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Investment Protection under Bilateral Investment Treaties and Investment Contracts

Piero BERNARDINI*

I. INTRODUCTION

Although the notion of "investment" is subject to evolution with the passing of time and the development of trade exchanges and techniques, a common denominator may be said to exist which identifies this notion with all categories of assets, including all categories of rights and interests. This has become a standard definition in modern bilateral investment treaties (BITs) designed to encourage investments by nationals of a State into the territory of another State by according them a well-defined protection.[1]

However, as the term indicates, an investment does not consist merely in the transfer into or creation of an asset in the economy of a given State. Such an asset is, in fact, only the instrument through which the private investor aims at obtaining, after a certain period of time, a return justifying the risk it has accepted to run. Thus, both the lapse of some time for the investment to become rooted in the economy of the host State and the assumption of the risk that no return (or a return lower than expected) will be forthcoming characterize all investments.[2]

The passing of time required for an investment to yield the expected return, coupled with the transfer or creation of an asset in the host State—normally an asset having a significant economic value—have made imperative the establishment of an adequate system of guarantees for private investment. This has also been a result of the problems which, due to the parties' different objectives, have characterized investments made by foreign companies in developing countries, particularly after the end of the Second World War. As a matter of fact, while the private investor looks for the return of the invested capital within a framework of contractually guaranteed

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[1] R. Dolzer and M. Stevens, *Bilateral Investment Treaties*, Martinus Nijhoff, The Hague, 1995, pp. 26 *et seq.*

[2] Even if no definition of investment is given by the Washington Convention of 1965 on the Settlement of Investment Disputes between States and Nationals of other States (the ICSID Convention), the investment characteristics mentioned in the text appear to be shared by ICSID. Thus, ICSID's Secretary-General has refused to register a request for arbitration filed under the ICSID Convention where the dispute related to a contract for the straightforward sale of goods against payment of the purchase price because, due to these features, the transaction was not considered to constitute an investment.

stability, the host State aims at ensuring a flow of capital, technologies and managerial skills capable of guaranteeing its orderly economic and social development without renouncing its sovereign prerogatives. Under such kinds of constraints which characterized the history of the relations between States and private investors up until the late 1960s, States accepted to pursue their objectives by entering into contractual arrangements with a private entity in a position of substantial parity, such arrangement being significantly denominated "investment contract" or "economic development agreement".

II. The Development of the Parties' Relations

The experience, particularly in the 1960s and 1970s, of one of the sectors of economic activity which has most significantly mobilized the industrialized world's resources towards developing areas—the exploitation of mining resources and, more specifically, petroleum—shows how difficult it was during this period to reconcile the parties' different objectives.[3]

The exploitation of mining resources is a sector where the high level of risk of the activity, the size (not only economic) of the transfer of the required resources, as well as the political instability and the undeveloped legal order of many developing States are all factors which have led to the establishment by the large multinational companies of a particularly refined system of contractual guarantees for the protection of their investments. Classic examples of the legal apparatus which was then established are the contractual techniques prevailing in an investment contract with a State or a State-owned entity aimed at removing the contractual relationship from the supremacy of the local laws, either by stabilizing the contractual terms and conditions or by requiring that the contract be governed by general principles of law, principles of law recognized by civilized nations, international law or the like, the whole within the framework of what has been referred to as the "denationalization" or "internationalization" of the investment contract.

It is a matter of common experience that such techniques have shown their efficacy thanks to the particular dispute settlement method chosen by the parties. When called to intervene pursuant to the arbitration clause normally present in this type of contractual arrangement, the international arbitrator has given full effect to the above-

[3] An analysis of the parties' relationship during this period can be found in Piero Bernardini, *State Contracts, New Trends in International Trade Law*, Guiffre, Turin, 2000, pp. 47 *et seq.*

described clauses in accordance with the parties' (or, at least, the private investor's) intent.[4]

This complex system of relations started to give signs of crisis in the first half of the 1960s, concurrently with the access to independence by an always greater number of States and the more and more far-reaching actions undertaken by international organizations established by developing countries, such as the Organization of Petroleum Exporting Countries.

The developing countries' objective was to regain a sovereignty which had been limited by a number of legal institutions (such as the highly criticized "concession") or contractual clauses (such as those purporting to denationalize the investment contract), both of which had been accepted in a period of economic dependency. This objective set in motion a profound revision of the old relations in the name of the establishment of what was called a "New International Economic Order". This process found expression in various resolutions of the UN General Assembly during the 1960s and 1970s which reaffirmed the permanent sovereignty of each State over its natural resources, including the unrestricted right to regulate foreign investments according to the State's internal laws and the right to nationalize foreign property.[5]

Greater attention was paid in this period to the nature of the investment contract and of the State's intervention as a signatory party. The public-law nature of the investment contract depends upon the State acting *iure imperii* rather than merely *iure gestionis*. The former is held to be the case whenever the State pursues a public interest in view of the sector of activity covered by the investment contract and the country's

[4] The reference here is mainly to the following arbitration cases: *Petroleum Development (Trucial Coast) Ltd. v. The Sheikh of Abu Dhabi*, Award of 28 August 1951, by Lord Asquith of Bishopstone, International and Comparative Law Quarterly, 1952, 247; *Ruler of Qatar v. International Marine Oil Company Ltd.*, Award of June 1953, by Sir Alfred Bucknill (Referee), 20 International Law Reports, 1953, 534; *Government of Saudi Arabia v. Arabian American Oil Company (Aramco)*, Award of 23 August 1958, by a tribunal composed of P. Sauser-Hall, M. Hassan and Saba Habachi, Revue critique de droit international privé, 1963, 272, and 27 International Law Reports, 1960, 117; *Sapphire International Petroleum Ltd. v. National Iranian Oil Company (NIOC)*, Award of 15 March 1963, by Pierre Cavin, 13 International and Comparative Law Quarterly, 1964, 1011; 35 International Law Reports, 1967, 136, and Annuaire suisse de droit international, 1962, 273; *BP Exploration Company (Libya) v. Government of the Libyan Arab Republic*, Award of 10 December 1973, by Gunnar Lagergren, Revue de l'arbitrage, 1980, 132; *Texaco Overseas Petroleum Company and California Asiatic Oil Company v. Government of the Libyan Arab Republic*, Award of 19 January 1977, by René-Jean Dupuy, Journal du droit international, Vol. 104, No. 2, 1977, and International Legal Materials, Vol. 17, 1977; *Libyan American Oil Company (Liamco) v. Government of the Libyan Arab Republic*, Award of 12 April 1977, by Sobhy Mahmassany, Revue de l'arbitrage, 1980, 117; *The American Independent Oil Company (Aminoil) v. The Government of the State of Kuwait*, Award of 24 March 1982, by a tribunal composed of Paul Reuter (Chairman), Hamed Sultan and Sir Gerald Fitzmaurice, International Legal Materials, 1982, 976, and 9 *Yearbook Commercial Arbitration*, 1984, 71.

[5] The most significant of such resolutions are those affirming the Permanent Sovereignty of each State over its Natural Resources of 14 December 1962 (Resolution No. 1803-XVII), 25 November 1966 (Resolution No. 2158) and 17 December 1973 (Resolution No. 3171-XXVIII); those concerning the establishment of a New International Economic Order of 1 May 1974 (Resolutions Nos. 3201 and 3202-SVI); and those defining the Economic Rights and Duties of the States in the so-called Charter of Algiers approved by Resolution No. 3281-XXIX of 12 December 1974.

development objective promoted by such activity.[6] Hence the need to ensure to the private investor a particular protection against the possibility of the State's intervention, whenever public interest so demands, for the rectification of the contractual terms or even the revocation of the contract, both being distinguishing features of a public-law contract.

Among the measures in force at international level during the 1960s and 1970s to guarantee a stable frame of protection to private investment were the minimum standards of treatment of foreign private property under customary international law or specific provisions for the fair treatment of the foreign investment provided for in BITs. Multilateral rules have been developed within the Organisation for Economic Co-operation and Development (OECD), even if not always of a binding character.[7] To the contrary, various attempts to conclude multilateral conventions on the subject, such as, most recently, the OECD's proposal in 1997 of a Multilateral Agreement on Investment,[8] have had no success.

Starting in the 1980s, the relations between the two areas of the world have progressively improved, showing a higher desire for co-operation due also to a better understanding of the reciprocal requirements and objectives—the so-called North-South dialogue. However, the uncertainty of the principles of customary international law applicable to foreign investment, coupled with the limited legislation on the subject enacted by certain developing countries, have reduced the legal security needed by private investors, thus channelling the flow of investment to countries where such security was best assured by the local legislation or where the same could be obtained through direct contractual arrangements.

III. National and International Protection Instruments

The failure of multilateral instruments and the need to ensure a higher standard of protection for private investment have led industrialized countries to favour a policy of State-to-State relations. Thus, since the mid-1990s the number of BITs has increased so that they have now reached the level of about 1,500, with some 180 States being contracting parties.[9] In addition, multilateral instruments in the field of investments have been concluded at regional level, such as the Association of South-East Asian Nations (ASEAN) Agreement for the Promotion and Protection of Investments of 17 December

[6] S.K.B. Asante, *Restructuring Transnational Mineral Agreements*, AJIL, 1979, pp. 335 *et seq.*: "A long term investment agreement spelling out comprehensively the relations between the government and the corporation in respect of the development and marketing of natural resources and specifying all relevant fiscal arrangements is anything but a private contract."

[7] Such as the 1976 Declaration on International Investment and Multinational Enterprises, followed by the 1991 Decision on National Treatment.

[8] G. Sacerdoti, *Bilateral Treaties and Multilateral Instruments on Investment Protection*, Martinus Nijhoff, The Hague, 1997, p. 292.

[9] The text of these treaties is published in ICSID, *Investment Promotion and Protection Treaties*, looseleaf, 1983- . For BITs practice, see Dolzer and Stevens, *supra*, footnote 1.

1987, the North American Free Trade Agreement (NAFTA) of 17 December 1992, the Common Market of the Southern Cone (MERCOSUR) under the Treaty of Asunción of 26 March 1991 and the Energy Charter Treaty of 17 December 1994.[10]

This detailed and complex legal framework for the encouragement and protection of international investments is completed by the two fundamental conventions adopted under the auspices of the World Bank—the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) of 1965[11] and the Multilateral Investment Guarantee Agency (MIGA) Convention of 1985[12] establishing a scheme for insuring foreign investments against political, currency and other risks.

At national level, since the mid-1980s, some 65 States have enacted laws for the encouragement and protection of foreign investments in their territory.

These various instruments, both international and national, provide on the whole a rather broad protection to foreign investment, the States' aim being that of encouraging the flow of capital, technology and other assets into their territory. Although a great number of these protective measures now follow a consolidated pattern and are similar in their formulation, the competitive environment brought about by the States' desire to promote and encourage investments explains some significant variations.[13]

IV. The Investment Contract

With the detailed national and international regulation of private investment characterizing the current status of relations between the industrialized world and the developing countries, one might wonder to what extent further guarantees have to be provided by the individual investment contract. Various considerations have to be borne in mind by the foreign investor when evaluating whether such additional protection is truly required.

The first issue to be investigated by the private investor is whether its national State has concluded a BIT with the State in the territory of which it plans to make the investment and, if so, what are the provisions of the BIT in question. In the absence of an applicable BIT (or of other measures at public international law level), the protection required by the private party for its investment will obviously be the highest.

[10] For an overview of these and other multilateral investment instruments, see A.R. Parra, *Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investments*, ICSID Rev.-FILJ, 1997, p. 287, at pp. 290 *et seq.*

[11] On 31 December 2000, 133 States were parties to the ICSID Convention.

[12] On 31 December 2000, 154 States were parties to the MIGA Convention.

[13] Thus, some BITs also cover investments made prior to their entry into force or provide for methods of despite settlement superseding any different agreement entered into by the parties on the subject, or for different methods of calculating compensation due in case of nationalization or expropriation of the investor's assets.

The situation will not be significantly different in the eyes of the investor in cases where the host country has enacted legislation governing private business activity and providing for some measures of protection of foreign investment. Especially where the country may be subject to political instability, the risk faced by long-term investments is not diminished by a legislation which could undergo changes in the future.

The need in such cases of strong contractual guarantees, capable of effective enforcement, is understandable. It would be a matter of negotiations with the State, based on the parties' respective bargaining power, to agree in the investment contract on the most suitable provisions.

In identifying areas where protection is felt to be required, the private investor should be guided by a realistic approach. Even if desirable, not every and all risk aspects encompassed by a long-term investment may in the end prove to be insurable under the investment contract. Priorities have therefore to be initially established regarding areas to be considered and the extent of protection to be provided for each.

In conducting this initial analysis the private investor will be guided by various considerations. Precedents established by the host country with regard to similar transactions concluded with other investors are one such consideration. The investor may try to raise the level of protection by invoking the specific characteristics of its investment in terms of duration, risk and size.[14] However, the unwillingness of the host State to concede more than what it has previously accorded to other investors is to be taken into account. As a matter of fact, such other investors may enjoy under their contracts the right to invoke the most favourable treatment accorded to future investors under similar agreements.

Another consideration is offered by the existence of a national or international insurance scheme against risks that may be incurred by national investors, depending on the country of the investment.[15] The availability of such type of protection may induce the private investor to adopt a more flexible approach in the search for contractual guarantees, to the extent that the risk deriving from the absence may be covered through one of these alternative methods. When making this kind of assessment, however, the investor should consider that the more its investment is contractually guaranteed, the easier and less expensive (in terms of premiums to be paid) it may be to obtain the relevant national or international insurance coverage.

The investment contract may usefully record the host State's confirmation that the particular investment project qualifies for the purpose of application of the BIT.

[14] In this respect, the experience of petroleum companies in their dealings with developing countries for the conclusion of petroleum exploration and development agreements appears significant. Useful precedents for such agreements, on a country by country basis, are published in *Basic Oil Laws and Concession Contracts*, Barrows Co., New York, continuing publication.

[15] At national level, reference may be made to insurance schemes administered by Sace in Italy, Coface in France, Hermes in Germany, OPIC in the United States, and the like. At international level, the MIGA Convention provides for a similar coverage scheme.

Although the more recent BITs are extremely broad in their coverage of investments,[16] it may prove convenient to bring the contractual provisions and the protection afforded by them within the frame of the BIT, thus binding the host State to grant to the investor the increased protection provided by an international instrument. This is made possible whenever a BIT includes a reference to contractual protection, thus extending the scope of its provisions to the State's obligations under an investment contract.[17]

V. Areas of Contractual Protection

A complete inventory of the areas which, depending also on the political and economic conditions of the host country, may be considered by the private investor as particularly sensitive in terms of potential risk would be beyond the purposes of this contribution. It is sufficient to identify those areas in which investors are normally more eager to obtain adequate guarantees.

A. *Stabilization Clauses*

The most important of the contractual guarantees is meant to secure that no changes will be introduced in the State's legislative or administrative framework which might adversely affect, to a significant extent, the economic return on the investment as originally forecast or, more generally, the investor's ability to continue to operate in the country according to the agreed conditions. The risk against which adequate protection should be contractually assured is not limited to increases in the State's overall fiscal take, in terms both of a higher tax rate and of non-deductibility (or more limited deductibility) of previously accepted tax-deductible items of costs. A similar risk will be incurred should the State (or any of its constituent subdivisions) impose restrictions on the investor's ability to charge tariffs for the use of facilities it has built (or acquired through its investment) during the agreed period of exploitation[18] or on the investor's ability to export natural resources it has discovered or the production obtained from the plant it has built in the country.

In these and other cases evidenced by the practice, the protection is in general ensured by a contract stipulation (the "stabilization" clause) by which the State undertakes to exempt the investor from changes it may introduce in its legislation or from administrative measures of a general application whenever their effect would be to significantly reduce the economic return expected from the investment.

[16] Parra, *supra*, footnote 10, p. 294.

[17] This is the case of BITs concluded by Germany. Other BITs prescribe that each party has to "observe any obligation it may have entered into with regard to investments"; U.S.A.–Argentina BIT of 14 November 1991, Article II 2(c).

[18] As in the case of a build-operate-transfer (BOT) transaction allowing the investor to recover the investment made in building a given facility for the State, such as a factory or a highway, by charging a price for the factory products or a tariff for the use of the highway.

B. *Renegotiation Clauses*

The binding character on the State of stabilization clauses (as well as of other clauses developed by the practice of investment contracts which have a similar effect) may be doubtful, considering that a State may not waive or limit sovereign prerogatives, the exercise of which is instrumental to pursuing the country's public interest. As an alternative to a stabilization clause, and in view of the public-law nature of the investment contract, renegotiation may offer a satisfactory protection against the unilateral revocation or modification of the contract by the State.[19]

By undertaking to renegotiate the contractual terms and conditions in case of supervening circumstances of any kind, including new legislative or regulatory measures, the State binds itself to conduct good faith negotiations with the private investor with the view of maintaining the economic equilibrium of the agreement as originally stipulated. An essential component of this type of provision is the granting to the international arbitrator of the power to determine the new economic equilibrium should the parties fail to find an agreement in this regard within a specified time-limit.

C. *Nationalization or Expropriation Measures*

As a part of the stabilization clause, or under a separate provision, the State may accept to guarantee the private investor against measures of nationalization, expropriation, confiscation or other actions of a similar nature and effect, whether taken by the central authority or by a political subdivision. This is certainly the most delicate stipulation of an investment contract, insofar as the State's ability to bind itself, presently and for the future, not to exercise a right which is held to be "inalienable" and subject to the State's "permanent sovereignty"[20] may be questionable.

The effect of this kind of stipulation, if held valid by the adjudicatory authority (be it a State court or the international arbitrator), has in some cases brought about the non-application of any such measures and an order allowing the private investor's activities in the country to continue according to the originally agreed terms, even if the *restitutio in integrum* so ordered may be at odds with the State's sovereignty over its territory.[21]

[19] Should the investment contract be concluded with a State-owned entity, rather than with the State itself, the guarantee usually takes the form of that entity's undertaking to indemnify the private investor for any loss it may suffer as a result of legislative changes or administrative measures or, alternatively, to renegotiate the economic terms of the contract to restore its original equilibrium. See Piero Bernardini, *The Renegotiation of the Investment Contract*, F.I.L.Y., 1998, pp. 411 *et seq.*

[20] See the UN Resolutions cited *supra*, footnote 5.

[21] The *restitutio in integrum* was ordered by Professor Jean-René Dupuy as sole arbitrator in the *Texaco Overseas Petroleum Company and California Asiatic Oil Company v. The Libyan Republic* case. This order followed a declaration that the nationalization of the foreign company's assets was invalid by reason of its non-compliance with public international law standards; the Award of 19 January 1977 is published in International Council for Commercial Arbitration, *Yearbook Commercial Arbitration*, Vol. IV, 1979, pp. 177 *et seq.*

D. *Transfer of Funds*

The guarantee regarding the investor's right to transfer abroad all earnings and payments accruing by reason of its investment is also of great importance. It would, in effect, be contrary to the very purpose of the investment operation—that of obtaining an economic return during the stipulated period of time—if the yearly profits and other payments received by reason of the investment would have to remain in the country to be reinvested there.

In addition to providing for the transfer abroad of funds earned or received by the investor, the relevant clause of the investment contract normally recognizes the investor's unrestricted right to open and maintain bank accounts in convertible currency, both in the host country and abroad, the availability of the necessary amounts in convertible and freely transferable currencies and the right of the investor's employees, contractors and suppliers to remit abroad, in freely convertible currency, their earnings.

E. *Governing Law*

A further provision frequently found in investment contracts addresses the fundamental issue of the governing law. Through this clause, the investor seeks protection against the risk that the State, sovereign in its country and over its territory, may change its own laws to the detriment of the investor's rights and legitimate expectations (*aléa de la souveraineté*). Hence, the objective is to remove the contract in question from the reach of the host State's laws by making it subject to either a third State's legal system or to other rules (such as "general principles of law", "general principles of law recognized by civilized nations", "principles of law common to the investor's national State and to the host State" or to public international law) with the effect, as already mentioned, of denationalizing or internationalizing the investment contract.[22]

Today, denationalization techniques are more and more replaced by clauses making both the host State's law and rules of public international law applicable at the same time. The most authoritative reference in this field is Article 42(1) of the ICSID Convention, providing that:

> "The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable."

[22] For an analysis of the law applicable to State contacts, see Piero Bernardini, *The Law Applied by International Arbitrators to State Contracts*, in *Liber Amicorum Karl-Heinz Böckstiegel*, Carl Heymanns Verlag, Köln, 2001, p. 51, and authorities cited therein.

The governing-law clause of an investment contract needs to be co-ordinated with the provisions of the applicable BIT. In fact, BITs more frequently contain principles and rules directed at assuring a better protection to foreign investment with a view to stimulate the flow of private capital and the host State's economic development.

Provisions of the applicable BIT concerning the "fair and equitable treatment" and the "full protection and security" to be accorded to the investment or the prohibition of "arbitrary or discriminatory measures" or the payment of a "prompt, adequate and effective compensation" or a compensation equivalent to "the fair market value" in case the investment is nationalized or expropriated, being established by an international treaty, take precedence over any contrary provisions of the applicable State law or may have the effect of supplementing the latter's provisions in case of *lacunae*. They shall have to be taken into account by the ICSID (International Centre for Settlement of Investment Disputes) arbitrator as "rules of international law" referred to by Article 42(1) of the ICSID Convention, whatever the rules of law chosen by the parties, since they normally reflect principles of customary international law. They have to be applied, in any case, as part of the host State's legal system whenever the latter is applicable, the BIT's provisions being part of such system as a result of it coming into force between the host State and the State of nationality of the investor.

The emergence of these new principles and rules, reflected by BITs, imposes on the international arbitrator a new challenge. He or she should be able to give a meaningful content to the often general formulation of such principles and rules when applying them to the particular circumstances of the case while, at the same time, harmonizing them with the provisions of the applicable legal system, be it chosen by the parties or determined by the arbitrator.

F. *Arbitration*

The importance of international arbitration as a method of settling disputes arising under an investment contract is evidenced by the preceding reference to arbitral awards having given effect to parties' various stipulations in the field of governing law. In the order of priorities which any good negotiator for the private party should establish regarding guarantees to be obtained from the State as its counterpart, a provision making sure that any dispute in connection with the investment contract will be adjudicated in a neutral forum acquires a definite importance.

The exclusion of the State courts' jurisdiction in favour of arbitration has historically raised a certain number of problems. Firstly, as shown by the principles prevailing in those legal systems which are rooted in the Napoleonic Code, the capacity of States or State-owned entities to validly conclude arbitration agreements was for a

long time prohibited.[23] In other States, the conclusion of an arbitration agreement by a public entity was made subject to parliamentary approval[24] or to authorization by the Council of Ministers.[25]

A second obstacle was represented by the traditional State privilege regarding its immunity from the jurisdiction of other States' courts (*par in parem non habet jurisdictionem*). A development has occurred in this field based on the consideration that, since the State may waive such immunity, a waiver is to be deemed as having been made implicitly whenever the State accepts an arbitration agreement.

The new climate of relations prevailing in the more recent phase in the field of investments between private parties and States or State-owned entities has been strengthened by important international instruments sponsored by the World Bank and largely accepted by States having the most varied political, social and legal backgrounds and culture. Reference is made once again to the MIGA Convention and, more specifically, to the ICSID Convention. The latter instrument has established a mechanism for the settlement of disputes in the field of investments by creating an authority—ICSID—for the administration of the relevant proceedings between States or State-owned entities and private investors under its own arbitration rules. Considering that this regulation finds its source in an international treaty and that the system so established is wholly independent of any State legal order and is self-sufficient, the extraordinary number of Contracting States of this Convention is not surprising. It is likewise not surprising that most of the modern BITs make reference to this instrument, often as an alternative to other international arbitration rules, such as those of the United Nations Commission on International Trade Law (UNCITRAL) or of the ICC Court of International Arbitration, for the settlement of disputes between investors and host States.

BITs' provisions in the field of dispute settlement through international arbitration represent an effective protection of the investment. This may run the risk not only of the host country's political instability and of the State's intervention through various regulatory measures (ranging from the revision of the contractual term to the nationalization or expropriation of the investor's assets) but also that of being subject, in

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[23] Such capacity was recognized for the first time at international level by the Geneva Convention on International Commercial Arbitration of 1961, ratified also by States where the prohibition in question was well-established (France, Belgium). Article II(1) of the Convention provides that "legal persons considered by the law which is applicable to them as 'legal persons of public law' have the right to conclude valid arbitration agreements." Possibly under the thrust of this Convention, the French Supreme Court in 1965 recognized the capacity of States to conclude arbitration agreements in the field of international trade (*arrêt Trésor Public v. Galakis* of 2 May 1966, JCP, 1966, II, 14798).

[24] Iran, Constitution of 15 November 1979, Article 139: "The resolution of disputes concerning State property, or the submission of such disputes to arbitration, shall in each case be subject to approval by the Council of Ministers and must be notified to Parliament. Cases in which one party to the dispute is foreign, as well as important domestic disputes, must also be approved by Parliament." See Philippe Fouchard, Emmanuel Gaillard, and Berthold Goldman, *On International Commercial Arbitration*, Kluwer, Deventer, 1999, pp. 314–315.

[25] Saudi Arabia, Council of Ministers, Resolution No. 58 dated 25 June 1963 and Resolution No. 164 of 4 April 1983 approving the Arbitration Regulation (Article 3). For a commentary, see *ICCA International Commercial Arbitration*, Saudi Arabia, Suppl. 17, pp. 9–10.

case of disputes, to the jurisdiction of the local courts. Having to adjudicate claims brought against their own State, the latter may hardly be able to resist the political pressure inherent in this situation.

By providing for international arbitration in the BIT with the State of the investor's nationality, the host State binds itself, under threat of being exposed to the other State's claim for breach of an international obligation, to accept the arbitration mechanism chosen by the investor out of the various alternative methods provided by the BIT. The chosen method will apply to the settlement of disputes arising out of or relating to the investment contract or the investment authorization granted by the State's foreign investment authority or of an alleged breach of contractual obligations entered into with regard to an investment which the State has accepted to guarantee under the BIT.[26]

On the other side of the relationship is the private investor, whose rights, as well as the host State's corresponding obligations, relating to the investment are spelled out either in the investment contract or in the investment authorization granted pursuant to the local investment law and regulation. Should the host State breach any of its obligations, the foreign investor may, at that point in time, accept such State's offer of binding international arbitration by filing a request for arbitration according to the rules of arbitration it has elected to apply out of the various alternatives proposed in the BIT.[27]

The methods of dispute settlement provided by modern BITs include, in the first place, a reference to the ICSID Convention or should one of the Contracting States not be a party to that Convention, to the ICSID Additional Facility Agreement and, as alternatives, to the UNCITRAL Arbitration Rules or the ICC International Court of Arbitration Rules.[28] The choice of the method to be applied in the particular case is normally left to the private investor.

Considering this rather favourable set-up of principles governing investment dispute settlement, one might be led to believe that nothing or very little is left to additional regulation under the investment contract. In order to establish if and to what extent additional provisions have to be contemplated by such contract, consideration should be given to the fact that, under the BITs, disputes to be referred to arbitration are in principle only those arising out of an alleged (by the private investor) violation of one or more of the obligations undertaken by the State under the BIT in question. This means that only "treaty claims" may be brought before the arbitration tribunal appointed in accordance with the relevant provisions of the applicable BIT. Disputes arising out of the investment contract or under any other contract concluded by the

[26] Examples of this kind of provision are offered by the BITs referred to *supra*, footnote 17.
[27] For a review of this method of concluding an arbitration agreement, see Jan Paulsson, *Arbitration without Privity*, ICSID Rev.–FILJ, 1995, pp. 232 *et seq.*
[28] This is the case of the United Kingdom's model treaty; see Dolzer and Stevens, *supra*, footnote 1, p. 148.

investor with the host State (contract claims) have to be settled in accordance with the particular settlement method provided by any such contract.[29]

In order to avoid that contract claims and treaty claims, often inextricably connected, be adjudicated through different settlement methods, it is necessary for the parties to achieve a co-ordination between these various methods. This objective may be attained either by providing in the investment contract for exactly the same arbitration agreement as is contemplated by the BIT or, alternatively, by confirming in the investment contract that the protection afforded by the BIT, including its arbitration provisions, extends to the obligations undertaken by the State in such contract so that the dispute arising out of their breach may be settled by the method provided for by the BIT.

In the former case, although formally two separate arbitration proceedings should be implemented to adjudicate contract claims and treaty claims respectively, there should be no difficulty in consolidating these different claims in one proceeding, considering the identity of the parties involved. In the latter case, contract claims are at the same time also treaty claims, and the dispute settlement method applicable thereto is only one—that provided by the BIT.

In addition, the investment contract might make other provisions to regulate certain aspects of the arbitration agreement which are not covered by the BIT, such as number of arbitrators and their qualifications, language, seat of the proceeding and specific procedural aspects.

VI. CONCLUDING REMARKS

The analysis which has been presented here reveals how important and far-reaching may be the negotiation of the terms and conditions of the investment contract. This represents a challenge for the investor's counsel. He should be capable of reconciling the requirements he believes should be satisfied through the contract in order to ensure a better protection to this client's investment with the latter's objective of concluding the contract without losing too much time at the negotiating table, particularly in the case negotiations develop in a competitive environment.

The higher the level or protection assured by international instruments to the private investment, the less acute shall be the need for the individual contract to make sure that the foreign party's legitimate expectations of an effective return on its investment are reasonably satisfied.

[29] It may happen that the investor-State relationship is governed by a contract providing for the settlement of disputes by the local courts, while the applicable BIT, sometimes entered into force at a later date, provides for dispute settlement by international arbitration.