/47-3, at ¶ 90 n.11 (1994) Reprinted in 89 *American Journal of International Law* 385 (1995).

nationalization the former owner of the nationalized property is normally entitled to the full value of the property taken."[187] In *Sola Tiles*, the Tribunal found the "full compensation" standard of the treaty to be the same as the standard under customary international law.[188] And the Partial Award in the *AIFC* case held, relying on *Chorzow Factory*, that the measure of compensation under international law for an unlawful expropriation was *restitutio in integrum*, while a lawful expropriation called for payment of "the just price of what was expropriated," which meant "the full value of the expropriated assets."[189] The authors are unaware of a single award of this tribunal that challenges the propositions that, under both the treaty and customary international law, the expropriation of alien-owned property requires the payment of full compensation, and that the measure of such compensation in the case of an enterprise is going-concern value.[190]

Between the oil-concession cases and the work of the Iran-U.S. Claims Tribunal, the last half of the Cold War period saw a notable increase in the number of investment arbitrations, certainly as compared with their almost total absence in the first half. The uniformity with which these cases upheld the Euro-American consensus is striking. Indeed, one might be forgiven for concluding that the dissension from that consensus—on the part of Latin America for well over one hundred years, on the part of the communist world for almost one hundred years, and on the part of most of the rest of the developing world from the 1950s until at least very recently—has had no effect on the development of the law. As a jurisprudential matter, that would largely be true, but it also would miss the arguably more important practical point, which is that this dissension has, to a great extent, precluded the resolution of investment disputes by third-party adjudication.

187. American International Group v. Islamic Republic of Iran, AWD 93-2-3, slip. op. at 14–15 (Mangard, Mosk & Ansari Moin, arbs., Dec. 19, 1983), 4 *Iran-U.S. Claims Tribunal Report* 96 (1983 III) (hereinafter "*AIG*"). The Tribunal went on to explain that "the appropriate method [of determining full value] is to value the company as a going concern." *Id.*, at 21.

188. Sola Tiles, Inc. v. Iran, AWD 298-317-1, slip op. at 15–16 (Apr. 22, 1987), 14 *Iran-U.S. Claims Tribunal Report* 223 (1987 I).

189. Amoco International Finance Corp. v. Iran, AWD 310-56-3, slip op. at 90 (Virally, Brower & Ansari Moin, arbs., 1987), 15 *Iran-U.S. Claims Tribunal Report* 189 (1987 II) (hereinafter "*AIFC*"). The award also held that "full value" in the case of an enterprise meant "going concern value." *Id*. at 115. There was a disagreement between Virally and Brower as to whether "going concern value" included consideration of a firm's lost future profits, with Virally taking the view that "lost profits" could be taken into account only in the case of an unlawful expropriation, and Brower taking the view that one could not determine the value of a going concern without considering its expected future profits. See Concurring Opinion of Judge Brower at pp. 17–19. The majority opinion in Phillips Petroleum adopted Brower's view of the matter. See Phillips Petroleum Co. Iran v. Iran, AWD 425-39-2, slip op. at 61–62 (Briner, Aldrich & Khalilian, arbs., June 29, 1989), 21 *Iran-U.S. Claims Tribunal Report* 79 (1989 I). It appears that no subsequent majority opinion of the Tribunal adopted the view expressed by Virally in *AIFC*.

190. *Cf.* Norton, "A law of the future or a law of the past? Modern tribunals and the international law of expropriation," op. cit., pp. 483–86. Decisions of the Iran-U.S. Claims Tribunal have also contributed materially to the jurisprudence of what constitutes an indirect expropriation. See, e.g., Tippets, Abbett, McCarthy, Stratton v. TAMS-AFFA, Award No. 141-7-2 (June 22, 1984) (in determining whether an expropriation has taken place, "[t]he intent of the government is less important than the effects of the measures on the owner, and the form of the measures of control or interference is less important than the reality of their impact"), 6 *Iran-U.S. Claims Tribunal Report* 291, 226 (1984 II), Sea-Land Service, Inc. v. Iran, Award No. 135-33-1 (June 20, 1984), 6 *Iran-U.S. Claims Tribunal Report* 149, slip op. at 14 (1984).

Jurisdiction over a State must be based on consent, and the dissenting States just described have given this consent only rarely.[191] The jurisprudence of State responsibility under customary international law may have emerged from the Cold War years clearer, and even more protective of investors, than it was before World War II. But during this period, and at its end, few States were prepared to have their investment disputes adjudicated according to this jurisprudence. Indeed, even by 1989, relatively few of the dissenting States had been willing to enter into FCN treaties or BITs that embodied this view of a State's responsibilities to foreign investors, even if the agreement did not contain a consent to investor-State arbitration. The next section will consider how and why this situation has changed in the years since 1989.

D. 1989—PRESENT: THE BIT ERA

Initially, it may seem odd even to imply that the "BIT era" began in 1989, some 30 years after Germany and Pakistan entered into the first treaty commonly referred to as a bilateral investment treaty. A few numbers, however, will serve to indicate that, if anything, the modern BIT era started later than 1989. The fall of the Berlin Wall nonetheless serves as a conceptually significant beginning point, because the changed political and economic conditions that underlay the enormous growth in the number of BITs, and in the number of BIT arbitrations, to a great extent can be traced to the late 1980s and early 1990s.

The first numbers to consider are those for the growth in the number of BITs over time. At the end of 1959 there was 1; at the end of 1969 there were 72; by the end of 1979 this number had about doubled, to 165; by the end of 1989 it had doubled again, to 385. Over the next ten years, however, the number of BITs grew to 1,857, a four-fold increase.[192] At the end of 2005, the total was a little over 2,500, and the rate of growth in the number of BITs had declined markedly.[193] As of June 2009, there were 2,701 BITs.[194]

The next numbers to consider are those relating to foreign investment in developing countries. UNCTAD data indicate that foreign investment flows into developing countries began to increase quite rapidly beginning in 1991–1992, increasing from a total annual inbound investment of less than US$40 billion in 1989 to about US$200 billion in 1999, and over US$600

191. State-to-State adjudication of investment disputes in the postwar years has been almost non-existent. Only one State during this period–Iran–consented to arbitrate investment disputes with investors after the disputes had arisen, and it did so under extraordinary circumstances. The only examples of consent to arbitrate with an investor prior to a dispute are the oil-concession cases that were based on contractual arbitration clauses. Contract arbitration is a useful option, but only if the investor has a contract with the State, which most often will not be the case unless the investment has to do with resource extraction.

192. United Nations Conference on Trade and Development, *Bilateral investment treaties 1959–1999*, fig. 1 (2000).

193. United Nations Conference on Trade and Development, *Bilateral investment treaties 1995–2006: Trends in investment rulemaking* 1 (2007), available at: http://www.unctad.org/en/docs/iteiia20065_en.pdf (last visited May 10, 2011).

194. United Nations Conference on Trade and Development, "Recent Developments in International Investment Agreements (2008–June 2009)," *International Investment Agreements Monitor* No. 3 *(2009)*, at p. 2, available at: http://www.unctad.org/en/docs/webdiaeia20098_en.pdf (last visited May 10, 2011).

billion in 2008; inbound investment in the 1970s and early 1980s was under US$10 billion per year.[195]

Perhaps more surprising than the steep upward trend in inbound investment is the rapid drop in acts of expropriation after 1974. Two estimates of the number of such acts for different time periods have already been discussed, a 1974 UN study that identified 875 acts of expropriation committed by 62 countries from 1960 to 1974,[196] and a U.S. State Department study that concluded that there had been "at least" 87 instances of expropriation of U.S.-owned property from 1971 to 1973.[197] Recent studies have yielded a time series of expropriatory acts that is largely consistent with the totals stated in the UN and State Department studies.[198] Not surprisingly, it shows expropriations increasing gradually in the early 1960s (from fewer than ten in 1960, to about fifteen in 1966) and then increasing very steeply beginning in 1967,[199] reaching a peak of over 60 expropriations in 1975, the year after the battles in the UN over the New International Economic Order. From 1976 to 1985, however, one sees a very sharp reduction in the number of expropriatory acts, falling literally to about one per year over the period 1985–1991 and then increasing slightly to three or four per year through 2004, and to eight in 2006.[200]

The final numbers to put into this mix are those showing the trends in the number of known investor-State arbitrations conducted pursuant to BIT dispute resolution provisions.[201] Until 1996, there were no more than two such cases per year. In 2001, there were 16 known cases. In 2004, there were 45. There were more than 25 in each subsequent year through 2008. By the end of 2008, there had been a total of over 300 known investor-State arbitrations conducted pursuant

195. Relevant UNCTAD statistics, available at: http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx?sRF_ActivePath=P,*5,27&sRF_Expanded=,P,5,27* (last visited June 3, 2011).

196. Permanent Sovereignty Over Natural Resources Report of the Secretary General, U.N. Doc. A/9716 (1974).

197. See Gantz, "The Marcona settlement," op. cit., p. 474, n. 2.

198. Because this time series begins in 1960, it excludes the sweeping nationalization programs of the new communist States that emerged immediately after World War II.

199. By which time independence had come to virtually all of Africa, South Asia, and Southeast Asia.

200. These data come from three studies: One by Stephen Kobrin, covering the period 1960–1979 ("Expropriation as an attempt to control foreign firms in LDCs: Trends from 1960 to 1979," 28 *International Studies Quarterly* 329 (1984), pp. 331–336; a study by Michael Minor that extends Kobrin's work to 1992 ("the demise of expropriation as an instrument of LDC Policy, 1980–1992," 25 *Journal of International Business Studies* 177 (1st Quarter, 1994), pp. 179–182); and the study by Hajzler noted above with respect to investment trends which extends the work of Kobrin and Minor on expropriation to 2006 (Chris Hajzler, "Expropriation and foreign direct investments: Sectoral patterns from 1993 to 2006," University of Otago Economics Discussion Papers No. 1011, (September 2010) p. 10, fig. 1.) The sudden increase in expropriations in 2006 may reflect the increase in levels of foreign investment seen in the immediately prior years (as Hajzler speculates). More likely it is an example of a large increase in a small number that signifies nothing.

201. The number of ICSID investor-State arbitrations is known with certainty because the existence of each ICSID case is a matter of public record. *ICSID convention, regulations and rules*, reg. 22(1), available at: http://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR_English-final.pdf (last visited May 10, 2011). Cases brought under UNCITRAL Rules, or the rules of the Arbitration Institute of the Stockholm Chamber of Commerce, do not necessarily come to public attention. See United Nations Commission on International Trade Law (UNCITRAL), *UNCITRAL arbitration rules*, available at: http://www.uncitral.org/pdf/english/texts/arbitration/arb-rules/arb-rules.pdf (last visited May 10, 2011); Arbitration Institute of the Stockholm Chamber of Commerce, *Arbitration rules: 2010*, available at http://www.sccinstitute.com/skiljedomsregler-4.aspx (last visited May 10, 2011).

to investment treaties.[202] Data concerning the number of arbitrations between foreign investors and host States, or host State entities, in which jurisdiction is based on a contract are largely unavailable, [203] but it is certain that there have been many over this same time period.

Four charts appear on the following pages that compare the trends discussed above. The first graphs the yearly number of acts of expropriation from 1960 to 2006. The second shows the number of BITs concluded annually and cumulatively from 1960 to 2008. The third shows the annual amount of inbound foreign investment for developing countries from 1970 to 2008. The fourth chart graphs the annual and cumulative number of investor-State arbitrations initiated from 1989 to 2008.

A few conclusions may cautiously be drawn from these data. First, and least important, the great increase in the number of investor-State arbitrations that began in the late 1990s (Figure 4) followed the increase in the number of BITs by about five years, supporting the notion that increased availability of an arbitral remedy produces increased use of that remedy.[204] Second, the great increase in the number of BITs shown in Figure 2 cannot be a cause of the surprising decrease in the number of expropriations seen since 1975 (Figure 1), since what came later cannot be a cause of what came before; nor is it plausible that these two events had a common cause inasmuch as they were separated in time by about fifteen years. Third, the great increase in foreign investment in developing countries that commenced in the early 1990s and continued into the next decade (Figure 3) coincided with the great increase in the number of BITs. This is not to say that one caused the other, much less which was the cause and which the effect.

The continuing debate over whether, and, if so, to what extent, BITs in fact encourage foreign investment is beyond the scope of this chapter, as is the debate over whether BITs are good for developing countries.[205] It seems reasonable to speculate, however, that the downward trend in acts of expropriation that began in 1976 indicates a fundamental shift in the attitudes of many non-communist developing countries toward foreign investment that preceded the end of the Cold War, that this attitudinal shift expanded geographically after, and was reinforced by, the

202. See United Nations Conference on Trade and Development, "latest developments in investor-state dispute settlement," *IIA Monitor* No. 1 (2009), at 3, Fig. 1.

203. Only those relatively few contract cases that are conducted under ICSID auspices systematically become matters of public record. Awards in other contract arbitrations become public somewhat randomly.

204. Since the UNCTAD data on arbitrations includes pending cases, this lag cannot be taken as evidence that investor-State arbitrations take a very long time to complete, a proposition that most practitioners in any event would view as self-evident.

It also is noteworthy that the level of expropriation activity remained reasonably steady, and low, from 1986 to 2006, averaging fewer than four acts of expropriation per year, while the annual number of investor-State arbitrations increased steadily over this period. It is not immediately apparent how one reconciles the initiation of between 40 and 45 such arbitrations each year in 2004, 2005, and 2006 with data indicating that there were only 26 expropriatory acts from 2001 through 2006. The likely explanation, however, is that the definition of an expropriation used in these studies requires a transfer of ownership and thus excludes some actions that might give rise to a BIT claim based on denial of fair-and-equitable treatment and/or acts that are equivalent to an expropriation ("indirect expropriation" or "creeping expropriation"). See, e.g., Hajzler, *Expropriation and foreign direct investments: Sectoral patterns from 1993 to 2006*, op. cit., pp. 4–6, 9–11 and Fig. 1. For example, neither Argentina's financial default nor any acts of the Czech Republic are included in the expropriations of this period.

205. See generally Jeswald Salacuse and Nicholas P. Sullivan, "Do BITs really work? An Evaluation of bilateral investment treaties and their grand bargain," op. cit.; Karl P. Sauvant, "Driving and countervailing forces: A rebalancing of national FDI policies," in Karl P. Sauvant, ed., *Yearbook on international investment law and policy 2008–2009* (New York: Oxford University Press, 2009), pp. 233–263; Vandevelde, "A brief history of international investment agreements," op. cit., pp. 184–190.

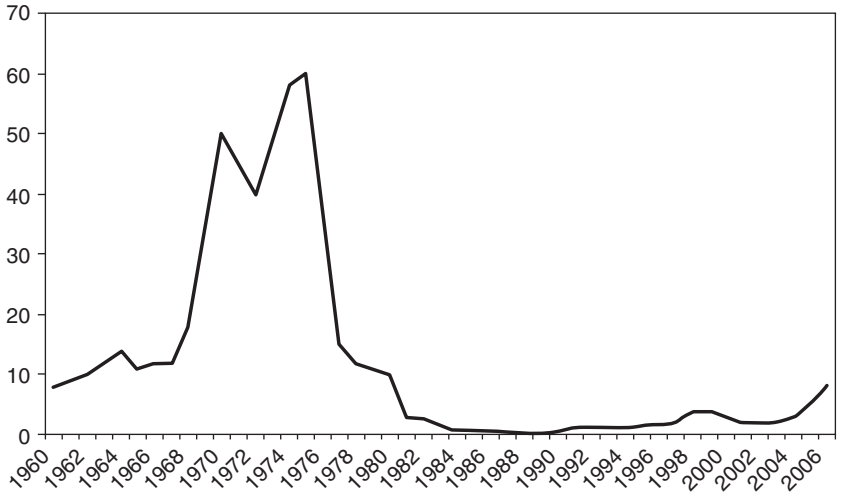

FIGURE 1: Acts of expropriation per year (1960–2006)

Source: Chris Hajzler, "Expropriation and foreign direct investments: Sectoral patterns from 1993 to 2006," University of Otago Economics Discussion Papers No. 1011, (September 2010) p. 10, Fig. 1

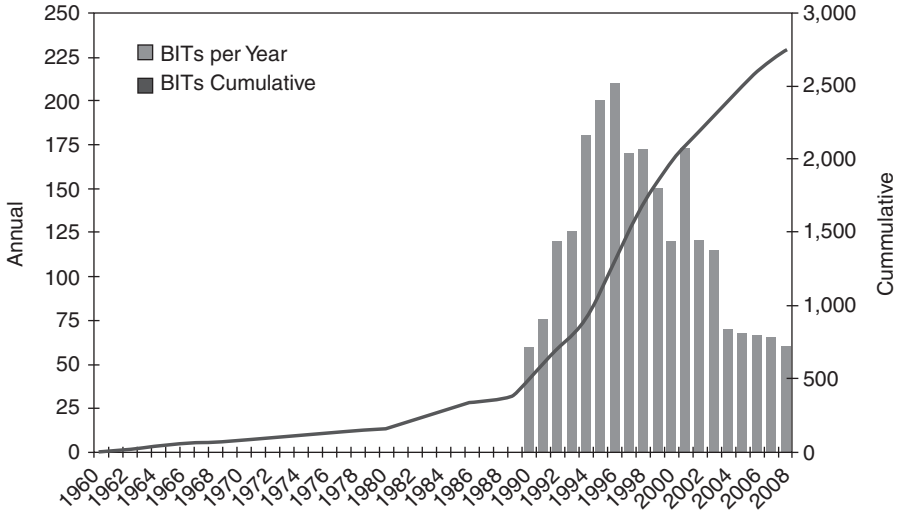

FIGURE 2: Number of BITs concluded year-by-year (1990–2008) and cumulative (1960–2008)

Source: Authors' compilation from United Nations Conference on Trade and Development, Bilateral investment treaties 1959–1999, Fig. 1 (New York and Geneva: UN Publishing, 2000), available at http://www.unctad.org/en/docs/poiteiiad2.en.pdf; United Nations Conference on Trade and Development, "Recent development in international investment agreements," IIA Monitor No. 2 (2005), Fig. 1, available at http://www.unctad.org/en/docs/webiteiit20051_en.pdf; United Nations Conference on Trade and Development, "Recent developments in international investment agreements (2008–June 2009)," IIA Monitor No. 3 (2009), Fig. 1, available at http://www.unctad.org/en/docs/webdiaeia20098_en.pdf (last visited June 3, 2011).

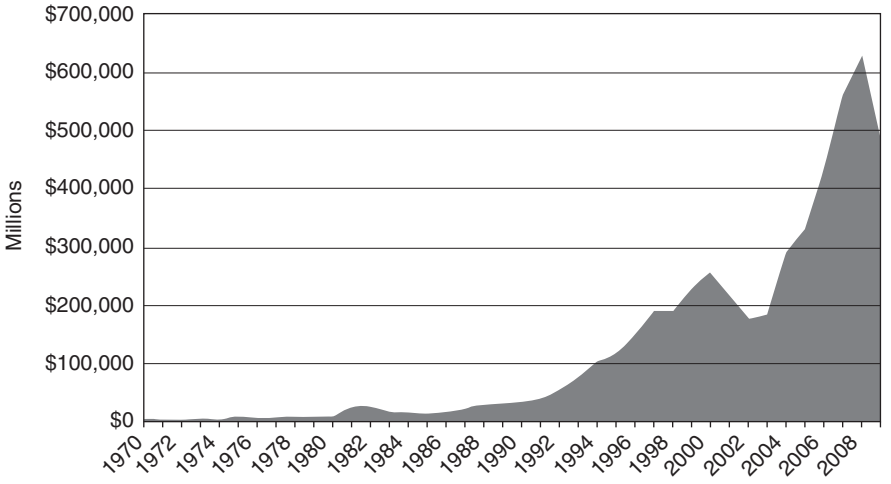

FIGURE 3: LDC inbound investment (1970–2008)

Source: Data available from UNCTAD Stat: http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx?sRF_ActivePath=P,5,27&sRF_Expanded=,P,5,27 (last visited June 3, 2011).

end of the Cold War, and that this near-global change in attitude is reflected in the simultaneous and stark increases in annual inbound investment (Figure 3) and numbers of BITs coming into force each year (Figure 2) that began in the early 1990s. Even if this speculation is well founded, however, it does not support the conclusion that BITs have had a material positive impact on foreign-investment trends. The fact that two events have a common cause does not mean that the occurrence of one was necessary to, or even supported, the occurrence of the other.

The clear positive impact of BITs is to be found not in investment trends but in the history of the last 200 years. With very few exceptions, that history has been one of claims resolution by

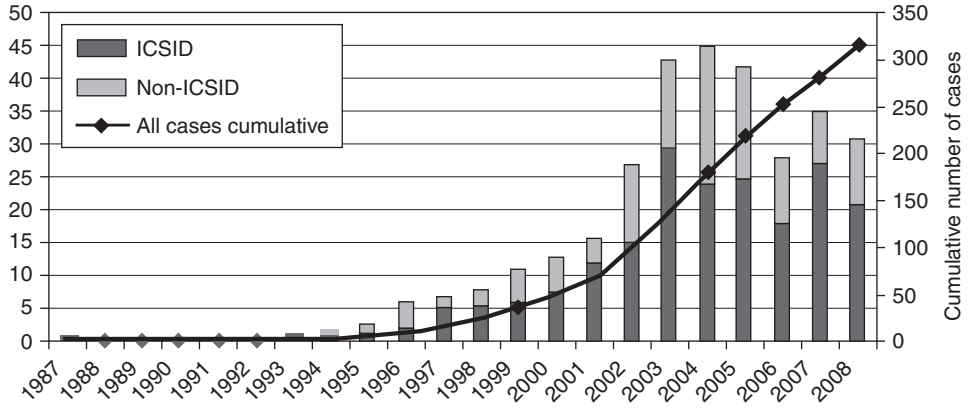

FIGURE 4: Known investment treaty arbitrations (cumulative and newly instituted cases), 1989–2008

Source: United Nations Conference on Trade and Development, "Latest Developments in investor-State dispute settlement," IIA Monitor No. 1 (2008), Fig. 1, available at http://www.unctad.org/en/docs/iteiia20083_en.pdf (last visited June 3, 2011).

after-the-fact government-to-government negotiations that, when successful, have resulted either in lump-sum settlements or the creation of arbitral tribunals with jurisdiction to adjudicate a defined group of existing claims. As the upward trend in the number of BIT arbitrations indicates, there is no shortage of international investment disputes in the world, although they may manifest themselves in less obvious ways than before. Yet, apart from a few settlements with communist or formerly communist States in the 1990s, the disputes that have arisen in the "BIT era" have not been the subjects of negotiated government-to-government lump-sum settlements. Nor have the last twenty years seen the creation of any mixed claims commissions to deal with expropriation or similar claims of foreign investors, although the Iran-U.S. Claims Tribunal lives on, dealing with the claims of the two governments against each other.[206] To be sure, governments still make representations to host States on behalf of their investors, but, in the last twenty years, the foreign ministries of capital-exporting countries very largely have gone out of the claims-settlement business, and the foreign ministries of capital-importing countries have turned the claims of foreign investors over to their lawyers.

CONCLUSION

The current global network of BITs and the increasingly frequent settlement of investment disputes by resort to investor-State arbitration, rather than to diplomatic (much less military) protection, is a reflection of our time. It could not have happened until the States that became independent in the 1940s, '50s, and '60s sorted out their post-colonial investment issues in the 1970s; States bent on expropriating alien-owned property will not sign BITs with the States of the property owners. It also could not have happened—certainly not on anything like its current scale—in the atmosphere of the Cold War. The interwar years, had there been many more of them, might have seen the development of a truncated version of the current system (likely excluding Russia and much of Latin America); after all, several FCN treaties were signed in that period with investment-protection provisions, and there were more than a few third-party adjudications of investment disputes, including important decisions of the PCIJ. But the interwar period was short, and, by today's standards, levels of foreign investment were small indeed. If our current BIT regime is a product of our time, it is important to keep in mind how valuable a part of our time it is, and wherein that value lies, particularly as one considers current questions such as whether BITs serve the interests of developing countries and whether their arbitration provisions unduly intrude upon State sovereignty.

The history reviewed in this chapter is one of episodic resolution of investment disputes by arbitration, with consents to arbitrate usually coming after the fact and as a result of pressure—often military pressure—from the claimant State, occasional government-to-government negotiations of settlements requiring great diplomatic effort, and unending disagreement between

206. Other claims commissions did important work during this period even if they were not concerned with typical foreign-investor claims. For example, the UN Compensation Commission dealt with the claims of parties injured by Iraq's invasion and occupation of Kuwait; the Eritrea-Ethiopia Claims Commission adjudicated the claims of these States and their nationals arising from violations of the laws of war during the 1998–2000 border war between these two countries; the Kosovo Property Claims Commission has sought to resolve conflicting claims to real property in Kosovo that arose as a result of the conflict there and the events leading up to it; and the Bosnia Property Claims Commission which has sought to resolve claims similar to those addressed by the Kosovo Commission just described.

developed and less-developed countries over the content of applicable international law. This history reveals that the fundamental value of BITs is twofold. First, the existence of more than 2,700 BITs in the world may not have resolved the debate over what customary international law requires of a State when it expropriates alien-owned property, but it has rendered that debate largely academic. As former ICJ President Stephen Schwebel observed in his comment on the September 30, 2009, Report of the United States Advisory Committee on International Economic Policy Regarding the Model Bilateral Investment Treaty:

> What is the customary international law that governs the treatment and taking of foreign investment? That question was at the heart of the United Nations debates over "permanent Sovereignty over Natural resources," the "New International Economic Order," and the "Charter of Economic Rights and Duties of States." The resolutions adopted on those questions demonstrate that, while in the view of the industrialized democracies, there is a customary international law in this sphere—whose core provides for prompt, adequate and effective compensation for expropriated foreign property—in the view of the very large majority of UN Members, no such customary international law exists. In their view, a State is free to treat foreign investment as its law and policy dictates without regard to alleged international obligations of which there are none.
>
> Far from relying on a customary international law whose existence, not to speak of its content, is contentious, The United States will do far better to rely on the terms of BITs, such as its Model 1994 BIT, which vault over the traditional divide of the international community and provide specific, progressive terms for the treatment and taking of foreign investment.[207]

The second fundamental value of our current BIT regime is to be found not in the typical investment-protection provisions, but in the typical arbitration provisions that allow investors to resolve disputes with host States directly, without the involvement of the investor's home State. A principal purpose of this chapter has been to emphasize the importance of this innovation by giving it some historical context. But the importance of this process innovation is perhaps best appreciated if it is viewed looking forward from the past. What follows is a long excerpt from a short essay written by Professor Edwin Borchard in 1927.

> Protection by the nation of a citizen abroad reflects one of the most primitive institutions of man — the theory that an injury to a member is an injury to his entire clan. […]
>
> A cursory examination of the existing practice will demonstrate the inefficiency, if not, indeed, the unfairness of the system. When the citizen abroad is injured he is expected first to exhaust his local remedies […] Assuming that the local remedy is ineffective, the citizen may invoke the diplomatic protection of his own government. That government may act as it sees fit in the matter, either extend good offices, make diplomatic claim, or institute coercive measures of protection in the event that diplomacy fails. Coercive measures invite the danger of war, involving all the people of the claimant's state […]
>
> It has been suggested heretofore that the nations should voluntarily agree automatically to submit all pecuniary claims to arbitration if diplomacy failed, and that arbitration should be deemed an inherent part of due process in such matters. […]

207. Report of the Subcommittee on Investment of the Advisory Committee on International Economic Policy Regarding the Model Bilateral Investment Treaty, Comment by Judge Stephen Schwebel, at p. 34, available at: http://www.state.gov/e/eeb/rls/othr/2009/131098.htm (last visited May 10, 2011).

> It is submitted that international law may well go a step further. Whether or not the nations agree to submit such legal issues to arbitration, the individual himself should have the opportunity of trying the issue in the international forum before his state becomes politically involved in the case. […] It would require treaties by which states would agree to permit themselves to be sued, but there would be a strong incentive on the part of both defendant and plaintiff states to institute this intermediary forum. […] By enabling the injured citizen to sue the defendant state in the international forum, […] all three parties to the issue and the cause of peace would be benefited, for they would rely upon legal processes for the assurance of international due process of law to the alien. That is all any of the parties has the right to ask. […] The institution of the practice would remove from the political to the legal field an important department of international relations.[208]

Professor Borchard, quite literally, could only imagine the legal regime that now deals with international investment disputes. But the alternative to that regime was all too real to him in 1927.

Whether the current BIT regime serves the economic interests of capital-importing countries, capital-exporting countries, both, or neither is a matter better discussed by economists than by lawyers. But lawyers can discern, as Professor Borchard did more than eighty years ago, that the current BIT regime helps weak States by insulating them from unwelcome diplomatic, economic, and perhaps military pressure from strong States whose nationals believe they have been injured, and helps strong States by enabling them to deflect pressures that could lead them into unwelcome conflict over investment issues with weak States, or other strong States, with which they have more important business. The alternative to the clear investment-protection standards of BITs is a return to the contentious, and diplomatically troublesome, debates of the 1970s over the content of customary international law. The alternative to compulsory investor-State arbitration is either compulsory State-to-State arbitration, which requires the claimant State either to take an adversarial posture with respect to the host State or to leave its injured national without a remedy, or direct diplomatic and/or economic intervention by the claimant State. It is difficult to imagine a foreign minister of either a capital-importing or a capital-exporting country who would welcome any of these alternatives.

208. Edwin M. Borchard, "Limitations on coercive protection," 21 *American Journal of International Law* 303 (1927), pp. 303–306.