Endangered Element of ICSID Arbitral Practice: Investment Treaty Arbitration, Foreign Direct Investment, and the Promise of Economic Development in Host States

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ENDANGERED ELEMENT OF ICSID ARBITRAL PRACTICE: INVESTMENT TREATY ARBITRATION, FOREIGN DIRECT INVESTMENT, AND THE PROMISE OF ECONOMIC DEVELOPMENT IN HOST STATES

By: Felix O. Okpe*

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Abstract

The omission to define the term "investment" in the ICSID Convention is one of the most critical decisions that has led to inconsistent jurisprudence and the resulting debate regarding the propriety of the ICSID Convention and investment treaty arbitration. The legislative history and the circumstances leading to the birth of the ICSID Convention strongly suggest that its main objective is the protection and promotion of economic development in the host State. Most of the propositions aimed at giving a meaning to the term "investment" in ICSID arbitral practice have focused more on whether the scope of the meaning of "investment" should extend to any plausible "economic activity or asset." The focus of this approach is flawed. It has relegated the element of "contribution to economic development" of the host State to the back seat of investment treaty arbitration. This article challenges this relegation as historic to the ICSID Convention. The article argues that from the standpoint of the host State, the ICSID Convention is meaningless if the analysis of the relationship between FDI and investment treaty arbitration excludes considerations of economic development in view of the omission in the ICSID Convention. The article hinges this argument on the implication of international development as the main foundation of the ICSID Convention. The article acknowledges the difficulty that may be associated with the determination of an "investment" that contributes to economic development, but contends that relegating the element of "contribution to economic development" to the back seat of investment arbitration is contrary to the main objective of the ICSID Convention in host States.

INTRODUCTION

The jurisdiction of ICSID arbitration is regulated by Article 25(1) of the ICSID Convention. The gateway to ICSID arbitration and

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practice is, more often than not, determined by the meaning that may be ascribed to the term “investment,” pursuant to the ICSID Convention and the applicable investment agreement governing the investment dispute. In other words, the jurisdiction of ICSID arbitration depends on the answer to the question whether or not the foreign investment that led to the investment dispute arbitration is an “investment” in line with the ICSID Convention. ICSID arbitral practice has recognized and applied certain elements in the determination of an “investment” because the term is undefined in the ICSID Convention. In spite of the considerable consensus on certain elements that have been applied by arbitral practice in the determination of the meaning of “investment,” the jurisprudence of ICSID, which includes scholars, academics, and ICSID arbitral tribunals, are split on the definition of “investment.” Part of the debate revolves around the question of whether there should be a separate consideration of “contribution to economic development” of the host State of FDI as an element or characteristic of the meaning of an “investment” as the term is understood in the context of investment treaty arbitration in ICSID arbitral practice. However, the debate and propositions for a broader meaning of

The jurisdiction of the Center shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Center by that State) and a national of another Contracting State, which the Parties to the dispute consent in writing to submit to the Center. When the parties have given their consent, no party may withdraw its consent unilaterally.


3 See, e.g., David A. R. Williams & Simon Foote, Recent Developments in the Approach to Identifying an “Investment” Pursuant to Article 25(1) of the ICSID Convention, in Evolution in Investment Treaty Law and Arbitration 42, 47-48 (Chester Brown et al eds., 2011). (The authors addressed the piecemeal approach to identifying an “investment” pursuant to the ICSID Convention. They observed that “...the progressive development of international investment law on the topic of investment has led, perhaps inevitably, to piecemeal and sometimes inconsistent approaches to determining whether there is an investment as the term is used in Article 25(1)”.

4 Christoph H. Scheuer et al., The ICSID Convention: A Commentary 133 (2009). See also Salini Costruttori S.P.A and Italstrade S.P.A v. Kingdom of Morocco, ICSID Case No. ARB/00/4, Decision on Jurisdiction, (Jul. 29, 2001), 6 ICSID Rep. 400 (2004). The Salini ICSID Tribunal espoused what is now commonly known as the “Salini Criteria” in determining what constitutes of an “investment” in the context of the ICSID Convention. The decision of the Tribunal contributed immensely to the intellectual foundation of the debate over the meaning of “invest-
“investment,” without a consideration of whether the investment contributes to the economic development of the host State, forgoes a critical objective of the ICSID Convention. In this respect, the proponents appear to be more concerned with extending the meaning of “investment” to include any conceivable economic activity in the host State. The analysis in this article is focused on the element of “contribution to economic development” from the standpoint of what may be considered the main objective of the ICSID Convention and the legitimate expectation of host States in ICSID arbitration and international investment law. In carrying out the tasks in this article, it is pertinent to briefly comment on the concept of law and international development. An analysis of the relationship between law and international development may be utilized in understanding the circumstances and considerations that led to the negotiation and ratification of the ICSID Convention.

It has been argued that the rule of law with reference to development “has become significant not only as a tool of development policy, but as an objective for development policy in its own right.” This article questions the mechanism of investment treaty arbitration and

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5 See, e.g., Julian D. Mortenson, Quiborax SA et al v Plurinational State of Bolivia: The Uneasy Role of Precedent in Defining Investment, 28 ICSID Rev. 254 (2013) (arguing that Article 25 of the ICSID Convention “should properly be understood to reach any plausible economic activity or asset”).

6 In the context of investment treaty arbitration, investment disputes may arise from the violations of foreign investment agreements or contracts as a result of the interference or the omission of the host State to act in a manner envisaged by the applicable legal regime or international investment agreements.

Foreign Direct Investment (FDI) in the context of the protection and promotion of foreign investment within the framework of the ICSID Convention. The ICSID Convention is part of an international mechanism for the arbitration of investment disputes negotiated by sovereign States to promote and protect foreign investment for economic development.

It is appropriate to note that economic development is the outcome of a successful relationship between law and economics. For example Clarke, Murrell, and Whiting have argued that China's economic development and transformation success can be traced to the important role and process of law. These commentators find support in Justice Ocran who, writing extra-judicially, posited that the study of law and development should be consciously used to meet the challenges of economic development. The process of economic development involves the interplay of law and economics that impact the quality of life and infrastructural development of a sovereign State. Promoting and sustaining the economic development of a State challenges the political and economic activities of all sovereign States.

Indeed, the phenomenon of globalization continues to make economic development a major challenge in developing countries. Developing countries strive to catch up with global economic development through the creation of international wealth for the benefit of its citizens and the international economy. The recent economic downturn in the United States, spreading to Europe and other parts of the world, stands as a testament to the reality of the inter-connectivity of the

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8 ICSID Convention, supra note 1.
12 Id.
14 See Robert Pritchard, The Contemporary Challenges of Economic Development, in Economic Development, Foreign Investment and the Law 1, 3 (Robert Pritchard ed., 1996) (arguing that "[a]ll countries aim to be as 'sovereign' and economically self-sufficient as they can possibly can. They have a need therefore for domestic financial institutions and mechanisms to encourage the highest possible level of domestic savings and to develop efficient domestic capital markets . . .")
global economy. From a legal perspective, the process of economic development makes the relationship between law and development relevant to the challenges of economic development.

The reference to law in the context of this article implies the combination of efficient domestic and international laws including statutes, systems, international norms, and treaties that are designed to promote and sustain economic development. The thesis of Trubek and Santos states that the theory of law and development ought to be examined as “the intersection of current ideas in the spheres of economic theory, legal ideas, and the policies and practices of development institutions.” In spite of the recognition of some scholars of the relationship between law and development, there is still considerable debate on the actual role of law in economic development, particularly with reference to international economic development. In other words, there is no consensus on the precise nature of the relationship between law and development. Pritchard puts the issue this way, “[d]espite the consensuses which have emerged on many of these issues [economic development and foreign investment] the development process remains something of an international intrigue . . . many of the cast of this intrigue are very suspicious of each other.”

However, this article hypothesizes that the place and role of law cannot be divorced from the process of economic development because law and development are mutually reinforcing factors. According to Morgan, “[t]he relationship between law and development, in the context of an integrated global economy, has moved from a niche area of study to an increasing central location in scholarly inquiry over the past several decades.

The intrigue complained about by Pritchard may be unraveled by the progressive development or reform of the international norms, systems, or laws that interpret the process and the factors that impact

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15 The reference to development in this article is in the context of economic development.
16 Trubek & Santos, supra note 7, at 4.
17 See generally, Poverty and the International Legal System: Duties to the World’s Poor (Krista N. Schefer ed., 2013); Sustainable Development in World Investment Law (Marie-Claire C. Segger et al. eds., 2011); Governance, Development and Globalization: A Tribute to Lawrence Tsushima (Julio Faundez et al. eds., 2000); and International Law and Development (Paul De Waart et al. eds., 1988).
18 Trubek & Santos, supra note 7, at 5.
19 Pritchard, supra note 14, at 4. The cast of the intrigue referred to by Pritchard comprises foreign investors and the host State with respect to the relationship between law and economic development.
economic development. Economists believe that one of the factors that can influence and contribute to economic development is FDI in the territory of the host nation.\textsuperscript{21} Most developing countries solicit FDI to attract foreign capital that will, in turn, contribute to the economic development of the domestic economy.\textsuperscript{22} Put simply, FDI is the acquisition of assets, the transfer of capital, or the direct participation by a foreign investor in the economic activities of the host State.\textsuperscript{23} FDI inflows into developing countries in Africa and Asia have increased since the 1980s.\textsuperscript{24} The legal regime regulating FDI facilitates access to international markets, higher exports, and a means of importing foreign capital into the local economy. It is intended to create employment and impact infrastructural development of the host economy.\textsuperscript{25} In other words, the inflow of FDI contributes to economic development. One reason for the need and increase of FDI to developing countries is that, regardless of the abundance of human and natural resources in these countries, these countries lack the necessary capital and technology to promote economic activities that can effectively develop the domestic economy.\textsuperscript{26} The emergence and the interaction of the variables of FDI, investment treaty arbitration, and economic development in the paradigm of international investment law, is the product of the need to create a system of international law to attract investment to developing countries as a means to advance economic development.\textsuperscript{27} As a result, the improvement of the international investment climate through the protection of foreign investment became one of the principal objectives

\textsuperscript{21} Vintila Denisia, \textit{Foreign Direct Investment Theories: An Overview of the Main FDI Theories} 3 EUR. J. OF INTERDISC. STUD. 53, 53-59 (2010).

\textsuperscript{22} See Emma Ujah, \textit{Foreigners Invest $20 Billion in Nigeria within 3 Years-Okonjo-Iweala}, \textit{Vanguard}, Nov.12, 2013, at 16. (Ujah reported, quoting Nigeria’s coordinating Minister for the Economy, Dr. Ngozi Okonjo-Iweala, that Nigeria’s effort at attracting FDI has been successful in the last 3 years with the country up USD$20 billion investment through FDI within the last 3 years); \textit{see also} A. Ode, \textit{The Robust Nigeria’s Foreign Policy (2)}, \textit{GUARDIAN}, May 16, 2013 at 84. (Ode is the spokesperson for Nigeria’s Ministry of Foreign Affairs. Ode explained that “[i]n a bid to encourage and promote inflow of FDI into the country, Nigeria has signed bilateral agreements and MOUs with several countries in the areas of trade, technology cooperation, ICT, education, culture/tourism, etc.”).


\textsuperscript{24} See \textit{FOREIGN DISTRICT INVESTMENT IN SUB-SAHARAN AFRICA: ORIGINS, TARGETS, IMPACT AND POTENTIAL 1-2} (S. Ibi Ajayi ed., 2006).

\textsuperscript{25} See Denisia, \textit{supra} note 21, at 104.

\textsuperscript{26} \textit{Id.}

\textsuperscript{27} See Andreas F. Lowenfield, \textit{INTERNATIONAL ECONOMIC LAW} 536 (2nd ed. 2008).
of international investment law. Accordingly, the World Bank created a Multilateral Investment Guarantee Agency (MIGA) as an incentive to attract private international investment for the purpose of promoting economic development in developing countries. To be clear, the protection of foreign investment is based on the theory that the protection of foreign investment will encourage private international investment in developing economies. In what appears to be tacit support of this theory, the World Bank also initiated a concerted effort to design and establish a mechanism for international arbitration of investment disputes between State Parties and foreign investors. The investment treaty arbitration mechanism initiated by the World Bank was created through the successful negotiation of the ICSID Convention. The tasks of this article are hinged on the theoretical assumption that "host States" connotes developing countries that offer investment arbitration in exchange for FDI into their domestic economies. The underpinnings of the ICSID Convention were designed to enable developing countries to give assurances for the settlement of investment disputes through arbitration in order to attract private international investments. This article analyzes the matrix of FDI and contribution to economic development in investment treaty arbitration under the ICSID Convention with reference to the jurisprudence of ICSID arbitral practice. Parts II-III of the article are devoted to the examination of the history of the ICSID Convention through a critical analysis of the travaux preparatoires and the law applicable in ICSID arbitration. In Part IV, the article argues that the mechanism for investment treaty arbitration attracts FDI. This connection between FDI and investment treaty arbitration calls for an independent consideration of contribution to economic development imperative in arbitral practice with respect to the ICSID Convention. Part V examines the classical theory of FDI as the intellectual foundation of why "contribution to economic development" should be the core element in investment treaty arbitration.

The article hypothesizes that the purpose of the ICSID Convention is the protection and promotion of foreign investment for economic

development in host States. Accordingly, it draws inferences from the classical theory to theorize that economic development is the fundamental objective of FDI and the legitimate expectation of host States with respect to the ICSID Convention. Part VI reviews the decisions of the SGS Cases with reference to the definition of “investment” as the term is understood under the ICSID Convention. This part of the article advances the argument that “contribution to economic development” should be the core element in investment treaty arbitration in the context of the ICSID Convention. In conclusion, the article acknowledges the difficulty that may be associated with the determination of an “investment” that contributes to economic development, but contends that relegating the element of “contribution to economic development” to the back seat of investment treaty arbitration endangers the main objective of the ICSID Convention in host States. This endangerment could generate dissatisfaction among hosts States against the ICSID Convention.

I. A BRIEF HISTORY OF THE ICSID CONVENTION AND THE PROMISE OF ECONOMIC DEVELOPMENT

At the end of the Second World War, there was a worldwide need to promote policies and programs that could spread international development, particularly in less developed countries in the third world. The attainment of political independence by third world countries from colonial masters that included Great Britain, France, Belgium, Portugal, and Spain also made international development imperative in developing countries. Against this background, the United Nations commissioned a report by the Secretary General on the international flow of private capital pursuant to Resolution 622 C (VII) passed in 1952. Taking note of the findings of this report, this august body consequently passed a Resolution to promote the international flow of private capital for the economic development of underdeveloped countries at its 510th Plenary Meeting of 11 December 1954. This Resolution received overwhelming support from the international community. The U.N. passed the Resolution on the basis that the flow

33 The SGS Cases were better known for bringing the debate over the scope and interpretation of umbrella clauses to the fore of ICSID arbitration. Umbrella Clauses are provisions in BITs or investments agreements that create an international obligation on the host State to guarantee the observance of the investment contract it entered with the foreign investor. See generally, Jarrod Wong, Umbrella Clauses in Bilateral Investment Treaties: Of Breaches of Contract, Treaty Violations, and the Divide Between Developing and Developed Countries in Foreign Investment Disputes, 14 GEO. MASON L. REV. 135, 135-77 (2006).
of private international investment to host States contributes to economic development.\textsuperscript{36} The premise of the Resolution is that productive activities resulting from the international flow of private capital contributes to the standard of living and the development of human and natural resources.\textsuperscript{37} The Resolution confirmed, "the flow of private investment has not been commensurate with the needs in those areas where rapid development is essential for economic progress."\textsuperscript{38} Based on the necessity of attracting foreign investment for proportionate international economic development, the Resolution recommended that countries seeking foreign investment should:

(a) Re-examine, wherever necessary, domestic policies, legislation and administrative practices with a view to improving the investment climate; avoid unduly burdensome taxation; avoid discrimination against foreign investment; facilitate the import by investors of capital goods, machinery and component materials needed for new investment; make adequate provision for the remission of earnings and repatriation of capital
(b) Develop domestic and foreign information services and other means for informing potential foreign investors of business opportunities in their countries and of the relevant laws and regulation governing foreign enterprise.\textsuperscript{39}

In what may be a confirmation of the purpose of creating a viable international investment climate for foreign investment as stated above, the Resolution declared that "in order for new foreign investments to be an effective contribution to the economic development of the under-developed countries, it is advisable to take into account, among other things, the situation with regard to previously established enterprises so as not to affect their normal development with the national interest."\textsuperscript{40} Furthermore, under Paragraph 1 (a-c), the Resolution recommended policy initiatives that might encourage and protect foreign investment in the territory of the host State.\textsuperscript{41} Admittedly, it appears that the declaration in Paragraph 5 of the Resolution points to the overall responsibility and purpose of foreign investment.\textsuperscript{42} This perspective may be justified by Article 1's apparent reference to and emphasis of the economic growth of developing countries

\textsuperscript{36} Id.
\textsuperscript{37} Id.
\textsuperscript{38} Id.
\textsuperscript{39} Id. ¶ 1.
\textsuperscript{40} Id. ¶ 5.
\textsuperscript{41} Id. ¶ 1.
\textsuperscript{42} Id. ¶ 5.
as the natural consequences of the implementation of the recommendations under Article 1 (a-b).

A. Options and Limitations of the Settlement of Investment Disputes under Customary International Law

The Resolution passed by the United Nations significantly influenced the promotion of foreign investment through private international investment. It may have laid the foundation for the relationship of the variables of foreign investment and economic development. The efforts of the United Nations contributed to the principles of customary international law by regulating the principal actors in international investment law. However, the traditional principles of customary international law regulating foreign investment subjected foreign investors to various barriers in their home courts as well as in the courts of the host State of their investments. Foreign investors lacked legal standing under international law in host States. Since States are the traditional subject of international law, foreign investors must go through their home States' and host States' legal systems to settle foreign investment disputes. Also, as Judge Tomka rightly noted, under customary international law, a State is only responsible for a breach of an international obligation occasioned by an unlawful act inimical to the principles of customary international law. As a result, private disputes between foreign investors and State Parties became very difficult to pursue.

Some scholars suggest, under customary international law, that a State may assert sovereign immunity to restrict the jurisdiction or authority of a foreign court with respect to claims against the State or to protect that State's property against foreign enforcement measures. In a case where a State asserts sovereign immunity, a foreign investor has limited options to pursue foreign investment claims. Simi-

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43 Id. ¶ 5.
44 See Muchlinski, supra note 28, at 6. (Stating that “[t]he earliest legal rules concerning foreign investors and investment assumed a tripartite set of actors: the home state, the host, and the investor”).
45 Id.
46 Id.
47 See Peter Tomka, Are States Liable for the Conduct of Their Instrumentalities?: Introductory Remarks, in STATE ENTITIES IN INTERNATIONAL ARBITRATION 7, 8-9 (IAI Ser. on Int’l Arbitration No. 4) (Emmanuel Gaillard and Jennifer Younan eds., 2008).
48 See Christopher F. Dugan et al., INVESTOR-STATE ARBITRATION 11, 20 (2008) (The authors explained that the assertion of sovereign immunity by the host State is absolute to prevent foreign investment claims against the State Party).
larly, a foreign investor may also be denied legal process to assert investment claims based on the "act of state doctrine."\(^{50}\) Under this doctrine, the home State of the foreign investor denies the investor access to its court system on the ground that the cause of action is the act of a foreign state not subject to the jurisdiction of the investor's home state.\(^{51}\) Therefore, the only clear avenue for the foreign investor to pursue investment claims against foreign states is through diplomatic intervention, or what is generally referred to as "gunboat diplomacy."

Diplomatic intervention, or gunboat diplomacy, exists because of the international law obligation of States to protect alien property for the development of trade and investment in developing countries.\(^{52}\) In other words, this obligation under customary international law falls under the rubric of the "Responsibility of States for Injuries to Aliens."\(^{53}\) Gunboat diplomacy allows foreign investors to obtain relief in respect of foreign investment claims through their government diplomatic intervention or the use of armed force.\(^{54}\) Capital export countries mainly employ gunboat diplomacy in cases of expropriation of alien property or investments.\(^{55}\) However, gunboat diplomacy brings

\(^{50}\) See id.

\(^{51}\) See David L. Jones, *Act of Foreign State In English Law: The Ghost Goes East*, 22 VA. J. INT'L L. 433, 435-56 (1982) (discussing the rule of non-justiciability in the context of the act of a foreign State); see also Banco Nacional de Cuba v. Sabbatino, 176 U.S. 398, 436-37 (1964) (where the United States Supreme Court held, inter alia, in an expropriation case that: "However offensive to the public policy of this country and its Constituent States an expropriation of this kind may be, we conclude that both the national interest and progress towards the goal of establishing the rule of law among nations are best served by maintaining intact the act of state doctrine in this realm of its application.").

\(^{52}\) See Francis J. Nicholson, *The Protection of Foreign Property under Customary International Law*, 3 B.C. L. REV. 391, 391-93 (1965) (explaining that the development of international trade and investment created certain principles which placed an obligation on nations to protect the acquired property rights of foreigners).

\(^{53}\) Id.; see also Edwin M. Borchard, *Theoretical Aspects of International Responsibilities of States*, in *MAX-PLANCK INSTITUTE FOR COMPARATIVE PUBLIC LAW AND INTERNATIONAL LAW* 223, 224-30 (1929), http://www.zaoerv.de/01_1929/1_1929_1_a_223_250.pdf (discussing the theories and foundation of the international Responsibilities of State for injuries to alien property as a part of international law).


\(^{55}\) The allegation of expropriation of alien property or foreign investment against the host State is one of the most critical factors that define the nature of foreign investment disputes from the prism of investment treaty arbitration. Expropriation or nationalization of foreign investments in the territory of the host State is
limited succor to some foreign investors. There are notable examples, such as where the United States and France employed it on behalf of their foreign investors in Venezuela and Mexico respectively in the 1860s.

Recourse to gunboat diplomacy in order to settle foreign investment disputes requires foreign investors to prove that they exhausted all local remedies to no avail. A foreign investor may also have to prove citizenship to his home government. The exhaustion of local remedies subjected foreign investors to the jurisdiction of the legal system of the host State. On the exhaustion of local remedies, Borchard explains that “the government of the complaining citizen must give the offending government an opportunity of doing justice to the injured party in its own regular way, and thus avoid, if possible, all occasion for international discussion.” The foreign investor’s home State may refuse to directly seek relief on behalf of an investor for political reasons, regardless of whether or not the foreign investor has a good claim under international law. From the perspective of the foreign investor, subjecting investment claims to the jurisdiction of the host government may lead to a conflict of interest between the host government, the home government, and the foreign investor, thus creating an institutional bias. The conflict of interest between the foreign investor and the home State may also arise because of political expediency in the diplomatic relationship between the home State and the host State.

Salacuse has expressed the frustration of foreign investors this way:

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permissible under international investment law. However, it must be for a public purpose, in accordance with due process of law and payment of compensation. The payment of adequate compensation has, more often than not, been the bone of contention in cases where expropriation is alleged against the host State by the foreign investor. Expropriation may be direct or indirect. Expropriation may be considered direct and easily ascertained, where an allegation of the actual taking of the alien property or foreign investment in the territory of the host State can be sustained against the latter. See generally Homayoun Mafi, Controversial Issues of Compensation in Cases of Expropriation and Nationalization: Awards of the Iran-United States Claims Tribunal, 18 INT’L J. HUMANITIES 83-85 (2011).

56 DUGAN ET AL., supra note 48, at 27.
57 Id.
58 Id. at 30.
59 Id. at 32.
60 EDWIN M. BORCHARD, DIPLOMATIC PROTECTION OF CITIZENS ABROAD TO THE LAW OF INTERNATIONAL CLAIMS 817 (1925); see also DUGAN ET AL., supra note 48, at 30.
62 Id.
63 Id.
The potential for conflict among the three parties [the foreign investor, the host country and the home country] is ever present. In most instances, conflicts arising out of foreign investments, results in disputes between the investor on the one hand, and the host country government, on the other. The home country of the investor may become engaged at the encouragement or request of its national. In such conflicts, the host country often considers the dispute to be subject to the host country law and host country legal and judicial process . . . [the] host government tends to see foreign laws and foreign courts as irrelevant to any issues of disagreement with foreign investors and may view any potential interference as an outright challenge to national sovereignty.  

In addition to the issue of conflict of interest, there are also potentially serious questions about the impartiality and the credibility of the host country's legal system. This is due to the probable influence or prejudice of the host government against the foreign investor. At the same time, the foreign investor has no recourse to the home country's legal system because of the doctrine of state sovereign immunity in customary international law. Limited options to settle investor disputes present difficulties as they make foreign investors wary and skeptical about the prospects of their investments abroad.  

Ultimately, the protection of foreign investment became a problematic issue in the international efforts aimed at promoting foreign investment for economic development. The economic development of the host State and the home State of the foreign investor could have been gravely affected if something was not done to address the legitimate concerns of foreign investors. Foreign investors from developed countries desire bigger foreign markets for investment in order to maximize FDI and repatriate profits that contribute to economic development in their home States. In contrast, developing countries want to attract foreign investment through private international investment for economic development. Therefore, there arose a potential peril to the variables of foreign investment and economic development because there was no effective mechanism to protect foreign investment nor overcome its limitations vis a vis the settlements or adjudication of foreign investment claims. In other words, the absence of a generally

64 See id.  
65 See id.  
66 Id.  
acceptable system for the resolution of foreign investment disputes became the weakest link in the international quest for the promotion and protection of foreign investment. The problem became a significant issue for international organizations charged with international development, including the World Bank.

B. The World Bank, The ICSID Convention, and the Resolution of Investment Disputes

The World Bank,\(^{68}\) established in 1944, assisted European postwar reconstruction and development at the end of World War II. With its success in Europe, the bank’s responsibilities metamorphosed into pursuing programs for the global reduction of poverty and development in third world countries.\(^{69}\) In the 1960s, the World Bank became concerned with the problem of settling disputes between foreign investors and host governments as an issue affecting the promotion of foreign investment.\(^{70}\) On several occasions, the foreign investors and host governments approached the World Bank to mediate the settlement of their investment disputes.\(^{71}\) These overtures to the Bank to intervene were made against the background of the limited and unacceptable options open to foreign investors and governments under customary international law.\(^{72}\)

In a note to the Executive Directors of the World Bank on “Settlement of Disputes between Government and Private Parties,” the General Counsel of the World Bank suggested the establishment of international arbitration as a way out of the imbroglio.\(^{73}\) The General Counsel phrased the problem this way:

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\(^{70}\) See Gautami Tandon, International Institutions and Dispute Settlement: The Case of ICSID, 22 BOND L. REV. 81, 83 (2010).


\(^{72}\) Id.

\(^{73}\) Id.
1. The many studies which have been undertaken in recent years concerning ways and means to promote private foreign investment have almost invariably discussed the problem of the settlement of disputes between foreign private investors or entrepreneurs and the Government of the country where the investment is made. In many cases these studies have recommended the establishment of international arbitration and/or conciliation machinery.

2. The absence of adequate machinery for international conciliation and arbitration often frustrates attempts to agree on an appropriate mode of settlement of disputes. Tribunals set up by private organizations such as the International Chamber of Commerce are frequently unacceptable to governments and the only public international arbitral tribunal, the Permanent Court of Arbitration, is not open to private claimants. The General Counsel then proposed the establishment of an international mechanism for the conduct of arbitration of investment disputes through the creation of a permanent tribunal and the provision of facilities for conciliation as an alternative to arbitration. The General Counsel based his suggestions on the premise that States should recognize the possibility of direct access by foreign investors to an international platform for the settlement of disputes and that agreement to submit such disputes to international agreements are binding international obligations. On September 19, 1961, recognizing that the World Bank was not fully equipped to resolve investment disputes, the President of the World Bank echoed the urgent need for an international arbitration system for investment disputes. The President declared that:

At the same time, our experience has confirmed my belief that a very useful contribution could be made by some sort of a special forum for the conciliation or arbitration of these disputes. The results of an inquiry made by the Secretary General of the United Nations showed that this belief is widely shared. The fact that governments and private interests have turned to the Bank to provide this assistance indicates the lack of any other machinery for conciliation and arbitration which is regarded as adequate by investors and governments alike. I therefore intend to explore with other institutions and

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74 Id. at 2.
75 Id.
other member governments whether something might not be done to promote the establishment of a machinery of this kind.\textsuperscript{76}

The proposal and the suggestions of the General Counsel to the Executive Directors of the World Bank thus laid the foundation for the process to create the ICSID Convention.

The ICSID Convention is a product of three stages of intense negotiations: a World Bank internal drafting stage, regional meetings of legal experts from participating States, and a convocation of member-states delegates.\textsuperscript{77} The convocation of delegates constituted the "Legal Committee" that prepared the final draft of the Convention for approval by the World Bank Executive Directors.\textsuperscript{78} The most critical consideration for the birth of the Center came out of the need to look for innovations that could accelerate international economic development. The discussions started in June of 1962 when the World Bank commissioned a working group under the leadership of Aron Broches, the General Counsel of the Bank.\textsuperscript{79} The World Bank mandated the working group to produce a draft Convention for internal consideration.\textsuperscript{80} The first draft Convention produced by the working group extended jurisdiction to any dispute between the parties with a minimum amount in dispute of $100,000, without reference to any subject matter restrictions.\textsuperscript{81} Upon review of the initial draft produced by the World Bank working group, others raised questions concerning the need to separate political or commercial disputes from disagreements over legal and contractual rights.\textsuperscript{82}

The questions raised in the initial draft laid the foundation for the exclusion of political or commercial disputes from the jurisdiction of the ICSID.\textsuperscript{83} The second internal draft submitted in October of 1963 limited the jurisdiction of the Center to "any existing or future investment dispute of a legal character."\textsuperscript{84}

Having specified and distinguished political or commercial disputes from foreign investments, why was the term "investment" not

\textsuperscript{76} Id. at 3.


\textsuperscript{78} Id.


\textsuperscript{80} Id.

\textsuperscript{81} Id.

\textsuperscript{82} Id.

\textsuperscript{83} Id.

\textsuperscript{84} Id.
defined? A consensus existed among members of the World Bank working group that investment disputes, to be adjudicated by the Tribunals constituted pursuant to the ICSID rules, must be purely of a legal character.\textsuperscript{85} The earliest omission to define "investment" occurred when officials of the World Bank involved in the process declared their keenness not to create a process that could lead to incessant disputes over foreign investments.\textsuperscript{86} Officials expressed the view that "to include a more precise definition would tend to open the door to frequent disagreements as to the applicability of the Convention to a particular undertaking, thus undermining the primary objective."\textsuperscript{87} It is evident from the preamble of the ICSID Convention that the need for economic development through private international investments is the main purpose of the ICSID Convention.\textsuperscript{88} The following propositions are discernible from the preamble of the ICSID Convention: (i) to give assurances in writing to foreign investors mostly from the developed economies of the protection of foreign investment, and (ii) to encourage international economic development through private investments.

In support of the discernible propositions on the objective of the ICSID Convention, the history of the Convention confirmed, "if the plans established for the growth in the economies of the developing countries were to be realized, it would be necessary to supplement the resources flowing to these countries from bilateral and multilateral government sources by additional investment originating in the private sector."\textsuperscript{89} Therefore, the hypothesis is this: a mechanism that does not reflect or mandate the consideration of economic development of the host State is contrary to the primary purpose of the ICSID Convention. Once there is the admission of foreign investment, there should be a corresponding extension of the term investment to include contribution to economic development. But, the deliberate omission to define "investment" under the ICSID Convention appears to relegate the requirement of economic development to a back seat, and prioritizes assurances given to foreign investors within the framework of the ICSID Convention. The situation makes it difficult for developing economies to maximize the benefits associated with the purpose of the ICSID Convention.

\textsuperscript{85} Id.


\textsuperscript{87} Id.

\textsuperscript{88} ICSID Convention, supra note 1, at 1.

\textsuperscript{89} Mortenson, supra note 79, at 263 n.14.
1. The Council of Legal Experts

This stage of the history of the Convention involved consultative meetings of legal experts of the negotiating parties that took place in Addis Ababa, Santiago, Geneva, and Bangkok between December 1963 and May 1964. During this phase, the contentious issue of the meaning of "investment" created a dichotomy between capital-importing countries and capital-exporting countries. Capital-importing countries wanted a precise definition of investment while the capital-exporting countries preferred an unrestricted approach to the nature of disputes the Center could adjudicate. It is on record that Sweden canvassed for the exclusion of the term altogether.

To resolve the opposing contentions represented above, the World Bank proposed a definition of "investment" for the first time. The Bank defined "investment" as "any contribution of money or other asset of economic value for an indefinite period or, if the period be defined, for not less than five years." The developed nations contended that the proposed definition was too restrictive, in that it could create impediments to investment agreements. In contrast, developing countries articulated a narrower definition of "investment." Some developing countries wanted a regulatory framework that could guarantee the exercise of sovereignty through control of internal affairs that might overlap with the conduct of FDI.

The working group reported that there was an impasse between the contending blocs and within the working group itself on how to define "investment." It appears that the World Bank favored a broad definition of "investment" to protect international investments. This is because there was a consensus on the need to spread development to emerging economies, but not that the protection of foreign investment was the problematic issue. It is debatable whether the interests of foreign investors would be better served by a broader meaning of "investment," but this perhaps explains the reason why the initial draft sent to the Committee of Legal Experts did not contain a proposed definition of "investment." There is no other explanation in the history of the Convention except the reservations expressed by the working group of the World Bank at the drafting stage. The UK broke

90 Id. at 283.
91 Id. at 284.
92 Id.
93 Id.
94 Id. at 286.
95 Id.
96 Id. at 287.
97 Id. at 288.
98 Id. at 289.
the impasse by proposing a solution that allows a broader reference to "investment" with powers given to State parties to stipulate their own definition of "investment." The UK's proposition received wide support and acceptance. The Convention eventually passed the Resolution for ratification in March of 1965. The UK's proposal did not define "investment" per se, but rather deferred the issue to State parties in their conduct of FDI.

On the notification mechanism, Article 25 (4) of the ICSID Convention provides that "[a]ny Contracting State may, at the time of ratification, acceptance or approval of this Convention or at any time thereafter, notify the Center of the class or classes of disputes which it would or would not consider submitting to the jurisdiction of the Center." The solution proposed by the United Kingdom on the definition of "investment" may be contrary to one of the primary purposes of the Convention. It appears to be tailored to cater to the protection of foreign investments without any economic development considerations from the perspective of the host State. There was considerable agitation that the meaning of "investment" ought to be in accordance with the public interest. According to the General Counsel of the World Bank, "nearly all the definitions [of investments] which had been proposed were in fact definitions of what the delegates involved believed their governments would in fact wish to submit to the center."

Similarly, the consent provisions under Article 25 (4) enable host States to limit foreign investments in areas they wish not to submit to the jurisdiction of the Center to protect the State advancement of economic development. Ultimately, the consent provisions could foreclose investment opportunities that may lead to economic development. Either way, critics defeated the consideration for economic development as the fundamental purpose of the ICSID Convention. Commenting on the controversy surrounding the omission to define "investment," Mortenson argued that there was an unsuccessful attempt to define the term. He stated that the consequence of the "failed" definition of "investment" is to give State parties to the ICSID Convention the freedom to define the term in their individual transac-

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99 Id. at 292.
100 Id.
101 Id.
102 Id. at 290-91.
104 Mortenson, supra note 79, at 289-90.
105 Id.
106 Id. at 293-94.
107 Id. at 257.
tions.\textsuperscript{108} Mortenson's analysis is incomplete as it fails to give adequate consideration to the implication of his argument on "contribution to economic development" as one of the main objectives of the ICSID Convention. The commentator was more frustrated about the failure of the Convention to define "investment" in much broader terms to include "any plausible economic activity" because he saw the compromise in Article 25 (4) as an appeasement to an influential Latin American Executive Director of the World Bank.\textsuperscript{109}

2. The International Center for the Settlement of Investment Disputes

The ICSID Convention is a multilateral treaty that provides for the settlement of investment disputes through arbitration. It established the Center to provide facilities for conciliation and arbitration of investment disputes between State Parties and Nationals of the signatories to the Convention according to the provisions of the ICSID Convention.\textsuperscript{110} In other words, the Center facilitates the resolution of investment disputes and does not by itself directly adjudicate investment disputes between contending parties. Through the ratification of the ICSID Convention, State Parties consent to the enforcement of the protections of foreign investments in exchange for private international investments to develop the host economy.\textsuperscript{111} Sornarajah contends that a critical factor influencing the negotiation of the ICSID Convention was the desire of developed economies to increase protections for their investors abroad.\textsuperscript{112} It has been held that the Center is conducive to the security of foreign investments through the provision of the mechanism for investment treaty arbitration.\textsuperscript{113} Therefore, it may be argued that the Center was established as part of a mechanism for the protection of foreign investments.\textsuperscript{114}

The primary seat of the Center is the principal office of the World Bank in Washington, D.C. But, the seat of the Center for the

\textsuperscript{108} Id. at 292.

\textsuperscript{109} Id.

\textsuperscript{110} See ICSID Convention, supra note 1, Art. 1(2).

\textsuperscript{111} See Susan D. Franck, Foreign Direct Investment, Investment Treaty Arbitration and the Rule of Law, GLOBAL BUS. & DEVEL. L.J. 337, 338 (2007) (analogously noting that "treaties offer foreign investors a series of economic rights, including the right to arbitrate claims, in hopes of attracting Foreign Direct Investment that will bring a country . . . economic stability").

\textsuperscript{112} MUTHUCUMMARASWAMY SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 41 (Cambridge Univ. Press 3rd ed. 2010).

\textsuperscript{113} Malaysian Historical Salvors, SDN, BHD v. Malaysia, ICSID Case No. ARB/05/10, Decision on the Application for Annulment, para. 57 (Apr. 16, 2009), available at https://icsid.worldbank.org/ICSID/cases (last visited Feb. 18, 2013).

\textsuperscript{114} Id.
purpose of investment treaty arbitration may be moved from place to place on the approval of the administrative council. The Center maintains a panel of Conciliators and Arbitrators that may be selected to arbitrate investment treaty claims between State parties and foreign investors. The Center’s mandate is principally to address the shortcomings of customary international law in the resolution of investment disputes between private and State parties in the mechanics of foreign investment through private international investment. The advent of the Center made it possible for the first time under international law for a foreign investor to litigate claims directed against foreign states. Thus, Article 25 (1) provides that:

The jurisdiction of the Center shall apply to any legal dispute arising directly out of an investment between a Contracting State (or any constituent subdivision or agency of a Contracting State designated by that State to the Center) and a national of another Contracting State which the parties in dispute consented in writing to submit to the Center. When the parties have given their consent, no party may withdraw its consent unilaterally.

According to the ICSID Convention, a national of another Contracting State includes natural and juridical persons in law. Based on Article 25 (1) of the ICSID Convention, a Tribunal constituted under the Rules of the Center may exercise jurisdiction over investment claims based on consent and agreement of the State Party and the foreign investor. It should be noted that the task of investment arbitration and conciliation within the framework of the Center is the responsibility of Conciliation and Arbitration Tribunals constituted pursuant to the ICSID Convention. In other words, the Center does

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115 ICSID Convention, supra note 1, Art. 2.
116 Id. at Ch. I, Art. 3.
117 See id. at Introduction.
118 Christoph Schreuer, International Centre for Settlement of Investment Disputes (ICSID) 1 (2001) This statement may also be interpreted to mean that the right of investors to arbitrate claims against the host State may no longer be stymied by the host State legal system or the assertion of sovereign immunity.
119 ICSID Convention, supra note 1, Art. 25 (1).
120 Id. Art. 25(2) a-b.
121 See ICSID Convention, supra note 1, Art. 26. For a more detailed examination of the element of consent in investment treaty arbitration see Christoph Schreuer, Consent to Arbitration 1, 5 (2007), available at http://www.univie.ac.at/intlaw/con_arbitr_89.pdf (last visited Jan. 9, 2013) (showing how the consent of the host State and the foreign investor to arbitrate investment claims is the bedrock of the jurisdiction of ICSID with respect to the ICSID Convention. Pursuant to the ICSID Convention, once there is consent to submit investment disputes to arbitration, that consent in itself excludes every other remedy in law).
not directly settle foreign investment disputes through arbitration or conciliation.\textsuperscript{122}

However, the ICSID Regulations and Rules that include the Rules of Procedure for Arbitration Proceedings (Arbitration Rules) are not the only process for settlement of investment disputes through arbitration. There are other internationally recognized arbitration rules that may be utilized to institute investment arbitration. Examples include the United Nations Commission on International Trade Law (UNCITRAL) Rules,\textsuperscript{123} the Stockholm Chamber of Commerce (SCC) Rules,\textsuperscript{124} and the International Chamber of Commerce (ICC) Arbitration Rules.\textsuperscript{125} However, most international investment agreements provide for ICSID arbitration.\textsuperscript{126} Further analysis of the other Rules that may be utilized for investment arbitration are outside the scope of this article.\textsuperscript{127} However, the analysis of the law applicable in ICSID arbitration should recognize economic development considerations in the host State.

II. THE LAW APPLICABLE IN ICSID ARBITRATION

The law applicable in ICSID arbitration comprises substantive law and procedural rules. It is widely known that substantive law must be distinguished from procedural rules where both regimes are applicable in the resolution of disputes between parties.\textsuperscript{128} Substan-

\textsuperscript{122} Report of Executive Directors, \textit{supra} note 77, para. 15.
\textsuperscript{126} Christoph Schreuer, \textit{Travelling the BIT Route: Of Waiting Periods, Umbrella Clauses and Forks in the Road}, 5 J. WORLD INVESTMENTS & TRADE LAW 231 (2004).
\textsuperscript{127} See id. (showing that the ICSID Arbitration Rules and the UNCITRAL Rules are the most commonly used Rules in investment arbitration. State Parties and foreign investors often define “investment” in BIT(s) and other international investment agreements that may be applicable to the investment disputes. Under the other arbitration Rules such as UNCITRAL, ICC, SCC, a definition of investment only need satisfy the BIT or investment agreement definition, whereas an ICSID claim would need to satisfy both the definition in the BIT itself and the ICSID Convention. The test whether an “investment” exists in an ICSID claim is often referred to as the “double barred” test or the “double keyhole approach”. For a further discussion of the “double barred” test in ICSID arbitral practice, see also K. Yannaca-Small, \textit{Definition of “Investment”: An Open-ended Search for a Balanced Approach, in Arbitration Under International Investment Agreements: A Guide to the Key Issues} 249-50 (2010).
tive law determines the rights and obligations while procedural rules provide the framework for the enforcement of the rights and obligations defined by substantive law.\textsuperscript{129} The State party and the foreign investor choose the law applicable to ICSID arbitration based on the doctrine of party autonomy, but ICSID arbitration procedural law or rules are dictated by the relevant provisions of the ICSID Convention. In other words, while the parties to international arbitration within the framework of the ICSID Convention may agree on the applicable procedural law, such agreement cannot be contrary to the procedural provisions of the ICSID Convention. This limitation applies even where a particular procedural provision could only be read into the letters of the ICSID Convention in the context of investment treaty arbitration.

A typical example is offered by the principle of public policy in the application of procedural rules to regulate international arbitration. Along this line, Hirsch elaborates that the doctrine of public policy “prohibits an arbitration tribunal from applying rules that are contrary to the public policy of the state in which an arbitration is being conducted or that of the international community.”\textsuperscript{130} Hirsch’s analogy is a common principle acceptable in international commercial arbitration, but it may be applicable to investment treaty arbitration on the theory that arbitral Tribunals may not apply a procedural rule that may violate a peremptory norm of international law. In what appears to be an attempt to justify the extension of the doctrine of public policy to ICSID arbitration, this article is drawn to the instructive hypothesis of Schreuer who notes that:

The matter is different with regard to certain basic international tenets that may be described as the public policy of the international community. These principles would include but not be restricted to the peremptory rules of international law. Examples are the prohibition of slavery, piracy, drug trade, terrorism and genocide, the protection of the basic principles of human rights and the prohibition to prepare and wage an aggressive war. Otherwise applicable rules, whether contained in the investment agreement itself or adopted by reference, which violate these basic principles, would have been disregarded by an ICSID tribunal. If any theoretical justification is needed for this conclusion, it can be found in the foundation of ICSID in the Convention and hence in in-


\textsuperscript{130} Id. at 113.
ternational law which, in a wider sense, is the *lex fori* of ICSID arbitration.\textsuperscript{131}

Schreuer’s postulation above is significant to the theme of this article in two ways. First, it alludes to an international public policy with reference to investment arbitration in the context of the ICSID Convention. Second, it references the foundation of the ICSID Convention as the premise of the consideration of public policy. It seems self-evident that the foundation of the ICSID Convention and, by extension ICSID arbitration, is international economic development and the protection of foreign investment. Therefore, it would seem that the determination of the law applicable in ICSID arbitration should recognize considerations for contribution to economic development and the protection of foreign investment. More so, it is a basic tenet of the interpretation of treaties that a treaty like the ICSID Convention should be interpreted according to its object and purpose.\textsuperscript{132}

The substantive law applicable to ICSID arbitration is determined in accordance to the provision of Article 42(1) of the ICSID Convention, which provides:

The Tribunal shall decide disputes 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 rules on the conflict of laws) and such rules of international law that may be applicable.\textsuperscript{133}

Article 54(1) of the ICSID Additional Facility Rules confirms the salient provisions of Article 42(1) of the ICSID Convention.\textsuperscript{134}

Regardless of the clear provision of Article 42(1), it has been suggested that, in practice, arbitral Tribunals employ a combination of the intention of the parties and the law that has a reasonable connection to the investment dispute in the determination of the substantive law that is applicable in international arbitration.\textsuperscript{135} This suggestion

\textsuperscript{131} Schreuer, *supra* note 118, para. 33.


\textsuperscript{133} ICSID Convention, *supra* note 1, Art. 42(1).

\textsuperscript{134} ICSID Additional Facility Rules, art. 54(1), Apr. 2006, ICSID/11 (“The Tribunal shall apply the rules of law designated by the parties as applicable to the substance of the dispute. Failing such designation by the parties, the Tribunal shall apply (a) the law determined by the conflict of laws rules which it considers applicable and (b) such rules of international law as the Tribunal considers applicable.”)

\textsuperscript{135} Hirsch, *supra* note 129, at 117.
is supported by the opening sentence of Article 42(1), which accords with the doctrine of party autonomy and encourages the State parties and foreign investors to express their intention with reference to choice of law to enable a Tribunal to give effect to that intention. When read in full, Article 42(1) draws a sharp distinction between the applicable law chosen by the State party and the foreign investor and the responsibility bestowed on the Tribunal to apply the domestic law of the host State and principles of international law subject to conflict of law rules. Pursuant to Article 42(1), the choice of law agreed to by the State party and the foreign investor may be in a self-contained investment agreement or national investment legislation. ICSID jurisprudence is consistent with the principle that where there is a conflict between domestic and international law, the latter prevails. Similarly, one author explains that "where the tribunal can find no guidance from the investment agreement on a particular issue, this may be treated by the tribunal as an 'absence of agreement' on the applicable law concerning that particular question." Once a Tribunal determines that there is an absence of agreement on the choice of law, that Tribunal may be guided by the second sentence of Article 42(1) which mandates an ICSID arbitration Tribunal to apply domestic law and the rules of international law that may be applicable. The connection of foreign investment to domestic law may arise out of a contract between the State party and the foreign investor. Once there is a clear choice of law between the investor and the State Party in the investment contract, the Tribunal should respect the intention of the parties pursuant to the first part of Article 42(1).

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136 See ICSID Convention, supra note 1, Art. 42(1).
137 Id.
138 Id.
139 See, e.g., CME Czech Republic B.V. v. The Czech Republic, UNCITRAL Arbitration Proceedings, Final Award, Mar.14, 2003) 9 ICSID Rep. 291, para. 91, where the Tribunal held, inter alia, that "[t]o the extent that there is a conflict between a national law and international law, the arbitral tribunal shall apply international law."
141 Id.
However, the language of the second sentence of Article 42 (1) appears to give ICSID arbitration Tribunals the discretion to determine the applicable law through an analysis of the relevant law of the host state and the principles of international law. On one hand, and with reference to the second sentence of Article 42 (1), the host state law is relevant only to the extent that it is not in conflict with the principles of international law. On the other hand, the exercise of discretion conferred on arbitral Tribunals by the second sentence of Article 42 (1) could be unpredictable and lead to inconsistency in the interpretation of the second sentence of Article 42 (1) of the ICSID Convention. The major driving force of this distinction is the extent of the application of domestic law and rules of international law. Banifatemi comments that a fundamental problem for Tribunals may be striking a balance of the law applicable in investment arbitration in the absence of an unequivocal choice of law clause. Two ICSID arbitration cases demonstrate the unpredictability of arbitral Tribunals and find support in Banifatemi’s skepticism with reference to the second sentence of Article 42 (1).

In Wena Hotels Ltd v. Arab Republic of Egypt, the ad hoc committee considered whether the Tribunal applied the applicable Egyptian law pursuant to the second sentence of Article 42(1). In the absence of a clear choice of law pursuant to Article 42(1), the ad hoc Committee held that in determining the applicable law, the his-

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144 Emmanuel Gaillard & Yas Banifatemi, The Meaning of ‘and’ in Article 42(1), Second Sentence, Of the Washington Convention: The Role of International Law in the ICSID Choice of Law Process, 18(2) ICSID Rev. 375, 380 (2003) (“International law is thus part of the equation from the outset. The task for the tribunal deciding on any dispute pursuant to the second sentence of Article 42(1) is therefore to determine the respective roles of the law of the host State and of international law.”).

145 Id. at 381 (“A cursory reading of the literature and case law on the topic might lead to the conclusion that there exists a quasi-unanimous understanding according to which, in the absence of a choice of law by the parties, the role of international law is limited to supplementing the law of the host State where it contains lacunae or to correcting it where it is inconsistent with international law. Under this reading, the word ‘and’ in the second sentence of Article 42(1) is understood as meaning ‘and, in case of lacunae, or should the law of the Contracting State be inconsistent with international law.’”).

146 See generally id. at 398 (“In the context of the choice of law process of the second sentence of Article 42(1) . . . the corrective role of international law is not devoid of ambiguities.”).

147 See id. at 380.

148 Banifatemi, supra note 144, at 201.


150 Id. ¶ 21.
tory of the ICSID Convention allowed for both domestic and international law to have a role.\textsuperscript{151} It added that both legal orders could be applied where there is justification, and likewise, international law can be applied by itself.\textsuperscript{152} This decision is in sharp contrast with the ruling of the Tribunal in Klöckner Industrie-Anlagen GmbH v. United Republic of Cameroon.\textsuperscript{153} In this annulment proceeding, the ad hoc Committee considered the question whether the application of domestic law pursuant to Article 42 (1) can be fulfilled by reference to one basic principle.\textsuperscript{154} The ad hoc Committee apparently examined this query against the second sentence of Article 42(1) of the ICSID Convention.\textsuperscript{155} In response to the question, the ad hoc Committee held that “Article 42(1) clearly does not allow the arbitrator to base his decision solely on the ‘rules’ or ‘principles of international law.’”\textsuperscript{156} According to the ad hoc Committee, the “arbitrators may have recourse to the ‘principles of international law’ only after having inquired into and established in the content of the law of the State party to the dispute . . . and after having applied the relevant rules of the State’s law.”\textsuperscript{157}

III. DOES INVESTMENT TREATY ARBITRATION MECHANISM ATTRACT FDI?

On the hypothesis that FDI contributes to economic development, it is fair to ask whether investment treaty arbitration mechanism attracts FDI.\textsuperscript{158} It has been suggested that the substantive or procedural right to investment treaty arbitration is one of the strongest incentives for the protection of foreign investment in the host State.\textsuperscript{159} As mentioned earlier, investment arbitration is designed to restore investors’ confidence and promote foreign investment against the limitations presented by the traditional methods of investment dispute resolution under customary international law.\textsuperscript{160} The protection of foreign investment is a critical component of the international in-

\textsuperscript{151} Id. ¶ 37
\textsuperscript{152} Id. ¶ 40.
\textsuperscript{154} See id. ¶ 68.
\textsuperscript{155} Id.
\textsuperscript{156} Id. ¶ 69.
\textsuperscript{157} Id.
\textsuperscript{158} See e.g. Franck, supra note 111, at 354 (“Investment Treaty Arbitration: Promoting FDI?”).
\textsuperscript{159} Id. at 341.
\textsuperscript{160} See supra, Part 1.A.
vestment regime.\textsuperscript{161} It is unlikely that a foreign investor will engage in FDI in the host State without concrete assurances for the protection of foreign investment.\textsuperscript{162} One way this has been done is through the consent to investment treaty arbitration, a means by which the foreign investor can enforce his substantive and procedural rights against the host State.\textsuperscript{163}

Before embarking on the journey that metamorphosed into the ICSID Convention, the World Bank also espoused that the proposed dispute resolution mechanism is aimed to improve the investment climate and would thereby tend to promote the flow of private capital.\textsuperscript{164} It was against this background that the World Bank took steps to study an international arrangement to facilitate the settlement of investment disputes between State parties and foreign investors that eventually led to the ICSID Convention.\textsuperscript{165} However, protection of foreign investment is not the only factor that may stimulate FDI.\textsuperscript{166} Potential foreign investors may also consider economic and political factors like market size, production costs, and political stability of the host State.\textsuperscript{167} Nonetheless, the protection of foreign investment appears to be one of the most critical considerations in the conduct of FDI from the perspective of the foreign investor.\textsuperscript{168} Thus, it would seem that if there is no protection mechanism, the consideration of the other factors may become unnecessary.

Nevertheless, the influence of the dispute settlement mechanism in attracting FDI is a contested issue. Some commentators believe that dispute settlement mechanisms, such as arbitration, attract FDI, but others insist that isolating investment arbitration from other substantive treaty rights may be impracticable.\textsuperscript{169} There is limited

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\textsuperscript{161} See Deborah L. Swenson, \textit{Why Do Developing Countries Sign BITs?}, 12 U.C. DAVIS J. INT'L L. 131, 136 ("[T]he expansion of investment protections is designed to facilitate increased globalization through international investment.").

\textsuperscript{162} See e.g. Jennifer Tobin & Susan Rose-Ackerman, \textit{Foreign Direct Investment and the Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties}, 22 (William Davidson Inst., Working Paper No. 587, 2003), available at \url{http://econpapers.repec.org/paper/wdipapers/2003-587.htm} ("In the extreme, the distrust on both sides can be so large that little or no investment takes place, even when this investment would be beneficial to both parties.").

\textsuperscript{163} See generally, Franck, \textit{supra} note 111, at 341-45.

\textsuperscript{164} See DUGAN ET AL., \textit{supra} note 14, at 49.

\textsuperscript{165} See \textit{id.}

\textsuperscript{166} See \textit{id.}

\textsuperscript{167} See \textit{id.}

\textsuperscript{168} See, e.g., Tobin & Rose-Ackerman, \textit{supra} note 162, at 22.

\textsuperscript{169} Compare Franck, \textit{supra} note 112, at 354-55 (stating that there is mixed evidence that investment treaties promote foreign direct investment), and Swenson, \textit{supra} note 162, at 133-34 (contending that dispute-settlement procedures under
empirical evidence in favor of either position of the debate.\textsuperscript{170} However, based on the antecedents of the ICSID Convention, the limitations of customary international law on the settlement of disputes between the foreign investor and the State party, and the relationship of FDI to economic development, a brief examination of the hypothesis on the issue is relevant to the task of this article.

Franck employed three hypothetical models with some evidence to explain the likely impact of investment treaty arbitration in attracting FDI to developing and host States.\textsuperscript{171} These models are: the Place Holding Model, the Political and Economic Reality Model, and the Market Liberalization Model.\textsuperscript{172} Franck adopts these models to describe the overriding consideration of foreign investors that determines the flow of private international capital compared to the hypothesis that investment treaty arbitration mechanism attracts FDI.\textsuperscript{173} With reference to the Place Holding Model, the author theorized that foreign investors may overlook the consideration of investment treaty arbitration mechanisms to invest in a country that will provide an opportunity for them to establish a place in the economy of the host country.\textsuperscript{174} The author cited China as a typical example of this model.\textsuperscript{175} Franck conceded that an empirical evaluation of China's BITs may give a better picture of the effect of its BITs.\textsuperscript{176} But China's success with attracting FDI has been traced to its extensive treaty network, offering an investment treaty arbitration mechanism to foreign investors for settlement of investment disputes.\textsuperscript{177} Nonetheless, Franck's theory may be true prior to China's reform and expansion of its investment treaty network including its unconditional consent to arbitration under the ICSID Convention.

On the hypothesis of the Political and Economic Reality Model, Franck articulated that political and economic stability of the host State will make provisions for investment treaty arbitration unneces-

\textsuperscript{170} See Franck supra note 111, at 355
\textsuperscript{171} Id. at 357
\textsuperscript{172} Id.
\textsuperscript{173} See id.
\textsuperscript{174} Id. at 359.
\textsuperscript{175} Id. at 358.
\textsuperscript{176} Id. at 358-59.
\textsuperscript{177} NORA GALLAGHER & WENHU SHAN, CHINESE INVESTMENT TREATIES: POLICIES AND PRACTICE 28, 29 (Oxford Univ. Press, 2009).
Franck referred to Australia as an example, citing the Free Trade Agreement between Australia and the United States that retains permission with the Contracting Parties to permit arbitration of investment claims between the foreign investor and the State party. It is conceivable that a stable economic and political environment may positively impact FDI in the host state, but the premise of this model appears to be based on the presumption that in a stable political environment investment disputes are rare and unlikely. Even where they occur, the decision to authorize investment arbitration lies with the Contracting Parties, as in the case between Australia and the United States concerning the Australian-United States Free Trade Agreement (AUSFTA). In fact, Article 11.16 (1) of AUSFTA provides:

If a [Contracting] Party considers that there has been a change in circumstances affecting the settlement of disputes on matters within the scope of this chapter and that, in the light of such change, the Parties should consider allowing an investor of a party to submit to arbitration with the other Party a claim regarding a matter within the scope of this chapter, the Party may request consultations with the other Party on the subject, including the development of procedures that may be appropriate. On such a request, the Parties shall promptly enter into consultations with a view towards allowing such a claim and establishing such procedures.

Notwithstanding the above provision, Article 11.16(2) of AUSFTA allows an investor to bring or arbitrate an investment claim directly against the other Party to the extent that it is permitted under that Party's law. The provision in the AUSFTA may be likened to diplomatic intervention. The requirement of consultation at the instance of either of the State Parties may subject investors to the same limitations under customary international law that negatively impacted FDI. The conflicts of interest that may result through diplomatic intervention spurred consideration for an alternative international arrangement for the settlement of investment disputes that was championed by the World Bank. Under international law, the espousal of diplomatic intervention and protection in the context of

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178 Franck, supra note 111, at 361.
179 Id.
181 Id. Art. 11.16(1).
182 Id. Art. 11.16(2).
183 Franck, supra note 111, at 371-73.
international investment law is absolutely within the discretion of States. The exercise of this discretion, more often than not, is subject to overriding political interests that may be at variance with the interests of the foreign investor.

Furthermore, through the Market Liberalization Model, Franck explains that reformation and modernization of an international investment regime in the host State will attract FDI regardless of whether or not there exists a mechanism for investment treaty arbitration. The author relied on the limited presence or absence of investment treaty arbitration mechanisms in the international investment regimes of countries such as Brazil and Ireland. Franck made her strongest point with the examples of Brazil and Ireland, which have a commendable attraction of FDI in spite of the near absence of provisions for investment treaty arbitration in their respective international investment regimes. But, as the author noted, some trading countries are still skeptical and have been urging Brazil, for example, to reform its international investment regime to reflect international standard and best practices that includes investment treaty arbitration.

There is no question that investment treaty arbitration mechanism is an incentive that can attract FDI to host States. Justice Mohammed Uwais, a former Chief Justice of Nigeria, argued that the mechanism for investment arbitration is a critical element to attract foreign investments into Nigeria, a developing country. According to Justice Uwais, "[t]he importance of international arbitration as the preferred choice of settlement of commercial and investment disputes cannot be over-emphasized." Some commentators merely suggest that an investment treaty arbitration mechanism should not be isolated from other treaty rights contained in international investment.

185 Id.
186 Franck, supra note 111 at 362.
187 Id. Brazil has no BIT in force. Resolution of foreign investment disputes are regulated by national investment legislation.
188 Id. at 362-63. The Republic of Ireland has only one BIT in force, which is with the Czech Republic. See Agreement between the Czech Republic and Ireland for the Promotion and Reciprocal Protection of Investments, signed Jun. 28, 1996 (entered into force Dec. 1, 2011) (Czech-Ireland BIT), available at http://www.dfa.ie/..%20Series%202012/2012/no.26%20of%202012.pdf, (last visited Mar. 11, 2013).
189 Franck, supra note 111, at 364.
agreements. Even if one concedes to the reservations of the “non-isolationists,” it is hypothesized that the concept of the protection of foreign investment is incomplete without a mechanism for investment treaty arbitration. This article contends that investment treaty arbitration mechanisms attract FDI. One of the major reasons for the proliferation of investment treaties is the procedural and substantive rights it offers to foreign investors to arbitrate investment claims directly against the host State.

IV. A BRIEF ANALYSIS OF THE CLASSICAL THEORY OF FDI

The classical theory of foreign investments explains the relationship between foreign investment and economic development. The classical theory of foreign investment theorizes that the purpose of foreign investment is to develop the host economy. The premise of this theory is that foreign investments ought to be utterly beneficial to the host economy. This theory supports the hypotheses of this article on the relationship between foreign investment and economic development. Ball conveyed a convincing thesis on what appears to be the basis of the classical theory when he noted that “nations that elect to pursue policies that tend to eliminate the private sector or discriminate against outside investment should be aware that they are denying themselves a source of capital that could otherwise greatly speed their own economic development.” Finding support in Ball, Sornarajah explains that the classical theory is supported by the fact that foreign capital exported into the host State through the process of foreign investment could be used for the public good which translates to economic development. In this regard, Schreuer added that the impact of foreign investment on the host State economy accelerates creation of employment, infrastructural development, and technology transfer, and positively impacts facilities such as health care and transportation for the benefit of the investor and the domestic economy. The main gist of the classical theory is in accord with development economics, which encourages the economic interaction of local

191 Stephan W. Schill, Investment Treaties: Instruments of Bilateralism or Elements of an Evolving Multilateral System?, 4TH GLOBAL ADMIN. L. SEMINAR (June 13-14, 2008).
192 See generally Sornarajah, supra note 112, at 48-52.
193 Id.
194 Id.
195 George Ball, Address to the United Nations Conference on Trade and Development, (1964) extracted from Kuusi, supra note 184, at 37.
196 Sornarajah, supra note 112, at 51.
197 Id.
resources with private international capital to maximize the benefit of foreign investment to the domestic economy.  

Development economics is a branch of economic theory that specifically focuses on institutions and policies that regulate the process of economic development in under-developed countries. The theory of economic development is a form of economic liberalism that metamorphosed from a movement concerned with finding an end to international poverty. The theory of economic liberalism is based on the assumption that industrialization is the path to economic development, and that developing countries should create an environment for the capital that will facilitate industrialization for such development. The classical theory is further strengthened by the notion that no meaningful economic development can take place in developing countries in the absence of foreign investment. As a result, the standing of foreign investment as a critical component of the international development agenda cannot be overemphasized.

Furthermore, the place and importance of foreign investment created the need for concerted efforts by international institutions not only to facilitate the flow of international investment, but to create measures and international policies that might guarantee the protection of investments. Sornarajah's thesis articulates that "focus on these beneficial aspects of the foreign investment flows enables the making of the policy-oriented argument that foreign investment must be protected by international law."  

The prescriptions of the classical theory may also be reflected in international instruments regulating the conduct of international investment law. The preamble of the ICSID Convention that alludes to the promotion and protection of foreign investment for the economic development of the host State is a classic expression of the classical theory of foreign investment. Similarly, the purpose and object of most international investment treaties are expressed in accordance with the hypotheses of the classical theory of foreign investment. The classical theory may also find eloquent expression in what Yusuf describes as the progression from the "rules of abstention" to the "rules

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198 Cf. id. at 51.
200 Id.
201 Id. See also Kenneth J. Vandevelde, Bilateral Investment Treaties: History, Policy, Interpretation 90 (2010).
203 Sornarajah, supra note 112, at 52.
204 Id. at 50.
205 Id.
of international co-operation” in the development of the rules of international law to reflect the emergence of a legal framework for economic development in developing countries.\textsuperscript{206} Yusuf uses his thesis to argue the case for a special treatment for low-income countries as the basis to address the reality of economic inequality.\textsuperscript{207} In Yusuf’s analysis, “the rules of abstention” created a system where interaction between sovereign States was dominated by the politics of avoiding war that was based on reciprocity, with little or no emphasis on international cooperation between States.\textsuperscript{208} The premise of the “rules of international co-operation” progresses from the theory of abstention that recognizes the need for maximizing international collaborative efforts “which in turn may widen the perception of these common interests and of the collaborative efforts to be undertaken in their pursuit.”\textsuperscript{209} Yusuf added that the emergence of international co-operation was necessitated by the occurrence of international events that shaped the character of international law in the nineteenth and twentieth centuries.\textsuperscript{210} The author alluded to the Russian Revolution of 1917 and the emergence of the socialist States in Eastern Europe, a massive trend of independence of former colonies in Asia and Africa, and the greater involvement of States in the control of economic activities prior to World War II.\textsuperscript{211}

Nevertheless, the classical theory of foreign investment has been criticized for promoting inequality in the host State and for not doing enough to eradicate poverty among the poor in the host State.\textsuperscript{212} In this sense, poverty is a symptom of underdevelopment in the host State. There are also legitimate concerns that the repatriation of capital by the foreign investor from the host State is much more than the capital inflow associated with the particular investment, thereby denying the host economy much needed capital that could be reinvested into the local economy to promote economic development. Similarly, technology transfer to the host State through foreign investment may not be as advantageous as presumed. According to Sornarajah, “it is usually the case that the technology that is introduced into the host state has become obsolescent in its state of origin.”\textsuperscript{213} Indeed, the transfer of management skills to local workers is uncommon with for-

\textsuperscript{206} \textsc{Abdulqawi Yusuf}, \textit{Legal Aspects of Trade Preferences for Developing States: A Study in the Evolution of International Law} 24, 24-25 (1982).
\textsuperscript{207} Id.
\textsuperscript{208} Id. at 24.
\textsuperscript{209} Id. at 24-25.
\textsuperscript{210} Id.
\textsuperscript{211} Id. at 25.
\textsuperscript{212} Vandeveld, supra note 201, at 97.
\textsuperscript{213} Sornarajah, supra note 112, at 49.
eign investors in host States. The social corporate responsibility of foreign investors in the form of infrastructural development that may include provision of healthcare, education, energy, and social services are illusory in most cases. The criticisms of FDI in this respect are valid. For example, the presence of oil giants Shell Global and Chevron Oil operating in Nigeria's oil-rich Niger Delta has done little to improve the economic development of the Ogoni region.

Despite the legitimate questions and criticisms of the classical theory of foreign investment, its underpinnings still dominate the phenomenon of globalization. As shown above, the classical theory is at the heart of international investment law's progressive development. The purpose of FDI, from the perspective of the host State, is not in doubt; the protection of international investments in the host State was at issue because of the limitations for the protection of foreign investment created for the foreign investor by the nuances of customary international law. The promotion and protection of international investment should not be divorced from the purpose of international investments. The criticisms of the classical theory of foreign investment perhaps demonstrate that the problem with the classical theory is how to properly harness its tenets to ensure protection and promotion of foreign investment for economic development. If there is evidence that foreign investment promotes economic growth, then there is a stronger case for the recognition that foreign investment "contribute[s] to the economic development" of the host State in the context of investment arbitration.

V. THE SGS CASES REVISITED: WHY "CONTRIBUTION TO ECONOMIC DEVELOPMENT" SHOULD BE CONSIDERED IN ICSID ARBITRATION.

It is important to understand the divergent interests of the major players in foreign investment when defining the term "investment." These interests may be reflected by two important considerations. First, foreign investors either directly or, within the framework of an applicable international investment agreement, usually ensure that foreign investments are structured beyond a mere

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214 Id. at 49-50.
215 Id. at 50.
216 Id. at 79.
217 From an investment treaty arbitration perspective, the major players connected with conduct of FDI within the framework of Bilateral Investment Treaties and other international investment agreements are: the foreign investors (which is either a natural or legal person from the State party), the host government and ICSID. See Stephen D. Cohen, Multinational Corporations and Foreign Direct Investments (2007).
contractual relationship to maximize the advantages offered by international arbitration. Such safeguards are mostly determined through an assessment of the definition of "investment" in an investment agreement or other laws that form part of the host State's legal framework for the conduct of foreign investment relating to the transaction in issue.\(^\text{218}\) Second, host States prefer a definition of "investment" that could stimulate the flow of foreign investments that have the potential to impact economic development. In what appears to be a confirmation of these contrasting interests, it has been argued that, "treaties [BITs] offer foreign investors a series of economic rights, including the right to arbitrate claims in hopes of attracting FDI that will bring a country infrastructure projects, financing, know-how, new jobs, and economic reality."\(^\text{219}\)

These contrasting interests on the definition of "investment" under the ICSID Convention were played out in the ICSID arbitration case of \textit{SGS Société Générale de Surveillance S.A. v. Republic of the Philippines}.\(^\text{220}\) In this case, the Republic of the Philippines entered into an agreement with Société Générale de Surveillance S.A. (SGS), a Swiss company, to carry out, on an exclusive basis, Pre-Shipment Inspection (PSI) in any country of export to the Philippines.\(^\text{221}\) Under the contract, inspection would cover quality, quantity, and price comparisons.\(^\text{222}\) The relevant articles of the agreement required SGS to maintain a liaison office in the Philippines and to provide, free of charge, training courses for the Philippines Bureau of Customs (BOC), the provision of customs equipment to the BOC and maintenance thereof, intelligence/investigative consultants, and a library stocked with the most comprehensive trade publications from the twenty leading exporting countries to the Philippines.\(^\text{223}\) The agreement at issue provided that all provisions were to be governed in all respects and construed in accordance with the laws of the Philippines, and all disputes in connection with the obligations of either party to the agreement shall be filed in the Regional Trial Courts of Makati or Manila.\(^\text{224}\) In exchange for the performance of SGS's obligations, the Philippines agreed to pay SGS, in Swiss francs, a fee amounting to 0.6


\(^{219}\) Franck, supra note 111, at 338.


\(^{221}\) Id. ¶ 19.

\(^{222}\) Id.

\(^{223}\) Id.

\(^{224}\) Id. ¶ 22.
percent of the Free On Board (FOB) value declared on the exporter’s final settlement invoice covering each shipment inspected.\textsuperscript{225} The Philippines and Switzerland have a binding treaty agreement for the Promotion and Reciprocal Protection of Investments.\textsuperscript{226}

SGS commenced investment treaty arbitration for alleged breaches of the agreement between it and the Republic of the Philippines by relying on the provisions of the Swiss-Philippines BIT.\textsuperscript{227} Citing relevant provisions of the BIT, SGS initiated arbitration under Article 25(1) of the ICSID Convention contending that: there is a dispute of a legal nature, arising directly out of an investment, between a contracting State and a national of another contracting State, and the parties have consented in writing to ICSID arbitration.\textsuperscript{228} The Republic of the Philippines challenged the jurisdiction of the Tribunal, contending that there was no “investment” in the Philippines in accordance with the purpose of the ICSID Convention.\textsuperscript{229} The Philippines also argued that the dispute was purely contractual.\textsuperscript{230} The Tribunal found for SGS, holding that the circumstances and elements of the services provided by SGS were sufficient to qualify the service as one provided in the Philippines.\textsuperscript{231} According to the Tribunal, “[s]ince it was a cost to SGS to provide it, this was enough to amount to an “investment” in the Philippines within the BIT.”\textsuperscript{232}

In the earlier case of \textit{SGS Societe Génér\'e\'ale de Surveillance S.A. v. Islamic Republic of Pakistan},\textsuperscript{233} SGS and the Islamic Republic of Pakistan entered into a PSI Agreement signed in 1994 similar to the service agreement signed with the Philippines. The PSI Agreement included an arbitration clause that provided that all disputes must be

\textsuperscript{225} \textit{Id.} \S 20.


\textsuperscript{227} \textit{Philippines}, 8 ICSID Rep. 518, \S 26.

\textsuperscript{228} The ICSID Convention established the jurisdictional requirements of investment treaty arbitration. ICSID Convention, \textit{supra} note 1, at Art. 25(1).

\textsuperscript{229} \textit{Philippines}, 8 ICSID Rep. 518, \S 51

\textsuperscript{230} \textit{Id.}

\textsuperscript{231} \textit{Id.} \S 112 (concluding that the dispute regarding “services” was within the meaning of Article 25(1) of the ICSID Convention).

\textsuperscript{232} \textit{Id.} p 103 (explaining the elements are sufficient when taken together).

settled in Pakistan. When communications initiated by the parties to resolve the issue failed, SGS filed suit against Pakistan in the Swiss Court of First Instance in Switzerland. Pakistan prevailed in the Swiss courts when it contended that, in the PSI Agreement, the parties had chosen to arbitrate any disputes arising out of the contract before an arbitration tribunal in Pakistan. SGS later brought a claim against Pakistan at the Center in accordance with Article 9(2) of the Swiss-Pakistan BIT that provided for arbitration within the framework of the ICSID Convention. Before the Tribunal, SGS contended that Pakistan violated Article 11 of the BIT by failing to guarantee observance of its contractual commitments. The tribunal, while siding with Pakistan held that it had no jurisdiction over contractual claims and decided conclusively in favor of SGS that it has jurisdiction over SGS BIT claims.

The focus of this article is the impact of the Tribunals’ decision on the definition of “investment” with respect to considerations of contribution to economic development. It is apparent that the Tribunals in the SGS cases adopted a broad interpretation of the BITs in question to determine that the service contracts and subject matter of the disputes were protected “investments” in the applicable BITs. SGS prevailed on the issue of jurisdiction in the Philippines case because that Tribunal was of the view that since “a substantial and non-severable aspect of the overall service was provided in the Philippines . . . SGS entitlement to be paid was contingent upon that aspect.” However, the basis of the definition of “investment” ought to be the inten-

234 Id. ¶ 1.
235 Id. ¶ 12.
236 Id. ¶ 19-20.
237 Id. ¶ 23. The Swiss Courts rejected SGS claim because of the arbitration clause in the PSI agreement.
238 Id.
239 Id. ¶ 101 (explaining Pakistan consented to submit all disputes to arbitration).
242 Philippines, 8 ICSID Rep. 518, ¶ 102 (explaining the tribunal's view of jurisdiction).
tion of the State party and the foreign investor on what constitutes an “investment” within the framework of the ICSID Convention, and not on the discretion of an arbitral Tribunal unsupported by any concrete rules of interpretation within the enabling ICSID Convention with reference to the definition of “investment.”

It is a truism that the foreign investor has had no part in the negotiation of the ICSID Convention. This fact raises the issue of investment in “Arbitration without Privity”243 and undermines the relevance of the intention of the State party and the foreign investor in the context of ICSID arbitration and treaty law. Generally, the agreement to arbitrate is a contract binding on the parties that have agreed to it. However, this article contends that the investor-state relationship, with reference to ICSID arbitration, integrates the concept of privity because the ICSID Convention was formulated between States for the benefit of the States parties and nationals of other States.

In the Philippines case, the Tribunal accepted SGS’s argument that its assets in the Philippines pursuant to the contract, juxtaposed with the BIT under review, fell within the “non exhaustive definition of [foreign] investments under Article 1(2) of the BIT.”244 In that Tribunal’s determination of an “investment,” this paper contends that the Tribunal should have made a “contribution to economic development” consideration of the protected investment in accordance with the purpose of the ICSID Convention. Once the issue of whether or not there is an “investment” in the territory of the host State is raised by either the State party or foreign investor, a Tribunal should consider “contribution to economic development” of the investment in issue. The protection of foreign investments and the attraction of foreign capital to promote domestic economic development are paramount to the conduct of foreign investment in host States. The protection of foreign investments through the mechanism of the ICSID Convention makes it imperative to consider why States enter into International Investment Agreements (“IIAs”).

On the intentions of States in entering IIAs and in international investment law, Garcia-Bolivar opined that States enter into IIAs to protect foreign investments with the expectation to attract foreign capital to promote domestic economic development.245 Garcia-Bolivar argued that the expectation of States should be interpreted to

244 Philippines, 8 ICSID Rep. 518, ¶¶ 48-49.
245 Omar E. Garcia-Bolivar, Economic Development at the Core of the International Investment Law Regime, in EVOLUTION IN INVESTMENT TREATY LAW AND ARBITRATION 587 (Chester Brown & Kate Miles eds., 011).
include the protection of foreign investment and the anticipated domestic economic development of the host economy.\textsuperscript{246}

In the face of the inconsistent approach of arbitral practice to “contribution to economic development” as a core element in investment treaty arbitration,\textsuperscript{247} the arbitral panel in \textit{Malaysian Historical Salvors Sdn. Bhd v. Malaysia} held that, for a foreign investment to come under the adjudicative mechanism of the ICSID, it must be shown that there is a substantial contribution to the economic development of the recipient State.\textsuperscript{248} Prior to this case, the panel in \textit{Ceskoslovenska Obchodni Banka, A.S v. Slovak Republic}\textsuperscript{249} relied on the preamble of the ICSID Convention to infer “an international transaction which contributes to cooperation designed to promote the economic development of a Contracting State may be deemed to be an investment as that term is understood in the Convention.”\textsuperscript{250}

Other Tribunals have disagreed with the approach of the arbitral Tribunals in the \textit{Malaysian Historical Salvors} and \textit{Slovak Republic}. As shown in this article, arbitral Tribunals have registered inconsistent views with respect to defining investment. On the other hand, Garcia-Bolivar's proposition was based on what ought to be the basic core element of the adjudicative principle of treaty investment arbitration.\textsuperscript{251} Still, it is argued that international investment agreements should contain express provisions that reflect the intentions of the State parties that execute BITs.

The purpose and preamble of investment agreements are insufficient to convey the intention of the State parties of BITs. A system of arbitration that leaves room for speculation as to the parties' intentions with investment treaty arbitration is bound to produce inconsistencies that could negatively impact the credibility of the process. The conduct of FDI through BITs, though revolutionary, cannot sustain the development of international investment law if its purpose is only to correct the limitations of multilateral treaties to resolve the uncertainties of customary international law in favor of foreign investors from developed economies.

Garcia-Bolivar's thesis is in accord with the dissenting opinion of Judge Shahabuddeen in \textit{Malaysian Historical Salvors v. Malay-

\textsuperscript{246} \textit{Id.}


\textsuperscript{248} \textit{Id.} ¶ 61.


\textsuperscript{250} \textit{Id.} ¶ 64.

\textsuperscript{251} Garcia-Bolivar, \textit{supra} note 245.
sia. Judge Shahabuddeen pointed out that a proper consideration of ICSID objective jurisdiction with reference to the definition of “investment” includes a requirement for a consideration of “contribution to the economic development of the host state.” According to Judge Shahabuddeen, “the need for a contribution to the economic development of the host State is consistent with both the formative documents of ICSID and case law.” Indeed, the preamble of the ICSID Convention states, inter alia, that the ICSID Convention was formulated “considering the need for international co-operation for economic development, and the role of private international investment therein; bearing in mind that from time to time disputes may arise in connection with such investments between Contracting States and nationals of other Contracting States.” Commenting on the preamble of the ICSID Convention, the Tribunal in Slovak Republic stated that “[t]his language permits an inference that an international transaction which contributes to the co-operation designed to promote the economic development of a Contracting State may be deemed to be an investment as that term is understood in the Convention.” Similarly, in Patrick Mitchell v. Democratic Republic of the Congo, the Tribunal cited the opinion of Schreuer on the interpretation of the preamble of the ICSID Convention, that contribution to economic development is the “only possible indication of an objective meaning” of the term “investment.”

If the raison d’être of the host States for entering IIAs is to attract capital that would finance and promote economic development, a consideration of whether or not a particular transaction is an “investment” within the scope of Article 25(1) of the ICSID Convention ought to include contribution to economic development. This article contends that the objective requirements of Article 25(1) of the ICSID Convention, with reference to the definition of “investment,” when considered together with the purpose of the ICSID Convention, put economic development and the protection of foreign investments at the core of ICSID arbitration and the international investment law regime. Therefore, in the absence of a concrete definition of “investment” in the ICSID Convention, an “investment” should not be determined under the ICSID Convention in the absence of a consideration of contribution.

253 Id. ¶ 65.
254 Id. ¶ 15.
255 See ICSID Convention, supra note 1, at 11.
256 Ceskoslovenska Obchodni Banka, ICSID Case No. ARB/97/4, at ¶ 64.
to economic development. Such construction would be contrary to the object and purpose of the ICSID Convention.

The view of the Tribunal in *Joy Mining Machinery Limited v. Arab Republic of Egypt* 258 ought to guide arbitral Tribunals. This Tribunal made a convincing point when it held that, for the purpose of ICSID jurisdiction, the parties to an investment dispute cannot by agreement define "investment" outside the objective requirements of Article 25 of the Convention, otherwise Article 25's definition of "investment" will be nugatory. 259 If the SGS Tribunals had considered contribution to economic development of the host State, substantial parts of the contract in the SGS cases that were performed outside the host State might have been critical in the determination of the meaning of "investment" with reference to Article 25(1) of the ICSID Convention.

However, a fundamental weakness of the consideration of contribution to economic development within the meaning of Article 25(1) of the ICSID Convention is how to determine investments that contribute to the economic development of the host State. Do they have to be substantial, significant, or only minimal? ICSID case law on the consideration of contribution to economic development has been inconsistent on the issue. Some Tribunals that have attempted to consider contribution to economic development in the context of Article 25(1) of the ICSID Convention have applied different paradigms on what transactions constitute a contribution to the economic development of the host State. In *Malaysian Historical Salvors*, the Tribunal held that for a transaction to contribute to the economic development of the host State, the "contract must have made a significant contribution to the development of the respondent." 260 According to this Tribunal, "were there not the requirement of significance, any contract which enhances the Gross Domestic Product of an economy by any amount, however small, would qualify as an investment." 261 However, in *CSOB*, the Tribunal considered the benefits of a loan contribution to the host State's public interests to reach a decision that the loan, even though devoid of visible transfer of resources, was an "investment" that contributed to the economic development of the Slovak Republic. 262

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259 *Id.*
260 *Malaysian Historical Salvors*, ICSID Case No. ARB/05/10, at ¶ 124.
261 *Id.* ¶ 123.
262 *Ceskoslovenska Obchodni Banka*, ICSID Case No. ARB/97/4, at ¶ 76.
In the more recent case of Inmaris v. Ukraine, contribution to economic development was disregarded altogether. The investment dispute in that case arose over a contract to renovate and operate a ship owned by the Respondent for tourism and training purposes. The Tribunal rejected a formal approach to apply the test and held instead that “[i]f the State Parties to a BIT agree to protect certain types of economic activity, and when they provide that disputes between investors and States relating to that activity may be resolved through, inter alia, ICSID arbitration, that means that they believe that the activities constitute an ‘investment’ within the meaning of the ICSID Convention as well.”

The majority of the Tribunal in Malaysian Historical Salvors annulled the award of the sole arbitrator because considering contribution to economic development elevated the criteria to a jurisdictional requirement that excluded “small contributions of a cultural and historical nature,” which was not supported by the ICSID Convention. Still, in the opinion of this article, the difficulty and inconsistency expressed by some Tribunals in the analysis of the criteria should not be construed to mean that contribution to economic development is irrelevant with reference to the meaning of “investment” in the ICSID Convention. In the absence of a concrete definition of “investment” under Article 25(1) of the ICSID Convention, the Convention will be meaningless if Article 25(1) is construed to exclude contribution to economic development contrary to the purpose of the ICSID Convention from the perspective of the host States. As a Tribunal rightly noted, “there exists a definition of an investment within the meaning of the ICSID Convention.”

VI. CONCLUSION

In view of the preceding analysis, the mechanism of foreign investment and investment treaty arbitration particularly under the ICSID Convention should not to be divorced from the goal of contribution to economic development. The expectation of host States in international investment law is the utilization of foreign capital to promote and advance economic development. This expectation with reference to the ICSID Convention cannot be fully achieved in the absence of an independent consideration of the element of contribution to economic development.

263 Inmaris Perestroika Sailing Maritime Services GmbH v. Ukraine, ICSID Case No. ARB/08/8, Decision on Jurisdiction, ¶ 129 (Mar. 8, 2010).
264 Id. ¶ 35.
265 Id. ¶ 130.
266 Malaysian Historical Salvors, Iside Case No. ARB/05/10, ¶ 80(b).
267 Victor Pey Casado and President Allende Foundation v. Republic of Chile, ICSID Case No. ARB/98/2, Award, ¶ 232 (Mar. 8, 2008).
development in the determination of an "investment" in ICSID arbitral practice.

It has been argued in this article that the presence of the principles of the classical theory of FDI in international investment agreements is a testament to the paramount importance of economic development. This article contends that there is no logical counter to the theory that contribution to economic development is the reason that developing countries as host States embraced the idea of the ICSID Convention. The expectation of contributing to economic development explains the positive attitude shown by most developing countries in the process leading to the conclusion of the ICSID Convention and the establishment of ICSID. For example, Tunisia was the first State to sign the ICSID Convention on May 5, 1965, and Nigeria was the first State to ratify the ICSID Convention on August 23, 1965. While it may be conceded that the inconsistent investment arbitration jurisprudence as to the definition of "investment" may have contributed to the relegation of the consideration of contribution to economic development, it is submitted that the embracing rubric of the ICSID Convention should be interpreted by arbitral Tribunals beyond the protection of foreign investment to include consideration for contribution to economic development of the State. This will ensure a balanced approach to the interpretation and application of the principal objective of the ICSID Convention that might create a better opportunity for host States to maximize the benefits of the ICSID Convention in the context of investment treaty arbitration.

The reasoning of most arbitral Tribunals that international investment arbitration mechanism has the final say on the adjudication of investment disputes makes it more imperative for host States to reform their international investment regimes to reflect their legitimate expectations. It is hoped that such a normative and legislative approach might bring the issue of contribution to economic development to the altar of international arbitration to get the proper attention in the context of the ICSID Convention. Ignoring considerations for contribution to economic development in investment treaty arbitration could fuel dissatisfaction among host States against the ICSID Convention.

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268 See supra Part II.