

**BALANCING THE INTERESTS BETWEEN
TNCS AND HOST DEVELOPING STATES -
THE ROLE OF LAW**

Nastja Pusic

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Declaration

I confirm that this thesis is my own work and that all materials consulted have been acknowledged in notes, footnotes or bibliography.

A handwritten signature in black ink, appearing to read 'N+ P' with a long horizontal stroke extending to the right.

Nastja Pusic, January 2017

Abstract

This thesis is focused on examining the lack of balance of interests between transnational corporations (TNCs) and host developing states. It also examines the aspirational differences between the parties vis-à-vis the investment practice(s) over the past few decades and reviews the perception of foreign direct investments (FDIs). The contribution of TNCs has been a heated topic of debates in international circles and policy-makers were unable to find solutions, not for the lack of attempts such as the UN draft codes of conduct on TNCs, the Havana Charter, MAIs and others, but due to gaps in aspirations between the parties, the negotiations were unsuccessful. There were also some successful attempts from the developing states, namely the UN Declaration on Permanent Sovereignty over Natural Resources and the UN Charter on Economic Rights and Duties of States. This revealed the limits of law in regulating the conduct of TNCs in host developing states during the course of foreign investments. Emphasis is given to the capacity building and the system of protection of investments, namely by means of bilateral investment treaties (BITs), as well as protecting the interests of both of the parties. International efforts to regulate foreign investments are gaining momentum. Research showed that changes are underway and the re-negotiations clause might be a way forward. It also makes an attempt in understanding the international investment law and increasing frustration with the existing mechanism for settlement of investment disputes, which arises from violations of BITs. It revealed that the role of law is of fundamental importance to offer protection to the investments and to ensure that both parties benefit from such investments, by balancing their interests.

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It is with gratitude, respect and thanks to my family who have contributed to my education and gave me the encouragement and the support for all of my dreams and ambitions. Writing this thesis has been the biggest challenge I had faced on my academic journey and the journey itself has been “insanely great”. The topic of the research has opened so many new perspectives and ideas that I would like to believe to be able to further explore and research some time in the future and make a valuable contribution not only to the science and academia but also beyond.

Doktorat poklanjam mami Ani Pusic, ki si je vedno zelela da bi jaz postala doktor, tako da...evo draga mama za tebe, moj doktorat namesto pravnukov.

Abbreviations

AJIL American Journal of International Law

ATCA Alien Tort Claims Act

BITs Bilateral Investment Treaties

BOT Build Own Transfer

BOOT Build Own Operative Transfer

BYIL British Yearbook of International Law

CDA UK Colonial Development Act

CUP Cambridge University Press

CERD Charter of Economic Rights and Duties of States

CTC Commission on Trans-National Corporations

DSB Dispute Settlement Body of the WTO

EC European Communities

EME Emerging Market Enterprise

EU European Union

ECOSOC Economic and Social Council

FCN Friendship, Commerce and Navigation Treaties

FDI Foreign Direct Investment

FET Fair and Equitable Treatment

FTAs Free Trade Agreements

GATT General Agreement on Tariffs and Trade

GDI Gross Domestic Investment

GDP Gross Domestic Product

HRC Human Rights Council

IBHR UN International Bill of Human Rights

IBRD International Bank for Reconstruction and Development

ICCt International Criminal Court

ICJ International Court of Justice

ICSID International Centre for the Settlement of Investment Disputes

ICTSD International Centre for Trade and sustainable Development

IAs International Investment Agreements

IISD International Institute of Sustainable Development

ILA International Law Association

ILC International Law Commission

ILO International Labour Organization

IMF International Monetary Fund

ISDS Investor-State Dispute Settlement

ITO International Trade Organization

JWT Journal of World Trade

LDS Least Developed States

MAI Multilateral Agreement on Investment

MDGs Millennium Development Goals

MFN Most Favoured Nation Treatment

MIGA Multilateral Investment Guarantee Agency

MNEs Multinational Enterprises

NAFTA North America Free Trade Agreement

NGOs Non-Governmental Organizations

NIEO New International Economic Order

OECD Organization for Economic Cooperation and Development

OUP Oxford University Press

PCIJ Permanent Court of International Justice

PSNR Permanent Sovereignty of States over their Natural Resources

RIAA Reports of International Arbitral Awards

RTAs Regional Trade Agreements

TNCs Trans-National Corporation

TPP Trans-Pacific Partnership

TTIP Transatlantic Trade and Investment Partnership

UDHR Universal Declaration of Human Rights

UN United Nations

UNCED United Nations Conference on the Environment and Development

UNCITRAL United Nations Commission on International Trade Law

UNCTAD United Nations Conference on Trade and Development

UNDP United Nations Development Programme

UNEP United Nations Environment Programme

UNGA United Nations General Assembly

WB World Bank

WTO World Trade Organization

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Introduction

This research establishes the lack of balance of interests between transnational corporations (TNCs)¹ and host developing states² and makes an attempt at establishing such balance by exploring the concepts and principles that contribute to closing the gaps between aspirational differences of the parties. It also evaluates the role of law in the relationship between TNCs and host developing states. It explores the role of private foreign investment as a key component towards socio-economic development, especially of host developing states. It further examines the aspirational differences between the key actors and analyses how aspirations of developing states and their government may contribute to socio-economic development. It critically examines the limits of international and domestic law, while controlling the activities of TNCs by means of codes of conduct.³ A critical analysis of some of the bilateral investment treaties (BITs) is conducted on case studies and examples. While examining the existing protection system for TNCs as well as host developing states this research explores the role of law in balancing their interests for common goal of achieving socio-economic development

¹ In the literature terms such as global, international, multinational, supranational, transnational, world, in addition to firm, company, corporation and enterprise have been used to describe companies doing business across the borders of their home-state. According to Dunning, David Lilienthal was first to use the term “multinational corporation” while addressing Carnegie Institute of Technology as chief executive of Development Resources Corporation of New York in John Dunning, *Explaining International Production* (Unwin Hyman 1988) 134-136. This research maintains transnational corporations, following the UNCTAD definition.

² According to the UN ‘For analytical purposes, WESP classifies all countries of the world into one of three broad categories: developed economies, economies in transition and developing economies. The composition of these groupings ... is intended to reflect basic economic country conditions. Several countries (in particular the economies in transition) have characteristics that could place them in more than one category; however, for purposes of analysis, the groupings have been made mutually exclusive. Within each broad category, some subgroups are defined based either on geographical location or on ad hoc criteria, such as the subgroup of “major developed economies”, which is based on the membership of the Group of Seven. Geographical regions for developing economies are as follows: ‘Africa, East Asia, South Asia, Western Asia, and Latin America and the Caribbean’. See The United Nations, ‘Country Classification’ <http://www.un.org/en/development/desa/policy/wesp/wesp_current/2014wesp_country_classification.pdf> accessed 20 March 2016. Note also that ‘...an increasing number of developing countries subscribed to basic standards for investment protection and treatment (while rejecting them on the multilateral level), though typically not to positive rights of entry and establishment, which remained within the discretion of the host contracting party’. UNCTAD, *International Investment Agreements, Key Issues, Volume I* (New York and Geneva, United Nations 2004) 9.

³ The challenge of the codes of conduct is that they are voluntary in nature and as such not legally binding or enforceable. See Dinah Shelton (ed), *Commitment and Compliance – The Role of Non-Binding Norms in the International Legal System* (OUP 2008).

and consequently socio-economic independence and the implementation of the rule of law.

This research does not exclude the international organisations and their role in international law and in governing the relationship between TNCs and host developing states. Extensive literature review revealed that over the past four decades' researchers have conducted numerous studies in the area of TNCs in host developing states⁴ and private foreign investment, but these studies were not done in a consolidated manner to examine all three components in relation to each other and review the effect that they have on socio-economic development, for which big gaps and contradicting conclusions still exist. This research attempts to examine the correlation and makes conclusive evaluation of the impact that TNCs conduct have on the host developing states⁵ and the contribution of private foreign investment to socio-economic development process.

In 1971, Vernon⁶ critically examined the “intrusive conduct” of the United States (US) transnational corporations (TNCs) as private foreign investors particularly in the developing world. More than four decades later, it is still worth examining whether investment practice(s) of transnational corporations (TNCs) have changed, and if so, in what way(s). Would it effectively be possible to change the perception of transnational corporations (TNCs) in regard to private foreign investments in the developing world, particularly in the natural resources sector,⁷ remains to be further explored.

Aspirational differences between TNCs, those of host developing states and the United Nations (UN) created complex international environment. Policy-making geared to striking a balance between the interests of TNCs, those of host developing states and the

⁴ See UN Doc E/5209 (1972) requested the Secretary General to appoint a Group of Eminent Persons to study the role of transnational corporations in world society and the Group produced a report ‘Multinational Corporations in World Development’; UN Doc ST/ECA/190 (1973); Juha Kuusi, *The Host State and the Transnational Corporation: An Analysis of Legal Relationships* (Saxon House 1979); The United Nations Code of Conduct on Transnational Corporations, UN Doc E/C.10/1982/6 (1982).

⁵ Activities of TNCs in developing states became the focus of international attention after the ITT scandal in Chile.

⁶ Raymond Vernon, *Sovereignty at bay: Multinational Spread of U.S. Enterprises* (Longman 1971).

⁷ See ‘Natural Resource Chapter’

<<http://naturalresourcecharter.org/sites/default/files/Natural%20Resource%20Charter%20second%20edition%202014.pdf>> accessed 20 June 2015.

UN is overdue.⁸ The differences and conflicts between host developing states and TNCs can only be overcome effectively through negotiations and under the UN auspices.⁹

Stereotyping of the perception of bargaining position needs to be reviewed. Developing states do have bargaining position, and it is important to appreciate that, until an effective alternative source of natural resources has been found by the developed world, the latter is very dependent on the supply of natural resources by many developing states. What is needed is to change the perception of developed states towards private foreign investment whereby both parties would derive benefits from such investments. Developing states should have benefited from foreign investments in the form of reinvestment of profits for the purposes of capacity building, such as infrastructure, education and health. The term “bargaining power” needs reviewing as it might not be appropriate and therefore “bargaining position” will be used for the future reference.¹⁰

Transnational corporations (TNCs) were seen as a tool for maintaining peace and stability. This was the foundation of the interdependence theory developed by Keohane and Nye in the 1970s,¹¹ where they described how states and non-states such as TNCs and International institutions such as the World Bank, the United Nations and the International Monetary Fund, work together in a complex interdependent environment. Wagner maintained that ‘the idea that asymmetrical interdependence is a source of power is nowadays common in writings on international political economy’ and by ‘using bargaining theory’ it ‘show that asymmetrical economic interdependence does not imply that one bargaining will be able to exercise political influence over another’.¹²

Another example of bargaining position of developing states was expressed in the ‘demands for a radical restructuring of the world trading and financial system, under the banner of the creation of a New International Economic Order’¹³ 1974 and the Charter of

⁸ See Paul R. Krugman and Maurice Obstfeld, *International Economics: Theory and Policy* (Addison-Wesley 2000).

⁹ See Robert L. Rothstein, *Global bargaining* (Princeton University Press 1979).

¹⁰ The word “power” may suggest abuse and coercion and will be therefore replaced with the word “position” in reference to the bargaining.

¹¹ Robert O. Keohane and Joseph S. Nye Jr, *Power and Interdependence: World Politics in Transition* (Little-Brown 1977).

¹² Harrison R. Wagner, *Economic interdependence, bargaining power, and political influence* (1988) 42(3) MIT Press, International Organization 461-483.

¹³ UNCTAD, *International Investment Agreements, Key Issues, Volume I* (New York and Geneva, United Nations 2004) 9.

Economic Rights and Duties of States 1974¹⁴ that was initiated by developing states in which they expressed their aspirations and stressed, *inter alia*:

[T]he urgency to establish generally accepted norms to govern international economic relations systematically and recognised that it is not feasible to establish a joint order and a stable order as long as a charter to protect the rights of all countries, and in particular the developing States, is not formulated.¹⁵

It is important to note that many important resolutions were initiated by the developing states such as the Declaration on Principles of International Law concerning Friendly Relations and Co-operation among States 1970. These *inter alia* include principles for the states to ‘refrain in their international relations from the threat or use of force against the territorial integrity or political independence of any State’, to ‘settle their international disputes by peaceful means in such a manner that international peace and security and justice are not endangered’ and ‘not to intervene in matters within the domestic jurisdiction of any State, in accordance with the Charter’ among others.¹⁶

On the recommendation of the United Nations Group of Eminent Persons (GEP)¹⁷ in 1973 the UN Commission on Transnational Corporations and the UN Centre on Transnational Corporations were founded. The UN General Assembly adopted a resolution that condemned the activities of TNCs in 1977.¹⁸ The issue of adopting appropriate policies by the developing world was highlighted by the UN Commission on Transnational Corporations (UNCTC) between the years 1982 – 1983 when a number of resolutions were adopted, urging TNCs to fully comply with them and as early as 1985 commissioned a panel.¹⁹ However owing to internal factors and political instability most of the

¹⁴ UNGA Res A/RES/29/3281.

¹⁵ UNCTAD Resolution 45 (111) of 18 May 1972.

¹⁶ UNGA Res 2625 (XXV) of Oct. 1970, Annex.

¹⁷ Group of Eminent Persons produced reports ‘Multinational Corporations in World Development’ UN Doc. ST/ECA/190 (1973); The Impact of Multinational Corporations on Development and International Relations, UN Doc. E/5500/Rev.1, ST/ESA/6 (1974); For views of states on the report of the Group of Eminent Persons, see The Impact of Transnational Corporations on the Development Process and on International Relations, UN Doc E/5595 (1974).

¹⁸ UNGA Res A/RES/32/73 of 9 December 1977.

¹⁹ See the Report from the Commission on Transnational Corporations, in 1984 the US had 406 TNCs, the UK 364 and Germany 142 TNCs in South Africa. TNCs have employed 600,000 workers and 400,000 of them were black. In South Africa, the activities of TNCs were particularly relevant as they were believed to have been contributing to the existing apartheid system. In 1977 a Tripartite Declaration of Principles regarding TNCs and social policy was adopted by the International Labour Organization (ILO).

developing states seem to have failed to adopt and implement such policies; in other words, private foreign investment is still, in general, an issue which is predominantly controlled by private foreign investors. Developing states should take responsibility as they have not been able to develop sufficiently, namely their judiciaries' decades after their independence. Main reason was the lack of confidence and therefore developing states did not contest and negotiate better terms, and as a result they have accepted the terms proposed by the West.²⁰ However the practice is changing significantly in the recent years, namely in Latin America, which once again is leading the way towards a global treaty on foreign investments.

On the other hand, profit-maximisers must protect the interests of their shareholders.²¹ However this raises another issue, whether it is ethical to earn profits, without taking responsibility other than through delegated boards of directors (BODs),²² some of whom are also shareholders.²³ According to Berle and Means shareholders were passive owners by only exercising the power of selling their shares in situation when they were not satisfied with the management or the performance of the corporation. Shareholders have

Unfortunately, the declaration was not binding but it did set the ground for the Codes of Conduct that followed. See also Dirk Willem te Velde, *Foreign Direct Investment and Development, An historical perspective* (Overseas Development Institute Jan. 2006 commissioned by UNCTAD).

²⁰ Chile has been the loudest voice of opposition from the host developing states, which started the discussions and put the issues of regulating activities of TNCs in host developing states on the map.

²¹ See Sarah Bradley, 'BCE Inc v 1976 Debentureholders: The New Fiduciary Duties of Fair Treatment, Statutory Compliance and Good Corporate Citizenship' (2009–10) 41 OLR 325, 333, stated that 'the stakeholder debate is nearly as old as the concept of a corporation itself'; See also Edwin Merrick Dodd Jr, 'For Whom Are Corporate Managers Trustees' (1932) 45 HLR 1145; Adolf A. Berle Jr, 'For Whom Corporate Managers Are Trustees: A Note' (1932) 45 HLR 1365; Stephen Bottomley, 'Taking Corporations Seriously: Some Considerations for Corporate Regulation' (1990) 19 FLR 203, 206-213; Davis A. Wishart, 'Models and Theories of Directors' Duties to Creditors' (1991) 14 NZULR 323; Andrew Keay 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's "Enlightened Shareholder Value Approach"' (2007) 29 SLR 577, 582–88; Andrew Keay, (2008) 'Ascertaining the Corporate Objective: An Entity Maximisation and Sustainability Model' 71 MLR 663; Paul Lyndon Davies, *Gower and Davies' Principles of Modern Company Law* (8th edn, Sweet & Maxwell 2008) 507.

²² TNCs have become very powerful and in the light of their power, activities of TNCs have to be controlled preferably by the United Nations, as the legal and political entity of nations as a compliment to the control exercised by the host developing states and their domestic legal system and judiciary.

²³ See also Loukas Mistelis, 'Regulatory Aspects: Globalization, Harmonization, Legal Transplants and Law Reform' (2000) 34 Int'l Law 1055; See Council Directive 85/374/EEC of 25 July 1985 on approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products; see Directive 2004/48/EC of the European Parliament and of the Council of 29 April 2004 on the enforcement of intellectual property rights; see European Commission, White Paper on Damages Actions for Breach of the EC Antitrust Rules, COM (2008) 165, 2 April 2008; see Directive 2009/22/EC of the European Parliament and of the Council of 23 April 2009 on injunctions for the protection of consumers interests; Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights.

surrender the control and responsibility of the corporation to the management by stating that the shareholders ‘surrendered the right that the corporation should be operated in their sole interest’.²⁴ One of the main objectives of transnational corporations (TNCs) is making profits for their shareholders and not the social good-doing.²⁵

Should directors be allowed to hold shares in a company is another controversial question awaiting clarification. What is the role of corporate governance in dealing with this issue? Both of which are outside the scope of this research.²⁶ Corporate social responsibility (CSR) was created as an attempt to address this issue.²⁷ Owing to constraints of word limits, any discussion of the concept of Corporate Governance had to be omitted. Among the issues that it should address is also the question what should be the principal obligations of an investor in a foreign jurisdiction? An investment made by private foreign investor should be beneficial for the host developing state concerned; as it is equally important that a balance between the interests of both the parties must be struck. BITs concluded between developed and developing states have developed a pattern which confirms that the issue of finding appropriate balance, as stated above, must be accorded paramountcy, including the equal protection and benefit distribution of both the parties.

Activities²⁸ of TNCs²⁹ across national borders have challenged the international legal system as non-state actors in spite of the fact that states are the main actors of international

²⁴ Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (first published 1932, 2nd edn, Transaction Publishers 1991).

²⁵ TNCs and other smaller businesses over the globe have been heavily criticised for their lack of responsibility to society, mainly due to the fact that they are profit maximisers. In other words, any commercial activity that is or could be damaging or destructive. The policy makers such as governments have therefore tried to encourage TNCs and other businesses to include CSR in exchange for either tax relief or some other kind of benefits. The concept of CSR can be traced back to the 1950s; see also Archie B. Carroll, ‘Corporate Social Responsibility Evolution of a Definitional Construct’ (1999) 38(3) *Business & Society*, 268-295; see also Peter T. Muchlinski, ‘Corporate social responsibility’ in Peter T. Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (OUP 2008) ch 17, 637.

²⁶ See for example Bradley R. Agle, Thomas Donaldson, Edward R. Freeman, Michael C. Jensen, Ronald K. Mitchell and Donna J. Wood, ‘Dialogue: Toward Superior Stakeholder Theory’ (2008) 18(2) *Business Ethics Quarterly* 153-190.

²⁷ See also Joseph Heath, ‘Business ethics without stakeholders’ (2006) 16(3) *Business Ethics Quarterly* 533-557; Jose M. Moneva, Juana M. Rivera-Lirio, María Jesús Muñoz-Torres, ‘The corporate stakeholder commitment and social and financial performance’ (2007) 107(1) *Industrial Management and Data Systems* 84-102; Samuel F. Mansell, *Capitalism, Corporations and the Social Contract, A Critique of Stakeholder Theory* (CUP 2013).

²⁸ See also Donna J. Wood, Jeanne M. Logsdon, Patsy G. Lewellyn, and Kim Davenport, *Global business citizenship: A Transformative framework for ethics and sustainable capitalism* (M.E. Sharpe 2006); Amartya K. Sen, *An economic inequality* (OUP 1997).

²⁹ Effects of TNC activities can be measured by the means of FDI according to John Dunning, *Multinational Enterprises and the Global Economy* (Addison-Wesley 1992); UNCTAD, World

law.³⁰ Bennett maintained that ‘good corporate governance at home and abroad, promoting economic inclusiveness and community goodwill, are important elements of international security’ hence ‘This interweaving of roles calls for new partnership between business and government, in which sharing skills and expertise can be valuable in promoting regional and global stability’.³¹ Haque³² maintained that:

Globalization is a process of integrating nations, societies, and peoples in the domains of economy, politics, culture, ideology and knowledge through the transnational networks of capital, production, exchange, technology, and information, owned and controlled unequally by dominant states, organizations, classes, and individuals³³

He also added that TNCs are the key creators of globalisation and as such they shape the world economy, control global trade, finance, investment, information as well as technology.

Most of the published works on transnational corporations (TNCs) have described them as "agents" of development³⁴ and even highlighted the extent of dependence of developing states, in general. Unfortunately, many of these works have also failed to examine the issue of responsibility. The boundaries of responsibilities of TNCs are usually confined to contractual terms determined through negotiation process; thus issues such as "capacity building" or "ploughing back of profits" or Build Operate Transfer (BOT)³⁵ or Build Own

Investment Report – Foreign Direct Investment and the Challenge of Development (United Nations, Geneva 1999).

³⁰ David J. Bederman, *Globalization and International Law* (Palgrave Macmillan 2008).

³¹ Juliette Bennett, ‘Multinational Corporations, Social Responsibility and Conflict’ (2002) (55)2 *Journal of International Affairs* 393.

³² Shamsul M. Haque, ‘The growing challenges of globalization to self-reliant development in developing nations’ in Gedeon M. Mudacumura and Shamsul M. Haque (eds), *Handbook of development policy studies* (Marcel Dekker 2004) 535– 550.

³³ Shamsul M. Haque, ‘The growing challenges of globalization to self-reliant development in developing nations’ in Gedeon M. Mudacumura and Shamsul M. Haque (eds), *Handbook of development policy studies* (Marcel Dekker 2004) 535– 550.

³⁴ When economic growth concept became equal to the economic development concept the dominant indicator became per capita income according to Ulrich Menzel, ‘40 Jahre Entwicklungsstrategie = 40 Jahre Wachstumsstrategie’ 131-155 in D. Nohlen, F. Nuscheler (ed), *Handbuch der Dritten Welt. Grundprobleme, Theorien und Strategien*, Vol 1 (J.H.W. Dietz 1993); see also UNCTAD, World Investment Report 1992, *Transnational Corporations as Engines of Growth* <http://unctad.org/en/Docs/wir1992_en.pdf> accessed on 20 December 2015.

³⁵ Private financing for public infrastructure has been widely spread worldwide, where the private investors are the operators. In a way BOT is a form of public-private partnership (PPP) providing public infrastructure and services. See also A.M. Algarni, D. Arditi, G. Polat, ‘Build-operate-transfer in the

Operate and Transfer (BOOT)³⁶ have not received much attention. Bilateral investment treaties (BITs) made an attempt to protect foreign investors interests by means of fair and equitable treatment(FET), full protection and security, most-favoured-nation (MFN) and national treatment,³⁷ mainly due to widespread phenomenon of nationalisation and providing for investor-state arbitration.³⁸ As Vernon pointed out in his work, the importance of the relationship between TNCs and states is crucial in understanding international business or in other words, how a business works across the state borders.³⁹ Salacuse maintained that ‘in the early twenty-first century’ there were examples of expropriation where ‘the investor’s assets was transferred to the state or state-owned enterprise (SOE) through a variety of legal means undertaken by the governments concerned’⁴⁰ which called for higher protection of foreign investments.

Vernon maintained that ‘To assess the economic consequences of foreign direct investment, one has to know something about the nature of the resource transfer involved’.⁴¹ Equally to assess the key elements of negotiations by means of bargaining position, the key definitions and concepts have to be explained.

Bargaining position is the ability to achieve the desired outcomes through the negotiation process. However, the problem occurred with the newly born independent states in the decolonisation⁴² process that have not yet developed a proper strategy for their further

United States’ (2007) 133(10) ASCE Journal of Construction Management and Engineering 728-735.

One of the first substantial BOT projects was the Suez Canal construction in 1854.

³⁶ BOOT is a form of concession agreement between public and private partnership.

³⁷ Ever evolving international law on the subject of protecting the investors and the investments interest has implemented the fair and equitable treatment standard that are primarily based on the obligations of host developing states to the investors and their investments. While the obligations of host developing states have been discussed the conduct of investor has not receive much attention to date, see Peter T. Muchlinski, ‘Caveat Investor?’ (2006) 55 Int’l & Comp. L.Q. 527 in which he explored the relevance of the conduct of the investor under the fair and equitable treatment standards. See also UNCTAD, *Fair and Equitable Treatment series on issues in international investment agreements* (United Nations New York and Geneva 1999); Rudolf Dolzer, ‘Fair and Equitable Treatment: A key standard in investment treaties’ (2005) 39 Int’L Law 87.

³⁸ See further Konstantin Katzarov, Bradley Anthony Wilfred (ed), *The Theory of Nationalisation* (Springer Netherlands 1964).

³⁹ Raymond Vernon, *Sovereignty at bay: Multinational Spread of U.S. Enterprises* (Longman 1971).

⁴⁰ Jeswald W. Salacuse, *The Law of Investment Treaties* (OUP 2015) 315. In two highly publicised expropriation cases, Yukos v Russian government and YPF v Argentine government. Both investors challenged these actions as illegal under the international law under investment treaties. Both arbitrations concluded in 2014. Argentina settled with US\$5billion in bonds issued by Argentina. Russian government had to pay US\$50 billion, ‘which was the highest amount of damages ever awarded in the history of international arbitration’.

⁴¹ Raymond Vernon, *Sovereignty at bay: Multinational Spread of U.S. Enterprises* (Longman 1971) 151.

⁴² The United Nations played crucial role in decolonisation process and process of self-determination of people leading to independence of peoples and formation of sovereign states. Decolonisation is based on

socio-economic development. Developing states had respect for the developed states, which in many cases were colonial powers and felt that they were in some way superior. Five decades after the decolonisation the situation does not seem to have changed significantly in terms of their socio-economic development. Improving negotiating techniques and understanding each other aspirations may be a way forward. Developing states have to take the position that they will only engage in collaboration and accept private foreign investment from TNCs when it will be beneficial for both parties, and when the large portion of the benefits will go to developing states and not only to TNCs. There should also be an agreed share of the profits reinvested back in the host developing states. One solution would be to have it equally split between the TNCs and host developing states based on performance and transfer of profits clause. Other option is also plough back a portion of their profits in the developing states capacity building or buy-back. In any case re-negotiation clause, should be included in the future investment agreements. TNCs have to therefore review their expectations, as high profits are no longer sustainable as they do not contribute to the socio-economic development of the developing states nor do they contribute to the stability of global political economy.

Focus should be put on what can be done in the course of the current climate of private foreign investments and in the future. The best way to start is by reviewing the perception of bargaining position. However, bargaining position alone is not sufficient. Knowledge and the know-how have to be recognised in addition to these resources. Frank pointed out that the relationship between TNCs and host developing states is hostile and at the same time shares some mutual interests.⁴³ It is not possible that TNCs will take over the role of the government in international peacekeeping, however in collaboration with the governments, non-governmental organisations (NGOs), and civil societies TNCs can offer their know-how, business skills and financial capacity to contribute to the global socio-economic stability.⁴⁴

the 'equal rights and self-determination of peoples', more specifically chapters XI, XII and XIII. After 1960 the General Assembly released Declaration on the Granting of Independence to Colonial Countries and Peoples, known as Declaration on decolonisation. Another document is resolution of General Assembly 1541 (XV) of 15 December 1960.

⁴³ Isaiah Frank, *Foreign Enterprise in Developing Countries* (Johns Hopkins University Press 1980) 25.

⁴⁴ See statement of G.A. Wagner, President, Royal Dutch Petroleum Company and Senior Managing Director of Royal Dutch Shell Group of Companies in Summary of Hearings before the Group of Eminent Persons to Study the Impact of Multinational Corporation on Development and on Industrial Relations (United Nations, Geneva, 5 November 1973).

Governments⁴⁵ should however, impose rules and regulations on TNCs. Notwithstanding that the governments often stand behind TNCs and their activities that effectively support profit-maximisation. TNCs have only one concern and that is to make profit for their shareholders on which their business performance is based. Friedman⁴⁶ maintained that ‘the sole purpose of a firm is to make money for its shareholders’⁴⁷ and contempt the businessman’s “social conscience” and their concern about the ‘social responsibilities of business in a free-enterprise system’ and seriously consider ‘its responsibilities for providing employment, eliminating discrimination, avoiding pollution’. Friedman called these businessman ‘unwitting puppets of the intellectual forces that have been undermining the basis of a free society these past decades’.⁴⁸

There is a lack of restrictions and legislation especially on environmental issues, because they were not given the needed attention.⁴⁹ The issue of environmental rights is however still in their early stages and call for new regulations to protect the environment. To that end a number of agreements were formulated, like the United Nations Framework Convention on Climate Change, however some of the developed states did not ratify environmental agreements, such as the US that has signed the Kyoto Protocol⁵⁰ on 12 November in 1998, but has not yet ratified it.

Distribution of ownership and control is another complex matter awaiting further clarification. In some cases, when TNCs did not have the option of ownership they

⁴⁵ From the 1970s the ability of governments to maintain control has been deteriorating according to Kevin Phillips, *American theocracy: The peril and politics of radical religion, oil, and borrowed money in the 21st century* (Viking 2006).

⁴⁶ Milton Friedman, ‘The Social Responsibility of Business is to Increase its Profits’ *The New York Times Magazine*, (New York, 13 September 1970) <<http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html>> accessed on 26 March 2015.

⁴⁷ Steve Denning, ‘The Origin of “The World’s Dumbest Idea”: Milton Friedman’ *Forbes Magazine* (New York, 26 June 2013). <<http://www.forbes.com/sites/stevedenning/2013/06/26/the-origin-of-the-worlds-dumbest-idea-milton-friedman/>> accessed 26 March 2015.

⁴⁸ Milton Friedman, ‘The Social Responsibility of Business is to Increase its Profits’ *The New York Times* (New York 13 September 1970) <<http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html>> accessed 26 March 2015.

⁴⁹ See Franklin R. Root, ‘Environmental risks and the bargaining power of multinational corporations’ (1988) 3(1) *The International Trade Journal* 115; Franz Perrez, ‘Cooperative sovereignty: From Independence to Interdependence in the structure of international environmental law (Kluwer Law International 2000).

⁵⁰ The Protocol to the United Nations Framework Convention on Climate Change (UNFCCC) was adopted at the third session of the Conference of the Parties (COP 3) in Kyoto, Japan, on 11 December 1997. In accordance with Article 24, it was open for signature from 16 March 1998 to 15 March 1999 at United Nations Headquarters, New York. By that date the Protocol had received 84 signatures <http://unfccc.int/kyoto_protocol/status_of_ratification/items/2613.php> accessed 26 March 2015.

insisted on having the control. Neither ownership nor control guarantees profits, on its stand-alone basis. The challenging part therefore is finding a balance between not only the bargaining position during the negotiation process, but also the ability to form joint-ventures (JVs) and share the ownership, share the control as well as the benefits and profits. The only problem with the international joint-ventures (IJVs) that has been identified by case studies over the years, is the fact that they come to an end for variety of reasons.⁵¹ The high rate of failure of the JVs was owing to poor management, because the decision-makers did not meet their expectations. In the UK for example, in 2006 the Companies Act was passed that instructed the shareholders to work closely with the management. Hence the role of management and key stakeholders should be reviewed and geared towards employees' participation in the management as well as employees as shareholders.

Some of the developing states (Angola, China, and Indonesia) have started implementing revised foreign investments legislation and by doing so they have managed to improve their bargaining position.⁵² Developing states are starting to implement indigenization policies, and are regulating as well as promoting foreign investments. Several developing states have undergone severe reforms, such as Bolivia, Brazil, Ecuador, Indonesia, South Africa and Venezuela and they continue to attract foreign investment. Some developing states are still in this process and others have not yet managed to start the reforms, mostly owing to the government instability.⁵³

Developing states are trying to take control through their jurisdictions, but lack access to the global markets. Passing new laws is necessary for developing states, however developing states are in a difficult position because by implementing new policies they are trying to assume control and attract foreign investments, while trying to maintain national sovereignty intact, all at the same time. Miozzo et al.⁵⁴ argued that it may still be worthwhile for host countries governments to continue to set policies to attract foreign

⁵¹ See Joel Bleeke and David Ernst, 'The Way to Win in Cross-Border Alliances' (1991) 69(6) HBR.

⁵² See Sue Liu, 'Inside China: FDI changes in the pipeline' (2015) 34(5) International Financial Law Review; Katherine Jo, 'FDI changes draw praise, spark confusion' (2014) China Law & Practice; Angola Country Report (The PRS Group, Inc 2014); Angola Power Report (2015) Q2 BMI's Industry Report & Forecasts Series; Indonesia Business Forecasts Report (Business Monitor International Ltd. 2014);

⁵³ Robert J. Barro, Xavier Sala-i-Martin, *Economic growth* (MIT Press 1995); Paul R. Krugman, Maurice Obstfeld, *International Economics: Theory and Policy* (Addison-Wesley 2000).

⁵⁴ Marcela Miozzo, Mo Yamin & Pervez N. Ghauri, 'Strategy and structure of service multinationals and their impact on linkages with local firms' (2012) 32:7 The Service Industries Journal 1171-91.

investments and ensuring collaboration with local firms simultaneously.⁵⁵ That brings balancing the interests of TNCs and host developing states back to the forefront, together with the role of law in this relationship, which is the core subject of this research.

To sum up, balancing the interests seems to be more complex than it initially looks. Synchronizing the reforms to be able to both, attract and control private foreign investments⁵⁶ at the same time, only adds to the complexity of balancing the interests between TNCs and host developing states. Governments have a challenging decision to make, when it comes to investment reforms. There is no doubt that the chain is only as strong as its weakest link(s), which is why it is all about finding the right balance. However, there could be no such “right balance” without the order, and the order has to have the ability to exercise its authority. The order can therefore only be established, effectively by means of the law and the rule of law. Hence the role of law is of crucial importance. This type of order, in social or everyday life, could be enforced by simply following the common etiquette and customs. However, the origin of which has to be formed and written and effectively communicated to the wider global community and civil society. The existence of institutions to control the process of maintaining the order is essential for the rule of law. Without these institutions, the rule of law has no ground. Any such actions of ignoring or disregarding these two concepts, can result in sanctions, which again call for trained forces, to ensure its implementation and compliance. Arguably, the categories of morality, etiquette and social sanctions can be subject of legislative restrictions, customs or even ideology⁵⁷ however there must be a uniform and unconditional applicable rule of law.

Plato reflected on the origins and the practical use of ethics in his *Euthyphro* dialogue and argued for the existence of independent standards.⁵⁸ Socrates on the other hand believed

⁵⁵ Marcela Miozzo , Mo Yamin & Pervez N. Ghauri, 'Strategy and structure of service multinationals and their impact on linkages with local firms' (2012) 32:7 *The Service Industries Journal* 1171-91.

⁵⁶ The subject matter of admission of investment and the right of establishment implies that each state has the ‘...sovereign right to regulate the entry of foreign direct investment (FDI). This right is based on the state’s control of its territory, which carries the attendant right to exclude aliens from that territory. That right is absolute and can only be restricted by international agreement’. Ignacio Gómez-Palacio and Peter T. Muchlinski, ‘Admission and establishment’ in Peter T. Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (OUP 2008) ch 7, 228.

⁵⁷ See also Elman R. Service, *Origins of the State and Civilization, The Process of Cultural Evolution* (W.W. Norton & Company 1975).

⁵⁸ Plato, *Euthyphro* (Translated by Cathal Woods and Ryan Pack, Creative Commons, 2007) <<http://myweb.facstaff.wvu.edu/nmarkos/Zola/Plato.pdf>> accessed 29 March 2015.

that definition of justice has to be reformulated thought his audience methods of inquiry. Human nature as undisputed fact, which for unknown reason seems to only steer an individual towards just behaviour only due to the fear they will not be able to get away with the unjust behaviour and they will have to bare the punishment.⁵⁹ The issue still remains to be clarified on why one should act justly, while an unjust behaviour could be more profitable, however unfortunately that is a subject for another research.

Within the authority of historical, legal, socio-economic context, which has been established throughout this research the bigger objective has emerged on the ground that international institutions have been built with the focus on reaching and maintaining international peace, security and stability. Therefore, the role of namely one such institution, primarily the UN is closely examined in relationships to TNCs and host developing states.

There can be many concepts relating to the topic of this research, however the most essential concepts have been identified and further developed in an attempt to ensure that knowledge of the main concepts will be helpful in appreciating the reasons for writing this research.

⁵⁹ See also Socrates and Plato, *Politeia* (The Republic written around 380 BC).

The reasons for developing this research

Until the 1970s the issue of balancing the interests between TNCs and host developing states did not receive much attention from academic writers other than Vernon,⁶⁰ Hymer,⁶¹ Kindleberger,⁶² Dunning⁶³ and to some extent Friedman.⁶⁴

In the 1960s and the 1970s developing states have indicated their aspirations. The evidence can be found in certain UN resolutions namely the Permanent Sovereignty over National Resources⁶⁵ 1962, Declaration on the Establishment of a New International Economic Order⁶⁶ 1974, and Charter of Economic Rights and Duties of States⁶⁷ in the same year. Despite the numerous efforts of developing states in this regard, they do not seem to have been met with success. The reasons were colonisation of the mind that left physiological consequences resulting in the lack of confidence as well as lack of consistency and government stability to develop reliable judiciaries, education, health and infrastructure systems. An attempt to review and analyse the reason for this has been explained in the following chapters of this research.

There have been a number of conflicts between TNCs and host developing states⁶⁸ as well as concerns over the impact of private foreign investments, while TNCs have:

⁶⁰ Raymond Vernon, *Sovereignty at bay: Multinational Spread of U.S. Enterprises* (London, 1971); Raymond Vernon, *The Economic Environment in International Business* (Prentice Hall 1972); Raymond Vernon, *Economic and Political Consequences of Multinational Enterprise: An Anthology* (Harvard University Press 1972).

⁶¹ Stephen H. Hymer, Hugo Radice, *The Multinational Corporation and the Law of Uneven Development* (Penguin books 1975); Stephen H. Hymer, *The International Operations of National Firms: A Study of Direct Foreign Investment* (MIT Press 1976); Stephen H. Hymer, Robert B. Cohen, Nadine Felton and Morely Nkosi, *The Multinational Corporation: A Radical Approach* (CUP 1979).

⁶² Paul Goldberg and Charles Kindleberger proposed a general agreement in international investment based on the GATT in 1970; Paul Goldberg and Charles Kindleberger, 'Towards a GATT for Investment: A Proposal for Supervision of the International Corporation' (1970) (2) *Law and policy in International Business*, 295 – 325.

⁶³ John H. Dunning, *Multinational Enterprises and the Global Economy* (Addison-Wesley 1993).

⁶⁴ Milton Friedman, *Capitalism and Freedom* (University Chicago Press 1962); Milton Friedman, *Money and Economic Development* (The Horowitz Lectures of 1972); Milton Friedman, *Why government is the problem* (Praeger Publishers Inc 1973); Milton Friedman, *On Economics: Selected Papers* (University of Chicago Press Journals 2010).

⁶⁵ UNGA Res 1803 (XVII), 17 UN GAOR Supp. (No.17) 15, UN Doc A/5217 (1962).

⁶⁶ UNGA Res/S-6/3201 (1974).

⁶⁷ UNGA Res/29/3281 (1974).

⁶⁸ See further Thomas N. Gladwin and Ingo Walters, *Multinationals Under Fire: Lessons in the Management of Conflict* (John Wiley & Sons 1980).

[E]xpand their global reach, integrate national economies, rearrange the international division of labour, consume environmental resources, manufacture homogenized products for a world market, and deliver goods and services across increasingly irrelevant national borders, they irrevocably and fundamentally transform the society in which we live.⁶⁹

However, at the same time host developing states did not manage to achieve capacity building and socio-economic development by means of private foreign investment.

Research Methodology

In reviewing the past events that led to the current situation the conclusions will be drawn based on the historical research method. This research is based on primary sources of information, such as the UN Charter and other legal documents, constitutions, protocols, conventions, treaties, namely the relevant materials (Codes of Conduct and other reports) developed by the United Nations (UN), Organisation for Economic Co-operation and Development (OECD) and World Trade Organisation (WTO) in addition to referring to those of the relevant documents developed by various states, and regional bodies, namely the United Nations Conference on Trade and Development (UNCTAD), World Bank (WB), International Monetary Fund (IMF), North America Free Trade Association (NAFTA) and various agreements such as International Investment Agreements (IIAs), Free Trade Agreements (FTAs) and Bilateral Investment Treaties (BITs). The bilateral investment treaties (BITs) concluded between developed and developing states will form a very important source of information for developing the themes of this research. Descriptive method will be used to establish norms in like circumstances. Correlation method will be used in examining the relationships between the concepts that have been developed and their interdependent relationship structure. Comparative method will play an important role in comparing the past and the present events. Decisions rendered from International Centre for Settlement of Investment Disputes (ICSID) and International

⁶⁹ Eric Kolodner, *Transnational corporations: impediments or catalysts of social development?* (UNRISD, occasional paper no.5 World Summit for Social Development, Geneva 1994) 1.

Court of Justice (ICJ) will also be closely examined based on the case study method and examples that set precedence as well as awards and decisions of tribunals. Domestic legislation applicable to transnational corporations (TNCs) activities or inapplicability of such legislation, particularly when identifiable customary rules of international law and/or standards of international law⁷⁰ are available. Decisions rendered by the English courts or by any other reliable judiciary and the relevant awards rendered by ICSID (International Centre for Settlement of Investment Disputes)⁷¹ and various ad hoc Arbitral Tribunals have been examined with a view to determining whether the decision of courts and tribunals, in particular, have formed part of the customary rules of international law. Evaluation methods will be used to describe the complex issues of civil society in developing socio-economic and political context. Opinions of authors expressed through their published works in the form of books and journals have been referred to as secondary sources of information, where necessary as they are divided in two main categories, supporters of TNCs and critics. Empirical studies have also been carried out in respect to the issues, where relevant. Method of analysis will be used throughout the thesis to review the ideas and principles in understanding how they affect each other. Comparative method will be used in researching and identifying common elements between different states and their systems, primarily in the context of balancing the interests between developed and developing states. Hypothetico-deductive method will be used in developing hypotheses from observations and testing in the final analysis.

Hypotheses

Based on this brief outline of ideas the following hypotheses are laid.

1. How may it be possible to develop a technique whereby interests of both parties may be balanced?

⁷⁰ Peter Malanczuk, *Akehurst's Modern Introduction to International Law* (7th edn, Routledge 1997).

⁷¹ See also Investor - State disputes on Energy Charter 1994 <<http://www.encharter.org/index.php?id=7>> accessed 20 May 2015.

2. A false notion of bargaining power⁷² has hindered the process of implementing the concept of balancing the interests.
3. The aspirational differences between the parties are currently unreachable and some progress on this issue can be made, if only true bargaining position concept is developed and applied.

Literature Review

This research has been developed by relying on mainly two sources of information, a) Primary and b) Secondary sources of information. Whereas primary sources of information will include the UN Charter, Constitutions, Conventions, Treaties, reports published by the UN agencies, UNCTAD, e.g. OECD bodies, World Bank, IMF, NAFTA, WTO and other inter-governmental bodies⁷³, non-governmental bodies, BITs, IIAs, FTAs, governmental reports, decisions of ICSID, ICJ and other tribunals and case studies. Published academic works in forms of books and scientific articles have been referred to as secondary sources of information.

This research has predominantly been developed on the basis of primary sources of information; the secondary sources of information (books and articles) have been developed under two distinct categories: promoters of transnational corporations (TNCs) and their activities and their "critics". Transnational corporations (TNCs) should not be undermined in developed states.⁷⁴ While TNCs 'can foster social development in developing countries by transferring management skills as well as research and

⁷² To reiterate further on footnote 10, power suggests dominant position of one party over the other and as such cannot facilitate equal negotiations. Therefore the shift in terminology is crucial in achieving balanced negotiations, where the interests of both parties will be equally represented. One cannot deny the existence of power on both sides, it only suggests that neither party abuses its power and resorts to their bargaining positions instead.

⁷³ Such as: World Trade Organisation (WTO), Organisation for Economic Co-operation and Development (OECD), United Nations Conference on Trade and Development (UNCTAD), UN Global Compact with Business, European Union (EU), International Labour Organisation (ILO), World Bank (WB), International Centre for Settlement of Investment Disputes (ICSID), Multilateral Investment Guarantee Agency (MIGA), International Finance Corporation (IFC).

⁷⁴ See Tagi Sagafi-Nejad and John H. Dunning, *The UN and Transnational Corporations, From Code of Conduct to Global Compact* (Indiana University Press 2008); Louis Emmerji, Richard Jolly, Thomas G. Weiss, *Ahead of the curve? UN Ideas and Global Challenges* (Indiana University Press 2001).

development (R&D) capacities, in practice their record in this filed is mixed' furthermore 'governments in developing countries have historically criticised TNCs for not employing enough nationals in management positions and, therefore transferring only minimal management skills'.⁷⁵

A different kind of behaviour of TNCs in developing states has also prompted many authors to critically assess their contributions to the socio-economic development process in those states. As regards the first category of authors - the promoters, it has become evident that in developing their ideas they seem to have failed to appreciate the adverse socio-economic consequence of colonisation on the former colonies and the psychological impact of it on their minds and attitudes (colonisation of minds) - under this category would come namely, Dunning⁷⁶, Robock, and Simmonds⁷⁷, and even Kotler⁷⁸, whereas under the second category the following authors may be included:

⁷⁵ Eric Kolodner, *Transnational corporations: impediments or catalysts of social development?* (UNRISD, occasional paper no.5 World Summit for Social Development, Geneva 1994) 13.

⁷⁶ John H. Dunning, 'Explaining the international direct investment position of countries: towards a dynamic and development approach' (1981) 117 *Weltwirtschaftliches Archiv* 30-64; John H. Dunning, 'Explaining outward direct investment of developing countries: in support of the eclectic theory of international production' in Kumar, K. and McLeod, M. (eds), *Multinationals from Developing Countries* (Lexington Press 1981) 1-22; John Dunning, *Multinational Enterprises and the Global Economy* (Addison-Wesley 1992); John H. Dunning, *Multinational enterprises and the global economy* (Addison-Wesley 1993); John H. Dunning, *Making Globalization Good* (Macmillan 2003); John H. Dunning, *New Challenges for International Business Research; Back to the Future* (Edward Elgar 2010); John H. Dunning and S. Lundan, *Multinational Enterprises and the Global Economy* (2nd edn, Edward Elgar 2008).

⁷⁷ Stefan H. Robock, Kenneth Simmonds, 'International Business: How Big is It-The Missing Measurement' (1970) 19(2) *Columbia Journal of World Business* 62; Stefan H. Robock, Kenneth Simmonds, J. Zwick, *International Business and Multinational Enterprises* (Richard D Irwin 1977).

⁷⁸ Philip Kotler, Gary Armstrong, Lloyd Harris, Nigel F. Piercy, *Principles of Marketing* (6th edn, Pearson 2013); Philip Kotler, Hermawan Kartajaya, Iwan Setiawan, *Marketing 3.0* (Wiley 2010); Philip Kotler, Kevin Keller, Mairead Brady, Malcolm Goodman, *Marketing Management* (1st edn, Pearson 2009).

Hymer⁷⁹, Muchlinski⁸⁰, Stiglitz⁸¹, Vernon⁸² and Perlmutter.⁸³ There already exist a large number of secondary sources of information, but there is no need to go into details of these works, as each of these, generally speaking, come under one of these two categories. The number of works emphasising the need for a "balanced view" are very few, other than that by Kuusi⁸⁴ and Stiglitz⁸⁵, the Codes of Conduct or the various reports published by various international, inter-governmental and non-governmental organisations.⁸⁶

⁷⁹ Stephen H. Hymer and Hugo Radice, *The Multinational Corporation and the Law of Uneven Development* (Penguin books 1975); Stephen H. Hymer, *The International Operations of National Firms: A Study of Direct Foreign Investment* (MIT Press 1976); Stephen H. Hymer, Robert B. Cohen, Nadine Felton and Morely Nkosi, *The Multinational Corporation: A Radical Approach* (CUP 1979).

⁸⁰ Peter T. Muchlinski, *Multinational Enterprises and the Law* (2nd edn, OUP 2008); Peter T. Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (OUP 2008); Peter T. Muchlinski, 'Trends in International Investment Agreements: Balancing Investor Rights and the Right to Regulate: the Issue of National Security' in Karl P. Sauvant (ed), *Yearbook on International Investment Law and Policy 2008-9* (OUP 2009) 35-78; Peter T. Muchlinski, 'Trends in International Investment Agreements: Calls for Reforms of Model Bilateral Investment Treaties in Norway, South Africa and the United States' in Karl P. Sauvant (ed), *Yearbook on International Investment Law and Policy 2009-10* (New York, OUP 2010) 41-85; Peter T. Muchlinski, 'Corporations in International Law' in Wolfrum, Rudiger, (ed), *Max Planck Encyclopaedia of International Law* (Oxford: OUP 2010); Peter T. Muchlinski, 'Multinational Enterprises as Actors in International Law: Creating "Soft Law" Obligations and "Hard Law" Rights' in Math Noortmann, and Cedric Ryngaert (eds), *Non-State Actor Dynamics in International Law: From Law Taking to Law Making?* (Ashgate Publishing 2010) 9-39; Peter T. Muchlinski, 'Holistic Approaches to Development and International Investment Law: The Role of International Investment Agreements' in Julio Faundez and Celine Tan (eds), *International Law, Economic Globalization and Developing Countries* (Cheltenham, Edward Elgar 2010) 180-204; Peter T. Muchlinski, 'Regulating Multinationals: Foreign Investment, Development and the Balance of Corporate and Home Country Rights and Responsibilities in a Globalising World' in Jose Alvarez and Karl P. Sauvant (eds), *The Evolving International Investment Regime: Expectations, Realities, Options* (New York, OUP 2011) 30-59; Non-State Actors in International Law, Politics and Governance Series (Routledge 2005-2016).

⁸¹ Joseph E. Stiglitz, *Globalization and its Discontents* (Penguin Books 2002); Joseph E. Stiglitz, *Making Globalization work* (Penguin Books 2007); Joseph E. Stiglitz, *Freefall, Free Markets and the Sinking of the Global Economy* (Penguin Books 2010); Joseph E. Stiglitz, *The Price of Inequality* (Penguin Books 2012).

⁸² Raymond Vernon, *Sovereignty at bay: Multinational Spread of U.S. Enterprises* (Longman 1971), Raymond Vernon, *Storm over the Multinationals, The Real Issues* (HUP 1977); Raymond Vernon, Louis T. Wells Jr., Subramanian Rangan, *The manager in the international economy* (Prentice Hall 1995).

⁸³ Howard V. Perlmutter, 'The Tortuous Evolution of the Multinational Corporation' (1969) Jan – Feb *Columbia Journal of World Business* 9–18; Howard V. Perlmutter, 'Perplexing Routes to M.N.E. Legitimacy: Codes of Conduct for Technology Transfer' (1976) 11 *Stan. J. Int'l Stud.* 169.

⁸⁴ Juha Kuusi, *The host state and the Transnational Corporation: An Analysis of Legal Relationships* (Saxon House 1979).

⁸⁵ Joseph E. Stiglitz, *Regulating multinational corporations: Towards principles of cross-border legal framework in a globalized world balancing rights with responsibilities* (Grotius lecture 2007).

⁸⁶ Draft United Nations Code of Conduct on Transnational Corporations, U.N. Doc. E/C.10/1982/6 annex (1982); UN Doc. E/5570/Add.1 ESCOR Res. 1913, 57 ESCOR, Supp. (No. 1A) 31, the UN Commission on TNCs, the role of the commission is '[c]onducting inquires on the activities of transnational corporations, making studies, preparing reports and organizing panels for facilitating discussions among relevant groups'; In 1975 the Commission gave top priority to the formation of a Code to be observed in dealing with transnational corporations (TNCs) and produced a Report of the First Session, UN Doc. E/C.10/6 para 9, at 2 (1975) where it highlighted areas of concerns and issues to be considered in Code negotiations 'Issues Involved in the Formulation of a Code of Conduct', UN Doc. E/C.10/17 (1976); Report of the Second Session, UN Doc. E/C/ 10/16 annex 1-4 (1976); Intergovernmental Working Group

on a Code of Conduct was established in 1977 by the UN Commission on Transnational Corporations in accordance with paragraph 1(d) of E.S.C. Res. 1913. See also Transnational Corporations in World Development, UN Doc. ST/CTC/46 para. 345, at 110 (1983) known as the Third Survey with an in depth study on aspects of TNC activity and impact in world society.

Chapter 1: Some Basic Concepts

1.1 Introduction

In this chapter an attempt has been made to explain some of the basic concepts as they are fundamentally important for the understanding of the issues with which this research is concerned. In developing this research, it is felt that misconceptions surrounding the activities of TNCs have impacted on the minds of many and it is important to bear in mind that in the final analysis TNCs are profit maximisers and the main objective of host developing states is to become economically independent. A way forward would be to sensibly negotiate a bargain between themselves and transnational corporations (TNCs).¹ Based on this premise some of the concepts will be defined, which are important for this research.

Some essential concepts have been identified for understanding and appreciating the reasons for writing this research. In this chapter an attempt is made to examine some such concepts. It is also believed that these concepts are often enmeshed with popular misconceptions. These concepts will be examined in their appropriate perspective.

One such concept is globalisation² and the question of its benefits³ to the developing states⁴, while TNCs have been making substantial profits.⁵ The perception ‘that

¹ See Fred Charles Ilk , *How nations negotiate* (Harper and Row 1964).

² It is recommended to replace globalisation with internationalisation as the concept of globalisation tends to be misleading and therefore internationalisation would be a more appropriate word to be used for future references. However literature refers to the phenomenon as globalisation with mixed conclusions.

³ Joseph E. Stiglitz, *Globalization and its Discontents* (Penguin Books 2002); Joseph E. Stiglitz, *Making Globalization work* (Penguin Books 2007); Joseph E. Stiglitz, *Freefall, Free Markets and the Sinking of the Global Economy* (Penguin Books 2010); Joseph E. Stiglitz, *The Price of Inequality* (Penguin Books 2012).

⁴ General Agreement on Tariffs and Trade, Trends in International Trade, *A Report by a Panel of Experts* (GATT, 1958).

⁵ Paul R. Krugman, Maurice Obstfeld, *International Economics: Theory and Policy* (Addison-Wesley 2000).

globalization creates poverty⁶ and inequality⁷ is however yet to be examined⁸ as there is no evidence to support raise of the living standards in host developing states.⁹

‘[T]he basic asymmetry between multinational enterprises and national governments may be tolerable up to a point, but beyond that point there is a need to re-establish balance’.¹⁰ Vernon suggested ‘accountability to some body, charged with weighing the activities of the multinational enterprise against a set of social yardsticks that are multinational in scope’.¹¹

Another such concept is transnationality, as defined by Dunning.¹² The most widely recognised definition is that ‘A multinational or transnational¹³ enterprise is an enterprise that engages in foreign direct investment (FDI) and owns or controls value-adding activities in more than one country’,¹⁴ ‘owns (in whole or in part), controls and manages income generating assets in more than one country’.¹⁵

⁶ Based on the World Bank definition of extreme poverty in 2008 there was 1,28 billion people living on less than US\$1.25 a day; 739 people were without adequate daily food intake; more than 100 million children under age of five remain malnourished. See World Bank, World Development Indicators 2012, 2-3.

⁷ World Economic Forum, Global Risks 2013, 10 has identified severe income disparity as the global risk that is most likely to manifest itself over the next decade.

⁸ Juliette Bennett, ‘Multinational Corporations, Social Responsibility and Conflict’ (2002) 55(2) Journal of International Affairs 393.

⁹ The UN General Assembly adopted the 2030 Agenda for Sustainable Development on September 25, 2015. It includes 17 Sustainable Development Goals (SDGs) to tackle poverty, inequality, injustice, and climate change by 2030. For the first time involvement of business in joint development with governments, civil society and UN agencies. Businesses are asked to help at the negotiating table by launching a Private Sector Advisory Group (PSAG) to help enhance UN-private sector engagement <www.sdgfund.org> accessed 25 February 2016. See also Peter Van den Bossche and Werner Zdouc, *The Law and Policy of the World Trade Organization* (3edn CUP 2013) <<http://www.book2look.com/vbook.aspx?id=9781107694293>> accessed 20 December 2015.

¹⁰ Raymond Vernon, *Sovereignty at bay: Multinational Spread of U.S. Enterprises* (Longman 1971) 271.

¹¹ Raymond Vernon, *Sovereignty at bay: Multinational Spread of U.S. Enterprises* (Longman 1971) 271.

¹² John H. Dunning, *Multinational Enterprises and the Global Economy* (Addison-Wesley 1993) 3.

¹³ There is a controversial element in the meaning of the transnational and multinational. The former being the better suited to fit for the purposes of explaining the essence of its nature, which is operating across the national borders and hence inter-national as in “inter” between or among nations. Multinational on the other hand is not the best word to use to describe such enterprise, because it suggests involvement of multiple nations in the basic enterprise as founding nations, such as international institutions like the Leagues of Nations or the United Nations, where multinational can truly apply. Ergo multinational should only be applied when the enterprise in its essence is composed and owned by multiple nations, which is not the case for the enterprise as a corporation conducting business across national borders. However, the terminology has been misused for so long it is extremely difficult to reverse back to the clearer definition. See Cynthia Day Wallace, *Legal Control of the Multinational Enterprise* (2nd edn, Springer 1983) 10-13.

¹⁴ John H. Dunning, *Multinational enterprises and the Global Economy* (Addison-Wesley 1993) 3-4.

¹⁵ Neil Hood, Stephen Young, *The Economics of the Multinational Enterprise* (Longman 1979) 3.

The United Nations Conference on Trade and Development (UNCTAD) defined TNCs as:

[I]ncorporated or unincorporated enterprises comprising parent enterprises and their foreign affiliates. A parent enterprise is defined as an enterprise that controls assets of other entities in countries other than its home country, usual by owing a certain equity capital stake. An equity stake of 10% or more of the ordinary shares or voting power for an incorporated enterprise, or its equivalent for an unincorporated enterprise, is normally considered as an threshold for the control of assets.¹⁶

Lilienthal defined TNCs as ‘corporations...which have their home in one country but which operate and live under the laws and customs of other countries as well’.¹⁷ In this research the term “transnational” is used rather than “multinational”.¹⁸ However Aharoni maintained that ‘there was no general agreement on the definition of multinational corporations’.¹⁹ The UN Transnational Corporations in World Development series defined them as transnational corporations.²⁰ The same applies to the neo-classical theory as well as according to the UN, development of a country is based on their Gross National Product (GNP), Gross Domestic Product (GDP), per capita income and growth.²¹

The United Nations Conference on Trade and Development (UNCTAD) definition of Foreign Direct Investment (FDI) states that:

FDI is defined as an investment involving a long-term relationship and reflecting a lasting interest and control of a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate).²²

¹⁶ UN Commission on Transnational Corporations, *Transnational Corporations in World Development: A Re-Examination* (1978 UN Sales No. E.78.II.A.5.) Annex I, 158-159; The United Nations Conference on Trade and Development (UNCTAD 2002b) 291.

¹⁷ David K. Fieldhouse, ‘The multinational: a critique of a concept’ in Alice Teichova et al (eds) *Multinational Enterprise in Historical Perspective* (CUP 1986) 9-10.

¹⁸ This research maintains that all business activities that go across their national borders, should be called transnational, while Multinational implies involvement of multiple nationalities it does not however put an emphasis on conducting business across national borders. See also Christopher A. Bartlett and Sumantra Ghoshal, *Managing across borders. The Transnational Solutions* (Harvard Business School Press 1989).

¹⁹ See Yair Aharoni, 'On the Definition of a Multinational Corporation' (1971) 2 Nov-Dec Quarterly Review of Economics and Business 27-37.

²⁰ See The United Nations, *World Investment Reports, UN/WIR/1991-2016*.

²¹ See Gerald M. Meier and James E. Rauch, *Leading Issues in Economic Development* (7th edn, OUP 2000).

²² The United Nations Conference on Trade and Development (UNCTAD 2002) 291.

In 1962 on the initiative of Chile the UN adopted Resolution on Permanent Sovereignty over Natural Resources²³ that imposed some conditions on the foreign investors. The Resolution stated that:

The exploration, development and disposition of such resources, as well as the import of the foreign capital required for these purposes, should be in conformity with the rules and conditions which the peoples and nations freely consider to be necessary or desirable with regard to the authorization, restriction or prohibition of such activities²⁴ ... [T]he profits derived must be shared in the proportion freely agreed upon, in each case, between the investors and the recipient State,...²⁵

The Resolution clearly supports the fair distribution of profits between the foreign investors and host developing states. However, the concrete terms and conditions of such profit distribution have to be agreed during the negotiation process in order to become a part of contract binding agreement.

Since 1980 many academics have been researching the impacts of private foreign investment on developing states, namely Kumar and McLeod,²⁶ Lall,²⁷ Lecraw,²⁸ Oman,²⁹ Wells³⁰ and Goldstein.³¹ First report in the series of the World Investment Reports was done in 1991 and until the present day the views are still split between critics and supporters of TNCs as private foreign investors, namely on the impact of private foreign investments on socio-economic development of host developing states.³²

²³ UNGA Res A/1803/XVII of 14 December 1962, Permanent Sovereignty over Natural Resources; UNGA Res A/523/VI of 12 January 1952; UNGA Res A/626(VII) of 21 December 1952; UNGA Res A/1314(XIII) of 12 December 1958; UNGA Res A/1515(XV) of 15 December 1960.

²⁴ UNGA Res A/1803/XVII of 14 December 1962, Permanent sovereignty over natural resources I (2).

²⁵ UNGA Res A/1803/XVII of 14 Dec 1962, Permanent Sovereignty over Natural Resources I (3).

²⁶ Krishna Kumar and M.G. McLeod (eds), *Multinationals from Developing Countries* (Lexington Books 1981).

²⁷ Sanjaya Lall, *The New Multinationals: The Spread of Third World Enterprises* (Wiley Chichester 1983).

²⁸ Donald J. Lecraw, 'Internationalisation of Firms from LDCs: Evidence from the ASEAN Region' in K. Kumar and M.G. McLeod (eds), *Multinationals from Developing Countries* (Heath 1981).

²⁹ Charles Oman (ed), *New Forms of Overseas Investment by Developing Countries: The Case of India Korea and Brazil* (OECD development centre Paris 1986).

³⁰ Louis T. Wells Jr., *Third World Multinationals: The Rise of Foreign Direct Investment from Developing Countries* (MIT Press 1983).

³¹ Andrea Goldstein, 'Emerging Multinationals' in the Global Economy: Data Trends, Policy Issues, and Research Questions (OECD Development Centre Paris 2005).

³² See UN World Investment Report series from 1991

<<http://unctad.org/en/pages/DIAE/World%20Investment%20Report/WIR-Series.aspx>> accessed 20 February 2016. The UNCTAD have made an attempt to explain the relationship between TNCs and FDIs

This research attempts to bring clarity on the role of law, while investigating the interests and aspirations of TNCs, the UN and host developing states. These arguments are made using the balance of interests as a basic parameter and by drawing on the extensive empirical literature that assesses the determinants and consequences of the role of law concerning activities of TNCs in host developing states. Based on the review of the published literature, bilateral investment treaties (BITs), international institutions and organisations, contribution by various authors, decisions of ICSID, ICJ, international tribunals and a number of case studies, the conclusions are drawn.

1.2 Bargaining Position

Misconception of bargaining power derives from the strategy³³ of achieving goals as a stronger power and it originates from the military³⁴ history.³⁵ Hence bargaining power in terms of force is a misleading concept and has been therefore replaced with bargaining position. Freedman added that ‘This balance requires not only finding out how to achieve desired ends but also adjusting ends so that realistic ways can be found to meet them by available means’.³⁶

To reiterate that the term “bargaining power” might not be the most appropriate term and has been therefore replaced with “bargaining position” rather than power. Developing states have bargaining position, and it is important that they recognise it in spite of being exposed to the “colonisation of the mind”³⁷ and ideology of westernisation.

in terms of development. The reports cover a wide area relating to the activities and role of TNCs effectively in the relationship with the UN.

³³ Lawrence Freedman, *Strategy, A history* (Oxford University Press 2013) IX.

³⁴ See Arthur F. Lykke, Jr., *Toward an Understanding of Military Strategy, Military Strategy: Theory and Application* (US Army War College 1989) 3-8.

³⁵ Sun Tzu, *The Art of war* (written in cca. 512 BC, Classic Books International 2009).

³⁶ Lawrence Freedman, *Strategy, A history* (OUP 2013) XI.

³⁷ Marcelo Dascal in his paper 'Colonizing and decolonizing minds' (Tel Aviv University 2008) defined the colonisation of the mind with the following characteristics (a) the intervention of an external source – the ‘colonizer’ – in the mental sphere of a subject or group of subjects – the ‘colonized’; (b) this intervention affects central aspects of the mind’s structure, mode of operation, and contents; (c) its effects are long-lasting and not easily removable; (d) there is a marked asymmetry of power between the parties involved;

The perception of bargaining position has to change towards striking a balanced relationship between transnational corporations (TNCs) and host developing states, notwithstanding that TNCs act as superior party. TNCs have to start recognising the bargaining position of host developing states. At the same time developing states have to start using their bargaining position and be more confident when negotiating investment agreements with TNCs.

Bargaining theory states that parties in a negotiation possess power over each other, which can be used to affect the course of the negotiation process.³⁸ Kobrin among others supported the idea that power usually derives from possession of attributes, which one party aspires and the other possess.³⁹ Inkpen and Beamish stressed that bargaining power depends therefore on the availability of resources.⁴⁰

The main interaction between the TNCs and the host developing states predominantly takes place during the negotiation process, where the benefits are distributed between the negotiating parties. According to Kobrin 'the actual distribution of benefits depends on agreed terms relative to the bargaining position of the host country and TNCs'.⁴¹ Moran argued that the bargaining model between host developing states and TNCs interactions consist of economic nationalism in terms of rational self-interest.⁴² The UN report reviewed key issues on the bargaining between TNCs and host developing states and their bargaining position to take the major share of the investment project's benefits.⁴³

(e) the parties can be aware or unaware of their role of colonizer or colonized; and (f) both can participate in the process voluntarily or involuntarily.

³⁸ Keith D. Brouters, Gary J. Bamossy, 'The Role of Key Stakeholders in the International Joint Venture Negotiations: Case Studies from Eastern Europe' (1997) 28(2) *Journal of International Business Studies* 285-308.

³⁹ Stephen J. Kobrin, 'Testing the bargaining hypothesis in the manufacturing sector in developing countries' (1987) 41(4) *International Organization* 609-638.

⁴⁰ Andrew C. Inkpen, and Paul W. Beamish, 'Knowledge, bargaining power, and the instability of international joint ventures' (1997) 22(1) *Academy of Management Review* 177-202.

⁴¹ Stephen J. Kobrin, 'Testing the bargaining hypothesis in the manufacturing sector in developing countries' (1987) 41(4) *International Organization* 609.

⁴² Theodore H. Moran, 'Multinational corporations and the developing countries. An analytical overview' in Theodore H. Moran (ed), *Multinational corporations: The political economy of Foreign Direct Investment* (Lexington 1985) 3-24.

⁴³ UN Report: Formulation and Implementation of Foreign Investment Policies: Selected Key Issues, Transnational Corporations and Management Division Department of Economics and Social Development (1992) ch V, 70 <<http://unctc.unctad.org/data/e92iia21a.pdf>> accessed 29 May 2015.

Reuber,⁴⁴ Lecraw⁴⁵ and Kobrin⁴⁶ suggested that the attraction of the domestic market increases the host government's bargaining position across a broader range of states.

Bargaining position as the ability to negotiate, where "bargain" accounts for 'discussion between two parties of the terms on which one is to give or do something to or for the other' as well as 'agreement between two parties setting how much each gives and takes, or what each performs and receives in a transaction between them'.⁴⁷

As mentioned before developing states do have bargaining position but often fail to recognise it for two primary reasons. One is the historical position of submissiveness and the second is psychological.

TNCs often fail to acknowledge that developing states have bargaining position. Grosse and Behrman⁴⁸ maintained that numerous theories on international business 'fail to focus on the distinguishing characteristics of business operating among different nations'⁴⁹ where the fundamental element is the relationship between the firms and the governments. It is a two-way process. On one side the firm identifies the host developing state where they would like to conduct their business and the government of the host developing state on the other side regulate and makes policies on admission of private foreign investments. Hence, Grosse and Behrman suggested that the 'theory can be built on existing bargaining power'.⁵⁰

Foreign investors and beneficiaries as well as the relationship between host developing states and TNCs can be analysed in terms of bargaining position.⁵¹ In the past few decades the issues of bargaining position was based on the concept 'that the stronger or mightier has a prerogative to dominate the weak'.⁵² While states bargaining position was

⁴⁴ Grant Louis Reuber, *Private Investment in Development* (Clarendon Press 1973).

⁴⁵ Donald J. Lecraw, 'Bargaining Power, Ownership, and Profitability of Transnational Corporations in Developing Countries' (1984) 15(1) *Journal of International Business Studies* 27–43.

⁴⁶ Stephen J. Kobrin, 'Testing the bargaining hypothesis in the manufacturing sector in developing countries' (1987) 41 *International Organization* 609-638.

⁴⁷ *The Oxford English Dictionary* (2nd edn, OUP 1989) vol 7, 953.

⁴⁸ Grosse and Behrman are referring primarily to the theories of David Ricardo on competitive advantage, Raymond Vernon on product life cycle and John Dunning on eclectic theory.

⁴⁹ Robert Grosse and Jack N. Behrman, 'Theory in international business, Transnational Corporations' (1992) 1(1) 93-126, 93.

⁵⁰ Robert Grosse and Jack N. Behrman, 'Theory in international business, Transnational Corporations' (1992) 1(1) 93-126, 93.

⁵¹ Raymond Vernon, *Sovereignty at bay: the multinational spread of US enterprises* (Longman 1971).

⁵² Charles Chatterjee, *International law and diplomact* (Routledge 2010) 90.

primarily based on the military, economic and technological strength, the TNCs bargaining position is based mainly on their capital contribution. It wasn't until the newly born independent states became aware of their sovereignty, which consequently made them aware of their bargaining position. Chatterjee asked 'whether possession of such power should necessarily give a stronger state the prerogative to dominate the other party in negotiating any matter'.⁵³

The UN Centre on Transnational Corporations made a note in their study claiming that developing states can use their bargaining position in order to acquire new technology:

[D]eveloping countries have generally shown pragmatism and flexibility, recognising that the world technology market is imperfect, that it is difficult to determine the reasonableness of the price for technology and that in the final analysis, the price is the outcome of the crude bargaining power of the technology supplier and the recipient.⁵⁴

The Report added that:

[T]he purpose of regulation has been, first, to strengthen the bargaining position of the national recipient entities; secondly, to reduce the overall level of technology payments; and thirdly, to take an integrated view of foreign participation for evaluating the implications instead of looking only at foreign equity investment.⁵⁵

Government of host developing states were keen on achieving socio-economic independence and:

To a certain extent, governments have also been motivated by the need to minimise unjustified transfer through transaction between parent companies and affiliated enterprises.⁵⁶

⁵³ Charles Chatterjee, *International law and diplomacy* (Routledge 2010) 90.

⁵⁴ UN Centre on Transnational Corporations, *Transnational Corporations in World Development* (New York 1985) 51.

⁵⁵ UN Centre on Transnational Corporations, *Transnational Corporations in World Development* (New York 1985) 51.

⁵⁶ UN Centre on Transnational Corporations, *Transnational Corporations in World Development* (New York 1985) 51.

Better negotiating skills do not consequently reflect stronger bargaining position. However, this does not mean that the negotiation skills are interchangeable with the bargaining position nor does it mean that they are the same. Bargaining position by definition is something that is determined outside, given the opportunity under certain circumstances.⁵⁷ Bargaining position therefore also depends on the environment in which the negotiations are taking place.

Ilké defined negotiations without the interference of bargaining power and has focused primarily on the negotiation process as an exchange of proposals and maintained that:

Negotiations is a process in which explicit proposals are put forward ostensibly for the purpose of reaching agreement on an exchange or on the realisation of a common interest where conflicting interest are present. It is the confrontation of explicit proposals that distinguishes negotiation from tacit bargaining and other forms of conflict behaviour.⁵⁸

Phatak and Habib model⁵⁹ explained the environment context of international business negotiations,⁶⁰ in outer circle and includes legal and political pluralism, currency fluctuations and foreign exchange, foreign government controls and bureaucracy, instability and change, ideological and cultural difference, and the influence of external stakeholders. The immediate context in inner circle includes “relative bargaining power” of negotiations and nature of dependence, immediate stakeholders, desired outcome of negotiations, relationship between negotiators before and during the negotiations and levels of conflict underlying potential negotiations.

The findings suggest that transitional governments as key stakeholders intervene at different stages of the negotiation process, have both direct and indirect influences on the process, and that they can change the balance of power in the negotiations, sometimes to the detriment of their own state-owned enterprise.⁶¹

⁵⁷ See also Franklin R. Root, ‘Environmental risks and the bargaining power of multinational corporations’ (1988) 3(1) *The International Trade Journal* 115.

⁵⁸ Fred Charles Ilké, *How nations negotiate* (Harper and Row 1964) 3.

⁵⁹ Arvind V. Phatak and M. Habib ‘The Dynamics of International Business Negotiations’ (1996) *Business Horizons*.

⁶⁰ The Public International Law & Policy Group and Baker & McKenzie, *The International Negotiations Handbook, Success through Preparation, Strategy, and Planning* 2007.

⁶¹ Keith D. Brouthers, and Gary J. Bamossy, ‘The Role of Key Stakeholders in the International Joint Venture Negotiations: Case Studies from Eastern Europe’ (1997) 28(2) *Journal of International Business Studies* 285-308.

Alternative options might give TNCs better bargaining position. Kobrin argued that when conflict and compatibility coexist, a range of mutually acceptable agreements are possible.⁶² 'The weakest bargaining position for the host country occurs when the investor's opportunity foregone is the difference in positive net profits between alternative investment'.⁶³ According to Schelling⁶⁴ bargaining power is the ability to influence the outcome of a negotiation. The main interest of TNCs is making profit,⁶⁵ and in this quest the executives work towards protecting their profit making interest and that is by acquiring control in respect to the bargaining position during the negotiation process.

It is important to distinguish between bargaining position on one hand, and negotiating skills on the other.⁶⁶ Brouthers and Bamossy argued that a key stakeholder may be able to shift the balance of bargaining position during a joint negotiation, and thus change the outcome of the negotiation process.⁶⁷ Kindleberger and Vernon have accepted the bargaining model between TNCs and host developing states.⁶⁸ Bargaining power alone is not sufficient, as knowledge, skills and experience can have much greater influence on utilisation of the bargaining position in the negotiation process.⁶⁹

The key stakeholder can influence the bargaining position of both the domestic and foreign firm by providing government controlled resources such as access to natural

⁶² Stephen J. Kobrin, 'Testing the bargaining hypothesis in the manufacturing sector in developing countries' (1987) 41(4) *International Organization* 609-638.

⁶³ UNSD, United Nations Conference on Environment & Development 1992, 70
<<https://sustainabledevelopment.un.org/content/documents/Agenda21.pdf>> accessed 12 June 2015.

⁶⁴ Thomas C. Schelling, 'An Essay on Bargaining' (1956) 46(3) *The American Economic Review* 281-306.

⁶⁵ Vernon argued that the goal of TNCs is profit maximisation, while the goal of the nation state is broader and involves socio-economic and political aspects, while both institutions have responsibilities, former to the shareholders and the latter to the citizens. However, there is also an important distinction, while TNCs operate across borders the nation state is limited by its own borders and consequently the interactions between TNCs and states lead to conflicts. See Raymond Vernon, *Sovereignty at bay: Multinational Spread of U.S. Enterprises* (Longman 1971).

⁶⁶ The United Nations, Transnational Corporations and Management Division Department of Economic and Social Development: *Formulation and Implementation of Foreign Investment Policies: Selected Key Issues ch V: Bargaining between TNCs and host countries*, 1992) 69-75.

⁶⁷ Keith D. Brouthers and Gary J. Bamossy, 'The Role of Key Stakeholders in the International Joint Venture Negotiations: Case Studies from Eastern Europe' (1997) 28(2) *Journal of International Business Studies* 285-308.

⁶⁸ Charles P. Kindleberger, *Six lectures on direct investment* (Yale University Press 1969) 145.

⁶⁹ Paul Streeten, 'Bargaining with multinationals' (1976) 4(3) *World Development* 225-229.

resources, providing required license approvals, or providing currency conversion and repatriation of profits.⁷⁰

Bargaining position has an important influence on the industry structure, which depends also on the number of TNCs that could negotiate a joint venture with the State-Owned-Enterprises (SOEs).⁷¹ Lecraw⁷² argued that when a key stakeholder take actions and try to restrict the number of potential foreign partners the result will be seen as a decrease in the domestic firm's bargaining power, however the key stakeholder has the ability to force a domestic firm to form an IJV, despite the desires of the firm's managers.⁷³ These so-called "forced" IJVs then create all kinds of different and intentional negotiation problems for TNCs, which do not necessarily happen in cases where IJVs are formed with consent.⁷⁴ This only reiterates the importance of negotiating the conditions and structure of ownership and profit sharing, which should become part of the legally binding terms of the investment agreement.

Brouthers and Bamossy suggested that 'ultimately, the key stakeholder can alter the outcome of the negotiation process by shifting the bargaining power of the MNE and state-owned-enterprises (SOE) participants' and claim that 'in the government's role as key stakeholder, it does impact bargaining power at different stages of the negotiation process, and that the impact is sometimes detrimental to the SOE'.⁷⁵ Host developing states should better negotiate the terms and conditions of investment agreements, which should contain capacity building clause, re-negotiation clause, succession clause, performance clause and transfer of profits in addition to the protection of foreign

⁷⁰ Keith D. Brouthers and Gary J. Bamossy, 'The Role of Key Stakeholders in the International Joint Venture Negotiations: Case Studies from Eastern Europe' (1997) 28(2) *Journal of International Business Studies* 285-308.

⁷¹ Keith D. Brouthers and Gary J. Bamossy, 'The Role of Key Stakeholders in the International Joint Venture Negotiations: Case Studies from Eastern Europe' (1997) 28(2) *Journal of International Business Studies* 285-308.

⁷² Donald J. Lecraw, 'Bargaining power, ownership, and profitability of transnational corporations in developing countries' (1984) 15(1) *Journal of International Business Studies* 27-43.

⁷³ Keith D. Brouthers and Gary J. Bamossy, 'The Role of Key Stakeholders in the International Joint Venture Negotiations: Case Studies from Eastern Europe' (1997) 28(2) *Journal of International Business Studies* 285-308.

⁷⁴ Steven B. Tallman and Shenkar Oded, 'A managerial decisionmaking model of international cooperative venture formation' (1994) 25(1) *Journal International Business Studies* 91-113.

⁷⁵ Keith D. Brouthers and Gary J. Bamossy, 'The Role of Key Stakeholders in the International Joint Venture Negotiations: Case Studies from Eastern Europe' (1997) 28(2) *Journal of International Business Studies* 285-308.

investment and set of standards of treatment.⁷⁶ Kindleberger supported the idea that as the interests of host states and foreign investors are likely to diverge, the two parties become antagonists and governments seek to re-negotiate the initial concession agreement when the initial advantages of TNCs decline,⁷⁷ for which re-negotiation clause must be included in the investment agreement.

1.3 Ownership and Control

How much does ownership really matter is the question that remains to be answered. As Madhok maintained that ‘there is still no consensus on the issue’ of which control is preferred dominant, minority’, or ‘equal, as measured by the extent of equity ownership, have all been linked to performance (howsoever defined) but with no consistent results’.⁷⁸

Berle and Means suggested treating shareholders as investors who have no necessary claims to control as ‘the owners of passive property’, because they have surrendered ‘control and responsibility over the active property’ as well as ‘the right that the corporation should be operated in their sole interest’ and added that ‘Neither the claims of ownership nor the those of control can stand against the paramount interests of the community’.⁷⁹

Demsetz⁸⁰ argued that ‘ownership tends to be an individual affairs’ and that the most notable “exception” is the publically held corporation. “Owners” of which tend to form the so called joint-stock-companies because the economies of scale only exist in the

⁷⁶ See for example Richard S. Newfarmer, ‘International Industrial Organization and Development: A survey’ in Richard S. Newfarmer (ed), *Profit, Progress and Poverty: Case studies of international industries in Latin America* (University of Notre Dame Press 1985) 13–61.

⁷⁷ Charles P. Kindleberger, *Six lectures on direct investment* (Yale University Press 1969) 145.

⁷⁸ Anoop Madhok, ‘How much does ownership really matter? Equity and trust relations in joint venture relationships’ (2006) 37(1) *Journal of International Business Studies* 4-11.

⁷⁹ Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (first published 1932, 2nd edn, Transaction Publishers 1991).

⁸⁰ Harold Demsetz, ‘Towards a Theory of Property Rights’ (1967) 57(2) *The American Economic Review* 347-359, 357; Alison Clark and Paul Kohler, *Property Law: Commentary and Materials* (CUP 2005) 324.

operating of these enterprises and not in the provision of the capital.⁸¹ The reason for the stock owners and therefore the owners of the corporation do not (cannot) participate in the decision making process is again directly related to the economies of scale. Through “delegated authority” ‘a small management group becomes the *de facto* owners’.⁸² However the partnership law commits the shareholders, in the case the corporation has debts, to meet the debts ‘up to the limits of his financial ability’.⁸³ In the limited liability corporations ‘Shareholders are essentially lenders of equity capital and not owners, although they do participate in such infrequent decisions as those involving mergers’.⁸⁴

Ownership was separated from the control and the shareholders no longer had any control over the management decisions. The separation of ownership and control is not a new phenomenon as it dates back to 1776 when Adam Smith wrote about joint stock companies and stated that:

[B]eing the managers rather of other people’s money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own...⁸⁵

Smith did not believe in this separation as he feared that the managers would be inefficient, because they would lack the incentives to operate as owner-managers would. Jensen and Meckling characterised the separation of ownership and control as an agency problem, a conflict between management and stockholders.⁸⁶

⁸¹ Harold Demsetz, 'Towards a Theory of Property Rights' (1967) 57(2) *The American Economic Review* 347-359, 357; Alison Clark and Paul Kohler, *Property Law: Commentary and Materials* (CUP 2005) 324.

⁸² Harold Demsetz, 'Towards a Theory of Property Rights' (1967) 57(2) *The American Economic Review* 347-359, 357; Alison Clark and Paul Kohler, *Property Law: Commentary and Materials* (CUP 2005) 324.

⁸³ Harold Demsetz, 'Towards a Theory of Property Rights' (1967) 57(2) *The American Economic Review* 347-359, 357; Alison Clark and Paul Kohler, *Property Law: Commentary and Materials* (CUP 2005) 324.

⁸⁴ Harold Demsetz, 'Towards a Theory of Property Rights' (1967) 57(2) *The American Economic Review* 347-359, 357; Alison Clark and Paul Kohler, *Property Law: Commentary and Materials* (CUP 2005) 324.

⁸⁵ Adam Smith, *The Wealth of Nations*, (first published 1776, Andrew S. Skinner ed, Penguin Books 1999) bk 5, ch 1, part 3, art 1.

⁸⁶ Michael C. Jensen and William H. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3(4) *Journal of Financial Economics* 305-360.

Behrman stated at the summary of hearings before the Group of Eminent Persons that the main issue in the relationship between TNCs and governments was the issue of control not ownership.⁸⁷

On the complete opposite side of an argument are the foundations of the Bullock Report 1977.⁸⁸ The Report was a product of in depth research of new phenomenon that involved substantial numbers of people being employed by TNCs and the topic of ownership and control gained momentum. The European Commission drafted the fifth directive on the company law coinciding with the draft statute for the European company, which included provision on worker directors on company boards.⁸⁹ At the same time union policy was translated into government action which led to the formation of the Bullock Committee.⁹⁰

Mjoen and Tallman⁹¹ and Yan and Gray⁹² claimed that control is significantly shaped by the bargaining power. Tallman and Shenkar⁹³ claimed that international joint venture (IJV) may be created under the influence of a key stakeholder, in order to control crucial resources. Peng and Heath⁹⁴ suggested that ‘the government controls the ownership of the State-Owned Enterprise’s (SOE’s)’, as well as ‘state’s resources and distribution channels’.⁹⁵

Steensma and Lyles,⁹⁶ on the other hand, argued that shared control creates mutual respect and a sense of fairness that promotes trust and reduces conflict between joint venture parents. Yang and Grey⁹⁷ however found evidence for both of the opposing points of

⁸⁷ UN Department of Economic and Social Affairs, *Summary of the Hearings before the Group of Eminent Persons* (UN 1979) 11.

⁸⁸ Report of the Committee of Inquiry on Industrial Democracy, *The Bullock Report 1977*.

⁸⁹ Bull.E.C. 10/72, 8/75 and 4/75 (Green Paper on the directive and draft European statute).

⁹⁰ Nita Clarke, *The Bullock Report: Thirty-five years old and still relevant today*, (IPA, 24 March 2012) <<http://www.ipa-involve.com/news/the-bullock-report/>> accessed 12 June 2015.

⁹¹ Hans Mjoen, and Stephen Tallman, ‘Control and Performance in International Joint Ventures’ (1997) 8(3) *Organization Science* 257-274.

⁹² Aimin Yan and Barbara Gray, ‘Bargaining power, management control, and performance in US – China joint ventures: a comparative case study’ (1994) 37(6) *Academy of Management Journal* 1478–517.

⁹³ Steven B. Tallman and Shenkar Oded, ‘A managerial decision making model of international cooperative venture formation’ (1994) 25(1) *Journal International Business Studies* 91-113.

⁹⁴ Mike W. Peng and Peggy Sue Heath, ‘The growth of the firm in planned economies in transition: Institutions, organizations, and strategic choice’ (1996) 21(2) *Academy of Management Review* 492–528.

⁹⁵ Mike W. Peng and Peggy Sue Heath, ‘The growth of the firm in planned economies in transition: Institutions, organizations, and strategic choice’ (1996) 21(2) *Academy of Management Review* 492-528.

⁹⁶ Kevin H. Steensma and Marjorie A. Lyles, ‘Explaining IJV survival in a transitional economy through social exchange and knowledge- based perspectives’ (2000) 21 *Strategic Management Journal* 831-851.

⁹⁷ Aimin Yan and Barbara Gray, ‘Antecedents and effects of parent control in international joint venture’ (2001) 38 (3) *The Journal of Management Studies* 393- 416.

views. Apart from the ownership, overall bargaining power and shareholder agreement and inside and outside control could also depend on the management.⁹⁸ That would make management more important than ownership.⁹⁹

‘The relationship between TNCs and host developing countries can be viewed as a bargaining relationship in which each party has certain resources the other needs and certain goals it wants to achieve’.¹⁰⁰ There are limited evidences¹⁰¹ that TNCs have developed the infrastructure in the developing states or have contributed to the capacity building.¹⁰² The UNCTAD report ‘stress the risk of FDI endangering local capabilities and extracting natural resources without adequately compensating poor countries’ however ‘in the past three decades has been that governments have become more favourable towards FDI’.¹⁰³ Lall maintained that governments of host states are liberalising foreign investment policies when they identify foreign investments beneficial to the socio-economic development.¹⁰⁴

Host developing states can increase its bargaining position by using their right to change legislation, laws, improve political stability, and change economic policies that will create more favourable investment environment. Root argued that in most circumstances compromise is required.¹⁰⁵ Furthermore, a host government can also withhold licences or approvals that are crucial for the operations of TNCs. A host government can exercise its right to restrict market access. Miozzo et al. research results showed that there is a

⁹⁸ The concept of management in this sense is meant leadership, the decision and policy makers.

⁹⁹ Donald C. Hambrick, Jiatao Li, Katherine Xin, Anne S. Tsui, ‘Compositional gaps and downwards spirals in international joint ventures management groups’ (2001) 22 *Strategic Management Journal* Strat. Mgmt. J 1033–53.

¹⁰⁰ UN Formulation and Implementaion of FDI Policies (1992) 69.

¹⁰¹ See also UNCTAD, Main Findings of a Study of Private Foreign Investment on Selected Developing Countries (TD/B/C.3/111).

¹⁰² Isaiah Frank, *Foreign Enterprise in Developing countries* (Johns Hopkins University Press 1980) 25.

¹⁰³ Dirk Willem te Velde, ‘Foreign Direct Investment and Development, An historical perspective ODI’ (Overseas Diplomatic Institute 30 January 2006, commissioned by UNCTAD) 2.

¹⁰⁴ Sanjaya Lall, FDI and Development: Research Issues in the Emerging Context (Policy discussion paper 20, Centre for International Economic Studies, University of Adelaide 2000).

¹⁰⁵ Franklin R. Root, ‘Environmental risks and the bargaining power of multinational corporations’ (1988) 3(1) *The International Trade Journal* 115.

preference to global sourcing and maintaining relations with multinational suppliers, rather than the local ones.¹⁰⁶ In any case TNCs ‘must make some key trade-offs’.¹⁰⁷

Developing states will not face problems attracting private foreign investments with balanced liberalised markets, which happened in the case of China. Latin America on the other hand had the support of international organisations,¹⁰⁸ but did not manage to reach similar economic growth, nor reduce poverty, namely due to the poor management.¹⁰⁹

The UN resolution on Permanent Sovereignty over Natural Resources 1962 in Article I(6) stressed that:

International co-operation for the economic development of developing countries, whether in the form of public or private capital investment, exchange of goods and services, technical assistance, or exchange of scientific information, shall be such as to further their independent national development and shall be based upon respect for their sovereignty over their natural wealth and resources.¹¹⁰

TNCs as investors therefore cannot have ownership over natural resources of a sovereign state, only control to a limited extent that can be beneficial to the socio-economic development of developing state. In any case there is a need to close the gap between aspirational differences between ownership and control among TNCs and sovereign states. Furthermore ‘owner shall be paid appropriate compensation, in accordance with the rules in force in the state taking such measures in the exercise of its sovereignty and in accordance with international law’.¹¹¹

Fagre and Wells Jr.¹¹² maintained in their study that the equity ownership would eliminate the control and economic benefits that the economists would consider to be priority

¹⁰⁶ Marcela Miozzo, Mo Yamin and Pervez N. Ghauri, 'Strategy and structure of service multinationals and their impact on linkages with local firms' (2012) 32:7 *The Service Industries Journal* 1171-91.

¹⁰⁷ Benjamin Gomes-Casseres, 'Firm ownership preferences and host government restrictions: An integrated approach' (1990) 21(1) *Journal of International business studies* 1, 2.

¹⁰⁸ Including government involvement, World Bank and IMF.

¹⁰⁹ See further UNCTAD, Dirk Willem te Velde, *Foreign Direct Investment and Development, An historical perspective ODI* (Overseas Diplomatic Institute 30 January 2006) 4.

¹¹⁰ UNGA Res A/1803(XVII) I(6) 1962.

¹¹¹ UNGA Res A/1803(XVII) I(6) 1962.

¹¹² Nathan Fagre and Louis T. Wells Jr., 'Bargaining power of multinational and host governments (1982) 13(2) *Journal of International Business Studies* 9-24.

between TNCs and host developing states as a measure of the bargaining position. From the economic point of view 'taxes and other financial provisions can assure the government economic benefits that are unrelated to the degree of ownership'.¹¹³ Stopford and Wells¹¹⁴ argued that when TNCs decide on the objective, their need for resources or their need for control, they try to negotiate it with the host country's government.¹¹⁵

Studies of restrictive host governments suggests that ownership policies do not have any across-the-board effect on ownership structure and actually their effect depends on the characteristics of the industry, the subsidiary, and especially, the host developing state which led Gomes-Casseres to suggest that the bargaining power is the essential ingredient for the negotiation process.¹¹⁶

There is also the right to appoint board members or others with the function and responsibility to control the relationships and operations that according to Fagre and Wells Jr.¹¹⁷ does not depend on the ownership. Motivation behind the control is primarily based on political interests, which makes the host governments unstable and on occasion unreliable in the eyes of the TNCs, because 'Politically unstable countries tend to receive relatively small amounts of FDI'.¹¹⁸ 'The main exception to this rule are countries rich in natural resources which have managed to attract considerable amounts of FDI despite often unstable environments'.¹¹⁹ Ownership element therefore is more important to the TNCs and less to the governments of host developing states. This is also the reason that TNCs are reluctant to coexist in the joint ventures. However, Vernon 'found that TNCs were sometimes prepared to accept – even to welcome local joint ventures, provided the bargaining position of the local partner was sharply limited'.¹²⁰ Studies have shown that

¹¹³ Nathan Fagre and Louis T. Wells Jr., 'Bargaining power of multinational and host governments (1982) 13(2) Journal of International Business Studies 9-24, 10.

¹¹⁴ John M. Stopford and Louis T. Wells, Jr., *Managing the Multinational Enterprise* (Basic Books 1972) 155-156.

¹¹⁵ Nathan Fagre and Louis T. Wells Jr., 'Bargaining power of multinational and host governments (1982) 13(2) Journal of International Business Studies 9-24, 10.

¹¹⁶ Benjamin Gomes-Casseres, 'Firm ownership preferences and host government restrictions: An integrated approach' (1990) Journal of International business studies 1-22.

¹¹⁷ Nathan Fagre and Louis T. Wells Jr., 'Bargaining power of multinational and host governments (1982) 13(2) Journal of International Business Studies 9-24, 10.

¹¹⁸ Dirk Willem te Velde, *Foreign Direct Investment and Development, An historical perspective* (Overseas Development Institute, 2006) 9.

¹¹⁹ Dirk Willem te Velde, *Foreign Direct Investment and Development, An historical perspective* (Overseas Diplomatic Institute 30 January 2006) 4.

¹²⁰ Raymond Vernon, *Sovereignty at bay: the multinational spread of US enterprises* (Basic Books 1971) 140.

mainly small firms in an industry tend to favour joint-ventures (JVs) as they are more pressed to expend, especially to the foreign markets than the leading firms.¹²¹

The question that awaits clarification is if the ownership gives to either party also the control? When speaking about ownership and profit distribution it is worth mentioning that the full ownership does not necessarily bring the highest profits, because it has been proven in some cases that the reduced equity share could actually bring bigger profits to TNCs. Lecraw¹²² suggested that the control of critical operational variable by the TNCs is directly related to success. As mentioned earlier the countries have the ability to determine and define the restrictions on the equity ownership in various sectors of their economy. The same applies to the host developing states. Some countries might decide not to pose restrictions on the equity ownership held by the TNCs when other countries might have severe restrictions or even prohibit it in many industry sectors.¹²³ There exists a third option to initially allow the equity share under the condition that the ownership share is reduced or eliminated over time.

Vernon identified the following four factors as being crucial to determining the level of equity ownership of TNCs in their subsidiaries:

1. The desired ownership level of the TNC
2. The bargaining power of the TNC
3. The desired level of local equity participation of the host country
4. The bargaining power of the host government (including the bargaining power of locally-owned firms in the host country).¹²⁴

¹²¹ John M. Stopford and Louis T. Wells Jr., *Managing the Multinational Enterprise* (Basic Books 1972); L.G. Franko, 'New forms of investment in developing countries by US companies: a 5 industry comparison' (1987) *Colombia Journal of World Business* 39-56.

¹²² Donald J. Lecraw, 'Bargaining power, ownership and profitability of subsidiaries of transnational corporations in developing countries' (1984) 15(1) *Journal of International Business Studies* 27-43.

¹²³ Such restrictions for examples can be seen in the US, which restricted foreign investments in commercial aviation, telecommunication, maritime industry, and real-estates. See also David N. Goldsweig and Roger H. Cummings (eds), *International Joint Ventures: A Practical Approach to Working with Foreign Investors in the U.S. and Abroad* (Amer Bar Assn 1990).

¹²⁴ See Raymond Vernon, *Sovereignty at bay: the multinational spread of US enterprises* (Basic Books 1971).

Vernon considered both, TNCs as well as host states' bargaining position as well as the desired level of ownership to have equal value when determining the level of equity ownership. This would suggest that TNCs do not automatically have the upper hand.

Fagre and Wells Jr. maintained that 'governments are hesitant to trade ownership for other kinds of benefits in an agreement'.¹²⁵ Nonetheless Dymsza¹²⁶ stressed that the idea of shared control as well as shared profits could be favourably considered by both parties.¹²⁷ In his later study he stated that in JVs, developed states' contribution may fade over time and therefore the managerial responsibilities are likely to be given to the host developing state.

Gomes-Casseres argued that 'government ownership restrictions deter firm entry'.¹²⁸ Smith¹²⁹ noted that small domestic market of developing state makes the origin of the foreign investor relevant especially when the products are produced for export. Venu maintained that TNCs influence the payment of balance of the host states and therefore possess a threat to their sovereignty.¹³⁰ TNCs are 'linking the assets and activities of different national jurisdictions with an intimacy that seems to threaten the concept of nation as an integral unit'.¹³¹ The question is if 'the multinational enterprise undermining the capacity of nations to work for the welfare of their people?' or is 'the multinational enterprise being used by a dominant power (read "United States") as a means of penetrating and controlling the economies of other countries?'¹³² Therefore Vernon was suspicious of foreign investment, which could be seen as a way of economic dominance of TNCs over host developing states by means of foreign investment.

¹²⁵ Nathan Fagre and Louis T. Wells Jr., 'Bargaining Power of Multinationals and Host Governments' (1982) 13(2) *Journal of International Business Studies* 9-23.

¹²⁶ William A. Dymsza, 'Multinational business strategy' (1972) 14(2) *Thunderbird The International Executive* 206-207.

¹²⁷ William A. Dymsza, 'Successes and failures of joint ventures in developing countries: Lessons From experience' in F. J. Contractor and P. Lorange (eds), *Cooperative strategies in international business* (Lexington Books 1988) 403-424.

¹²⁸ Benjamin Gomes-Casseres, 'Firm ownership preferences and host government restrictions: An integrated approach' (1990) 21(1) *Journal of International business studies* 1-22.

¹²⁹ David N. Smith and Louis T. Wells, Jr., 'Mineral Agreement in Developing Countries: Structures and Substance' (1974) 69 *American Journal of International Law* 560.

¹³⁰ S. Venu, 'The multinationals and developing societies: A profile of the future' (1974) 6(2) *Elsevier* 133-141.

¹³¹ Raymond Vernon, *Sovereignty at bay: Multinational Spread of U.S. Enterprises* (Longman 1971).

¹³² See Raymond Vernon, *Sovereignty at bay: Multinational Spread of U.S. Enterprises* (Longman 1971) 15.

TNCs would without a doubt like to have ownership when they are engaging in big projects that require high investments over long period of time. At the same time the host developing states are the rightful owners of natural resources and the foreign investment is due on their territory which will potentially have a huge impact on their economy. Fagre and Wells Jr.¹³³ claimed that the bargaining position between TNCs and host developing states is influenced by the resources brought by the foreign investor and by the number of firms offering similar resources.

As mentioned earlier, TNCs have the benefits of resources, high technology, product differentiation and most importantly the access to the foreign markets. The question how foreign investment effects socio-economic development has been addressed on many occasions. The UNCTAD report 1999 has identified the following areas: 1. Employment and incomes, 2. Capital formation, market access, 3. Structure of markets, 4. Technology and skills, 5. Fiscal revenues, and 6. Political cultural and social issues.¹³⁴

Berman argued that ‘regional economics has long been recognised as one of the most challenging and difficult areas of economic development’.¹³⁵ Possibly because, the local economy is not only dependant on the national economy, but also on the fiscal, and economic policies of their trading partners. The most relevant question that arises is how both parties in the process of private foreign investment can benefit equally. Is such equality even possible and how could it be achieved?

Gomes-Casseres¹³⁶ suggested that TNCs can select the kind of ownership structure that they would like to implement for their subsidiaries, which he supported by two different approaches. One approach suggested that TNCs choose the kind of structure that enables them to reduce transaction costs, while conducting business in foreign states. Second approach is completely opposite to the first one and even suggested that it has nothing to do with minimising the transaction cost and that it is in fact not up to the TNCs to select the form of ownership. This suggests that negotiations process is of fundamental importance because ownership structure is actually agreed upon during the course of

¹³³ Nathan Fagre and Louis T. Wells Jr., ‘Bargaining Power of Multinationals and Host Governments’ (1982) 13(2) *Journal of International Business Studies* 9-23.

¹³⁴ UNCTAD World Investment Report (UN New York and Geneva 1999).

¹³⁵ Barry Berman, *Marketing channels* (Business & Economic 1996) 195.

¹³⁶ Benjamin Gomes-Casseres, ‘Firm ownership preferences and host government restrictions: An integrated approach’ (1990) 21(1) *Journal of International business studies* 1-22.

negotiations between TNCs and host country's governments whose outcomes depend on the bargaining position of both the parties.¹³⁷ However based on the transactional costs TNCs have to choose between 'the costs of using the market' and 'internal channels for transferring organizational capabilities' which is crucial for separating internal and market channels and transferring their capabilities.¹³⁸ Miozzo et al. claimed that there were only a few cases, when TNCs actually helped local firms to upgrade their capabilities, such as for example, introducing quality control procedures and product offers.¹³⁹

As mentioned earlier, entry restrictions might not be the only challenge for TNCs as the ownership structure has to be negotiated between TNCs and host states' governments. Both parties involved have the trade-off options, which are again agreed upon during the negotiation process. Bargaining position in this situation could enable 'one party to skew the outcome of negotiations in the direction of the ownership structure it prefers'.¹⁴⁰ This is why bargaining position takes paramountcy in the negotiation process, where interests of both parties should be balanced.

1.4 Sovereignty in relation to TNCs

It has been highlighted by many authors that the relationship between TNCs and host developing states can be analysed in terms of the bargaining position.¹⁴¹ International relations are however conducted between sovereign states, which are also the actors of

¹³⁷ Benjamin Gomes-Casseres, 'Firm ownership preferences and host government restrictions: An integrated approach' (1990) 21(1) *Journal of International business studies* 1–22, 1.

¹³⁸ Jean-François Hennart, 'Theories of the Multinational Enterprises' in Peter T. Muchlinski, Federico Ortino and Christoph Schreuer (eds), *Oxford Handbook of International Investment Law* (OUP 2008) ch 5.

¹³⁹ Marcela Miozzo, Mo Yamin & Pervez N. Ghauri, 'Strategy and structure of service multinationals and their impact on linkages with local firms (2012) 32(7) *The Service Industries Journal* 1171-91.

¹⁴⁰ David A. Lax and James K. Sebenius, *The Manager as Negotiator: Bargaining or Co-operation and Competitive Gain* (The Free Press 1986).

¹⁴¹ See Nathan Fagre and Louis T. Wells Jr., 'Bargaining Power of Multinationals and Host Governments' (1982) 13(2) *Journal of International Business Studies* 9-23; Raymond Vernon, *Sovereignty at bay: Multinational Spread of U.S. Enterprises* (Longman 1971); Bruce R. McKern, *Multinational Enterprise and Natural Resources* (McGraw Hill 1976); David N. Smith and Louis T. Wells, Jr., 'Mineral Agreement in Developing Countries: Structures and Substance' (1974) 69 *American Journal of International Law* 560.

bilateral investment treaties (BITs). Sovereignty is the fundamental principle of international law. In terms of sovereignty there is no difference between developed and developing state.¹⁴² Sovereignty also gives a state the right to grant trading privileges to the contracting parties under BITs, which are predominantly concluded between developing and developed states. While sovereign state can impose restrictions on foreign investors and result to taking of foreign assets, international law requires compensation payment.¹⁴³ Sovereignty can also give a state the ground for higher bargaining position vis-à-vis TNCs. State practise on protection of corporations under the nationality principle still varies, because states can give nationality to corporations, however the emphasis is not placed on the place of incorporations but rather on the seat of TNCs management. It is state's discretion to extend the nationality principle to protect its nationals or corporations across their national borders. In the recent years the practice of concluding treaties has become well spread.

'The state is a type of legal person recognized by international law' however 'the possession of legal personality is not in itself a sufficient mark of statehood'.¹⁴⁴ Painter and Jeffrey have identified the following five distinctive features of a modern state:

- (1) are ordered by precise boundaries with administrative control across the whole;
- (2) occupy large territories with control given to organized institutions;
- (3) have to have a capital and be based somewhere with symbols that embody state power;
- (4) allow for state organizations to monitor, govern and control its population through police surveillance, electronic surveillance and record keeping by the "state";
- (5) monitoring has increased over time.¹⁴⁵

As the state is required to govern its citizens and control their territory it would extend that a state is also required to control all foreign activities on their sovereign territory.

Bodin's idea was based on the need for a system with clear and undoubted source of authority that leads to absolute sovereignty by saying '*Majestas est summa in cives ac*

¹⁴² In the General Assembly of the UN each sovereign member has one vote, as per Article 2(1) of the UN Charter.

¹⁴³ UNGA Res. No.1803 of 1962 Permanent Sovereignty over Natural Resources.

¹⁴⁴ Ian Brownlie, *Principles of Public International Law* (6th edn, OUP 2003) 69.

¹⁴⁵ Joe Painter and Alex Jeffrey, *Political Geography* (Sage Publications Ltd. 2009) 22–24.

aubditos legibusque solute potestas'.¹⁴⁶ He was convinced that it is the lack of strong government that creates turmoil and as a result of this conflict State is born. According to Bodin stability is not attainable in contrary to the belief of the social contract school. Bodin's definition of sovereignty '*la puissance absolue et perpétuelle d'une République*'.¹⁴⁷ The most important aspect of sovereignty is that there is no time limitation (perpetual principle), because only in such condition sovereignty is possible. That means that anyone or anything not timeless is less than sovereign.

Oppenheimer as "market socialist" opposed the idea of "social contract" as founding reason for a state and its guarantee of security, safety and prosperity. According to Oppenheimer the formation of a state as 'social institution' is based on domination of one group of people over another group. Moreover, a state is 'a social institution, forced by a victorious group of men on a defeated group, with the sole purpose of regulating the domino of the victorious group over the vanquished, and securing itself against revolt from within and attacks from abroad'.¹⁴⁸ Oppenheimer made an important distinction between the "economic means" and "political means".¹⁴⁹ This could also be understood as ways of acquiring wealth by coercion or by conducting peaceful trade.

Early states¹⁵⁰ have already had the element of development and have included the interaction with other states. Wright argued that crucial concept for understanding 'the

¹⁴⁶ Sovereignty is supreme power over citizens and subjects, unrestrained by the laws In Jean Bodin, *Les six livres de la République* (First published 1583, Confluences 1999).

¹⁴⁷ 'the absolute and perpetual power of a Republic' to which he adds that the sovereign prince is only accountable to god, Jean Bodin, *Les six livres de la République* (First published 1583, Confluences 1999).

¹⁴⁸ Franz Oppenheimer, *The State: Its History and Development viewed, Sociologically*, (John M. Gitterman tr, B.W. Huebsch 1922) <<http://oll.libertyfund.org/titles/1662>> accessed 29 May 2015.

¹⁴⁹ Franz Oppenheimer, *The State: Its History and Development viewed, Sociologically*, (John M. Gitterman tr, B.W. Huebsch 1922) <<http://oll.libertyfund.org/titles/1662>> accessed 29 May 2015.

¹⁵⁰ Primary state formation is not very clear due to the lack of written evidence. Anthropologists however have focused their research on primary states. Term coined by Henry T. Wright, 'Recent research on the origin of the state' (1977) 6 Annual Review of Anthropology 379–397, explained that the primary states have emerged from pre-state societies. Research of societies was largely influenced by a book of Lewis H. Morgan, *Ancient Society* (first published 1877, MacMillan & Company 1944), in which a theory of the three stages of human progress from savagery, barbarism to civilisation has been developed. It is interesting to note that Karl Marx and Friedrich Engels were also largely influenced by Morgan's book mostly because it tried to discover the principal stages of human development, based on the development of an individual from the bottom to the top in the society. Morgan did not recognise the theory of the Three-Age system, of stone, of iron and of bronze, maintaining that they lack element of progress. Primary states are the ones where no prior state formation has existed before in a social environment. These areas of first civilisations are known to be about 3500-3000 B.C. in Egypt and Mesopotamia, about 2500 B.C. in the Indus River Valley, about 1500 B.C. at the Great Band of the Yellow River in China and Valley of Mexico and in coastal Peru. See further Charles S. Spencer and Elsa M. Redmond, 'Primary State Formation in Mesoamerica' (2004) 33 Annual Review of Anthropology 173-199, see also Vere Gordon Childe, *Man Makes Himself* (Spokesman 1936), Vere Gordon Childe, *What Happened in History*

emergence of states – the development of internally specialized governance – as a key to understanding the rise of civilizations’.¹⁵¹

Childe in his concept of “urban revolution” stated that ‘there seemed a glaring conflict on economic interests’ between the ruling classes and those ‘excluded from the spiritual benefits of civilization’¹⁵² and as a result ‘guarantee them security in a new social organization’.¹⁵³ This indicates the importance of security as an important element as early as 5000 years ago.

Marxian¹⁵⁴ understanding of a state as a product of society during one of the stages of its development is based on the repressive force, whose only interest is to protect the economic interests of the ruling or dominant class, who is also the class that controls the state. Engels added that the state enables the economically dominant class to become the politically dominant.¹⁵⁵

Bodin¹⁵⁶ defined sovereignty as an absolute and perpetual power of a commonwealth and as such had believed that the power of the state had to be embodied in the prince or other appointed leader. Furthermore, the most important condition of sovereignty is that it has to be single, unlimited and absolute. Many scholars agree that theories of Bodin, Grotius and even Blackstone failed to include the dimension of political power. More recent theories however lack in providing tangible reasons of why should any citizen be at the mercy of this co called “sovereign leader” when at the same time all citizens ought to be equal in their rights and responsibilities. There is a big gap in research regarding the people in power and their accountability and the shortcomings of law to bind them to the

(first published 1942, Puffin 1985) and Elman R. Service, *Origins of the State and Civilization, Process of cultural evolution* (W.W. Norton & Company 1975).

¹⁵¹ Henry T. Wright, ‘Early state dynamics as political experiment’ (2006) 62(3) *Journal of anthropological research* 306.

¹⁵² Vere Gordon Childe, *The Urban Revolution* (Liverpool University Press 1950) 16.

¹⁵³ Vere Gordon Childe, *The Urban Revolution* (Liverpool University Press, 1950) 8.

¹⁵⁴ Karl Marx, *Preface to A Contribution to the Critique of Political Economy* (first published 1859, S.W. Ryazanskaya tr, Progress Publishers 1977) 43,

<<https://www.marxists.org/archive/marx/works/1859/critique-pol-economy/preface.htm>> accessed 20 September 2015.

¹⁵⁵ Fredrick Engels, *The Origin of the Family, Private Property, and the State* (Resistance Books 2004) 159.

¹⁵⁶ Jean Bodin, *Les six livres de la République* (First published 1583, Confluences 1999).

rules and regulations that apply to all other citizens, however it is unfortunately outside the scope of this research.¹⁵⁷

Habermas maintained that ‘the source of all legitimacy lies in the democratic law-making process, and this in turn calls on the principle of popular sovereignty’.¹⁵⁸ Austin however had a different view on sovereignty. According to Austin sovereignty is unique and therefore cannot be shared among two or anybody else for that matter, because as soon as it is no longer unique it is *ergo* no longer sovereign. Branch¹⁵⁹ for example argued that the nation state is actually a by-product of the 15th century map-making technology improvement.

There might be a justified concern that state sovereignty is in danger. One of such examples is the UN treaty to formulate International Criminal Court (ICC)¹⁶⁰ that will have the power to judge and consequently punish or imprison anyone, anywhere in the world for war crimes, crimes against humanity or genocide.

Ferreira-Snyman¹⁶¹ stated that the idea of absolute sovereignty is an outdated concept, especially due to the trend of interdependence and co-operation, internationalisation and universalisation of human rights. Perrez argued that ‘International law is based on the principle of sovereignty’ and that ‘sovereignty is the most important if not the only structural principle of international law that shapes the content of nearly all rules of international law’, and added that sovereignty is the ‘cornerstone of international law’.¹⁶²

Oppenheim noted that there is ‘no conception, the meaning of which is more controversial than that of sovereignty’ and that it ‘had never had a meaning which was universally

¹⁵⁷ At this point perhaps just a short note on the topic of exceptionism, see further Royal J. Schmidt, ‘Cultural Nationalism in Herder (1956) 17(3) Journal of the History of Ideas 407–417; Hans Kohn, ‘The Paradox of Fichte’s Nationalism’ (1949) 10(3) Journal of the History of Ideas 319–343.

¹⁵⁸ Jurgen Habermas, *Between facts and Norms: Contribution to a Discourse Theory of Law and Democracy* (William Rehg tr, MIT Press 1996) 89.

¹⁵⁹ Jordan Nathaniel Branch, *Mapping the sovereign state: cartographic technology, political authority, and systemic change*, dissertation (University of California, Berkeley 2011).

¹⁶⁰ ICC, Rome Statute of the International Criminal Court (A/CONF.183/9 of 17 July 1998) <<https://www.icc-cpi.int/iccdocs/PIDS/publications/RomeStatutEng.pdf>> accessed 20 January 2016.

¹⁶¹ Magdalena Petronella Ferreira-Snyman, ‘The evolution of state sovereignty A historical overview’ (2006) 12(2) *Fundamina* 1-28.

¹⁶² Franz Xaver Perrez, *Cooperative sovereignty: From Independence to Interdependence in the structure of international environmental law* (Brill 2000) 13.

agreed upon'.¹⁶³ Ferreira-Snyman stated that 'Sovereignty is the most extensive form of jurisdiction under international law. In general terms, it denotes full and unchallengeable power over a piece of territory and all the persons from time to time therein'.¹⁶⁴

Dicey provided the following explanation on the legal and political sovereignty stating that:

[W]hereas as a "merely legal conception", sovereignty is "the power of law-making unrestricted by any legal limit", by contrast 'that body is "politically" sovereign or supreme in a state the will of which is ultimately obeyed by the citizens of the state'.¹⁶⁵

Power without restriction is on this view the key idea. Power of one kind, normative power or "authority" is conferred by law. This may be a power of law-making in a certain territory conferred by a certain constitutional order that is effectively observed in that territory. MacCormick maintained that:

Sovereign power is that which is enjoyed, legally, by the holder of a constitutional power to make law, as long as the constitution places no restrictions on the exercise of that power... If the constitution then confers such a power but contains no limits upon the power (other than the discretion and judgment of those who exercise the power) we may say that sovereignty is vested in the holder of the law-making power.¹⁶⁶

Sovereignty is therefore defined by the territory and not by a higher power of authority.¹⁶⁷

Although it is not possible to formulate an all-inclusive definition of sovereignty, two major points of view with regard to the concept of sovereignty can continuously be identified. The first view is that sovereignty means absolute power above the law and that absolute sovereignty constitutes one of the most powerful and inviolable principles in

¹⁶³ Lassa Oppenheim, *International Law* (Sir Arnold D. McNair ed, 4th edn 1928); Arnold D. McNair, 'Aspects of State Sovereignty' BYIL 1949; Edwin De Witt Dickinson, *The Equality of State in International Law* (Cornell University Library 2009) 137.

¹⁶⁴ Magdalena Petronella Ferreira-Snyman, *The evolution of state sovereignty A historical overview* (2006) 12(2) *Fundamina* 1-28.

¹⁶⁵ A. V. Dicey, *Law of the Constitution* (OUP 2013) 27.

¹⁶⁶ Neil MacCormick, *Questioning Sovereignty* (OUP 1999) 127.

¹⁶⁷ See for example Stephen D. Krasner, *Sovereignty: Organized Hypocrisy* (Princeton University Press 2000) 575-577.

international law.¹⁶⁸ The second view is that it is of utmost significance that states – as the most important subjects of international law – do not claim that they are above the law or that international law does not bind them.¹⁶⁹ It is necessary to distinguish between the internal and the external sovereignty of a state. Internal sovereignty is considered the ability of a state to exercise its authority within its national borders and freely regulate internal affairs. Internal sovereignty gives the state the rights and attributes that are limited to its territory. External sovereignty on the other hand is a form of legal independence from any foreign powers and ability of state to protect itself from outside interference.

According to Perrez¹⁷⁰ external sovereignty broadly includes international independence, the right to international self-help and the authority to participate in international society. The idea of external sovereignty eventually led to the development of modern international law. In the external relations of states, sovereignty was regarded as legal independence from all foreign powers, in particular that of the Pope and the Emperor of the Holy Roman Empire. Perrez¹⁷¹ maintained that in general sovereignty is seen as independence and supreme authority of a state.

Arendt claimed that authority ‘is commonly mistaken for some form of power or violence’ however ‘authority precludes the use of external means of coercion’ and ‘is incompatible with persuasion’.¹⁷² The principle of national sovereignty gives states ‘the right to make laws that are supposedly in its national interests’.¹⁷³ ‘Suddenly, it seems, the sovereign states are feeling naked. Concepts such as national sovereignty and national economic strength appear curiously drained of meaning’.¹⁷⁴

¹⁶⁸ Djura Nincic, *The problem of sovereignty* (Brill Academic Pub 1970).

¹⁶⁹ Anne Bodley, ‘Weakening the Principle of Sovereignty in International Law: The International Criminal Tribunal for the Former Yugoslavia’ (1998-1999) 31(2) *New York University Journal of International Law and Politics* 417-471.

¹⁷⁰ See Franz Xaver Perrez, *Cooperative sovereignty: From Independence to Interdependence in the structure of international environmental law* (Brill 2000).

¹⁷¹ Franz Xaver Perrez, *Cooperative sovereignty: From Independence to Interdependence in the structure of international environmental law* (Brill 2000).

¹⁷² Hannah Arendt, *What is authority?* In *Between past and future: six exercises in political thought* (The Viking Press 1961) 1-2.

¹⁷³ Arvind V. Phatak and Mogammed M. Habib, ‘The Dynamics of International Business Negotiations’ (1996) 39(3) *Business Horizons* 30-38.

¹⁷⁴ Raymond Vernon, *Sovereignty at bay: Multinational Spread of U.S. Enterprises* (Longman 1971) XX.

TNCs play a crucial role in the international business and trade. Smith¹⁷⁵ recognised that jurisdictional reach is a necessary but not sufficient condition for an effective control system and added that developing states are in a difficult position as they are implementing policies that at the same time are trying to control and attract foreign investments however not at the expense of sovereignty.

Bain¹⁷⁶ examined three entry conditions in terms of the market structure; blocked entry, restricted entry and free entry. As an example Xerox entry was blocked in Japan due to a basic patent issue.¹⁷⁷ Smith recognised that ‘entry is restricted when post entry profit expectations become insufficient to motivate entry before a competitive solution is reached’.¹⁷⁸

Venu¹⁷⁹ reviewed the areas of conflict between TNCs and host developing states. There have been reported cases that TNCs have interfered with policies of host state and hence endangering the sovereignty of the host state for which Venu¹⁸⁰ maintained that many have been exaggerated, due to bad reputation of TNCs. Venu¹⁸¹ supported the idea that public awareness is an important tool, saying that ‘the impact of such events is great enough for the host society to regard it as an overall threat’.¹⁸² These kinds of threats brought hostile emotions demonstrated in a form of nationalism. Nationalism¹⁸³ is a complex subject and it has to be seen through the historical context. However, it cannot

¹⁷⁵ M.A.M. Smith, ‘International trade in second-hand machines’ (1974) 1(3) *Journal of Development Economics* 261-278.

¹⁷⁶ Joe S. Bain, *Barriers to New Competitions, Their Character and Consequences in Manufacturing Industries* (HUP 1956) 488-490.

¹⁷⁷ Roy A. Werner, ‘Is Japan an Open Market?’ (1982) 9(3) *Asian Affairs* 147–162. The Fuji Xerox Joint-Venture was proposed to advertise Xerox products in Japan, however Japanese government refused to give consent for the JV to be formed without the technology transfer from Xerox to Fuji. See Mike W. Peng, *Global Strategy* (2nd edn, South-Western Cengage Learning 2009) 197.

¹⁷⁷ David N. Smith and Louis T. Wells, Jr. ‘Mineral Agreement in Developing Countries: Structures and Substance’ (1975) 69 *American Journal of International Law* 560, 419.

¹⁷⁸ Henry Kissinger, *World Order; Reflection on the Charter of Nations and the Course of History* (Penguin Books 2014) 8.

¹⁷⁸ See also S. Venu, ‘The multinationals and developing societies: A profile of the future’ (1974) 6(2) *The Journal of policy, planning and future studies* 133-141.

¹⁷⁹ See also S. Venu, ‘The multinationals and developing societies: A profile of the future’ (1974) 6(2) *The Journal of policy, planning and future studies* 133-141.

¹⁸⁰ See also S. Venu, ‘The multinationals and developing societies: A profile of the future’ (1974) 6(2) *The Journal of policy, planning and future studies* 133-141.

¹⁸¹ See also S. Venu, ‘The multinationals and developing societies: A profile of the future’ (1974) 6(2) *The Journal of policy, planning and future studies* 133-141.

¹⁸² S. Venu, ‘The multinationals and developing societies: A profile of the future’ (1974) 6(2) *Elsevier* 133-141, 135.

¹⁸³ J. B. L. Mayall and J. Jackson-Preece, *Nationalism and International Society* (UOL 2011).

be ignored as it is important for understanding the evolution of international investment law as a focal point in the relationship between TNCs and host developing states.

Kissinger pointed out that there has never been a truly global “world order” in existence. The Treaty of Westphalia was based ‘on a system of independent states refraining from interference in each other’s domestic affairs and checking each other’s ambitions through a general equilibrium of power’.¹⁸⁴ States were given sovereign power over their entire territory. As a result, a new system of international order of states was established. The new system was based on recognising multiplicity and uniqueness of each of the state, whose objective was to maintain their sovereignty and not try to unify or standardise their political order, religions believes or structure.

Robock and Simmonds maintained that ‘Nation-states have developed a variety of ways to achieve national goals and protect national interests as far as international business transactions are concerned’.¹⁸⁵ Smith argued that ‘a national government has undisputed jurisdiction over the granting and regulation of industrial property, over conduct that occurs within its territory, and over the corporations that it charters’.¹⁸⁶ The United Nations Industrial Development Organisation (UNIDO) have been providing technical assistance to the developing countries that would like to attract foreign investments, according to Venu.¹⁸⁷ The UN has the resources to provide support to the host developing states especially during the negotiation process with TNCs in order for the developing states not to compromise their sovereignty at the point of entry of TNCs.

¹⁸⁴ Henry Kissinger, *World Order; Reflection on the Charter of Nations and the Course of History* (Penguin Books 2014) 3.

¹⁸⁵ Stefan H. Robock and Kenneth Simmonds, *International business and multinational enterprises* (3rd edn, Homewood 1983) 185.

¹⁸⁶ David N. Smith and Louis T. Wells, Jr. ‘Mineral Agreement in Developing Countries: Structures and Substance’ (1975) 69 *American Journal of International Law* 560, 433.

¹⁸⁷ S. Venu, ‘The multinationals and developing societies: A profile of the future’ (1974) 6(2) *Elsevier* 133-141.

1.5 Conclusions

For many years TNCs have been involved in development mainly through foreign investments in host developing states. While TNCs are profit maximisers, host developing states would like to achieve socio-economic independence. The main interaction between TNCs and host developing states takes place during the negotiation process when bargaining position is of significant importance in order to agree on the terms and conditions of the investment agreement. However, the concept of bargaining position seems to be remote from any legal basis because it is a power oriented concept. If bargaining position is remote from any legal basis then it will be limitless, coercive and indeed it can be used by force. This has unfortunately become the basis for using bargaining position. The non-legal dimensions to bargaining position can be tamed by bilateral investment treaties (BITs), and codes of conduct for TNCs. If a contractual arrangement is made solemnly on bargaining position, the fundamental principles of the law of contract will not form the basis of that contract. Unfortunately, this principle has been the basis for negotiating investment agreements between TNCs and host developing states for many years. During the colonial period foreign investor companies took the control of natural resources although they could not take over the ownership, but the colonial masters in practice subordinated the concept of ownership and expressed their strength through their power to control exploration and exploitation of natural resources in host developing states.

This practice aided the objectives of profit maximisation by TNCs without allowing in most cases much benefits to be derived by host developing states, in other words their legitimate base for control over the natural resources was taken away from the host developing states. From the 1980s a new trend seems to have emerged in certain states to reverse the traditional bargaining of TNCs engaged in exploring and exploiting natural resources in host developing states. One such example is Indonesia, which ‘does not restrict the transfers of funds to or from foreign states, but incoming investment capital requires approval’.¹⁸⁸

¹⁸⁸ Deloitte, Taxation and Investment in Indonesia, Reach, relevance and reliability (Deloitte Touche Tohmatsu Ltd 2014) 3.

The impact of foreign investment on host developing states has been on the agenda of many academics, including the UN and the views are split between the critics and the supporters.

After having discussed some of the most important concepts relating to the core of this research it may be maintained that during the colonial period the question of the colonies using their bargaining position in controlling the conduct of TNCs did arise. The corporate entities in the colonies were under the total control of the parent companies, which had a psychological impact that resulted in lost confidence. This can be seen in host developing states behaviour during the colonisation period approximately between the years 1945 to 1962. In this research it has been pointed out that the newly born independent states were able to express their aspirations at the UN level when the UN general assembly resolution entitled Permanent Sovereignty over the Natural Resources 1962 was adopted. Although initially it received opposition from most of the developed states it eventually became part of the customary international law.

It is believed that the extent of frustration led the newly born independent states to regain back control over their natural resources through nationalisation or “taking” of assets of foreign companies. This impacted the nature of international relations between host developing states and TNCs but from a neutral standpoint and based on the principle of fairness of contracts it is maintained that the balance of interests between the two parties was essential and therefore has received the needed attention in the subsequent chapters of this research.

The objective of investors is clear; they are mainly interested in the return on the investment (ROI). On the other hand, the host developing states if in position with multiple investments offers they are in a position to choose the best private foreign investor, however it is often the case that the host states are not in a position to choose their foreign investors. This means that the developing states do not have many options but to try to negotiate the best possible agreement that they can. Considering the benefits that derive out of the foreign investment. The alternative is the loss of investment altogether, which practically means that host developing states have no alternative.

Gomes-Casseres¹⁸⁹ noted that TNCs have only two options to consider when their interests are in conflict with the host state governments, they can insist and negotiate a compromise or decline to invest and pull out.

From the above the conclusion is that the bargaining position is dependent on the alternatives that are available to the foreign investors as well as to the host developing states. Host developing state has better bargaining position when there is no alternative investment for TNC. That means that the investor can settle with lower ROI whereas the host developing state cannot really settle with no foreign investment.

Arguably the alternative options are actually the one that define the bargaining position of both parties. Bacharach and Lawler¹⁹⁰ advocated that the availability of alternatives influence the bargaining position of both parties. Fisher and Ury¹⁹¹ stated that the party with more alternatives is more powerful due to the fact that it could walk away from the negotiations and exercise its “best alternative to a negotiated agreement” (BATNA).

Root¹⁹² maintained that TNCs bargain their technology, access to the world markets, management skills, capital and other proprietary assets with host developing states, which bargain their natural resources, labour and country specific assets. Yan and Gray¹⁹³ stressed that TNCs normally contribute technology, management expertise and global support to the relationship. Inkpen and Beamish¹⁹⁴ recognised that host states contribute some local knowledge of local market, culture and environment conditions to the partnership. Vernon and Hymer¹⁹⁵ argued that the industries in which the US based TNCs operate are oligopolistic.¹⁹⁶ However the main topic of negotiations between TNCs and

¹⁸⁹ Benjamin Gomes-Casseres, ‘Firm ownership preferences and host government restrictions: An integrated approach’ (1990) 21(1) *Journal of International business studies* 1-22.

¹⁹⁰ Samuel Bacharach and Edward Lawler, ‘Bargaining: Power, Tactics, and Outcomes’ (1983) 8(1) *The Academy of Management Review* 159-162.

¹⁹¹ Roger Fisher and William Ury, *Getting to yes: negotiating agreements without giving in* (1st edn, Penguin, 1981).

¹⁹² Franklin R. Root, ‘Environmental risks and the bargaining power of multinational corporations’ (1988) 3(1) *The International Trade Journal* 115.

¹⁹³ Aimin Yan and Barbara Gray, ‘Bargaining power, Management control, and performance in United States-China joint ventures: A comparative case study’ (1994) 37(6) *Academy of Management Journal* 1478-1517.

¹⁹⁴ Andrew C. Inkpen and Paul W. Beamish, ‘Knowledge, Bargaining Power, and the Instability of International Joint Ventures’ (1997) 22(1) *The Academy of Management Review* 177-202.

¹⁹⁵ Stephen H. Hymer, *The International Operations of National Firms: A Study of Direct Foreign Investment* (MIT Press 1976).

¹⁹⁶ Stephen H. Hymer, *The International Operations of National Firms: A Study of Direct Foreign Investment* (MIT Press 1976).

host developing states is the scarcity of the natural resources that the host developing states have and TNCs wish to exploit. TNCs can therefore offer resources that the host developing states do not have, such as capital, advanced technology, distribution network and skills.¹⁹⁷

Nevertheless, Root also added that the moment that TNCs enter into the joint-ventures (JVs) with the host developing states it immediately loses its bargaining position. The bargaining position shifts to the host developing state, because host developing state is controlling the prices, taxation, requirement, restrictions and even legislation. Root argued that ‘the venture becomes hostage to host-government behaviour’.¹⁹⁸ Svejnar and Smith stressed that ‘less developed countries have sought to increase their bargaining power in relation to the TNCs’.¹⁹⁹ Gomes-Casseres supported the hypothesis ‘that attractive domestic markets increase the relative power of host government’ but tries to find the answer to ‘the basic question of when and why TNCs form joint ventures abroad’.²⁰⁰ Gomes-Casseres implemented two important developments, ‘a new conception of the role of ownership in international business’ and ‘a better understanding of the process of negotiation between TNCs and host country governments’.²⁰¹

According to Brown the structure of cooperation and conflict called polyarchy has come to life in states ‘subnational groups, and transnational special interests and communities would have to be resolved primarily on the basis of ad hoc bargaining in a shifting context of power relationships’.²⁰² There is limited evidence that the involvement of TNCs in development of host developing states had made significant contribution in terms of socio-economic development or capacity building. Equally the effect of foreign investment on socio-economic development in host developing states is yet to be explored. Negotiations are important also because the host developing states should

¹⁹⁷ S. Venu, ‘The multinationals and developing societies: A profile of the future’ (1974) 6(2) Elsevier 133-141.

¹⁹⁸ Franklin R. Root, ‘Environmental risks and the bargaining power of multinational corporations’ (1988) 3(1) *The International Trade Journal* 115, 121.

¹⁹⁹ Jan Svejnar and Stephen C. Smith, ‘The Economics of Joint Venture in Less Developed Countries’ (1984) 119 *Quarterly Journal of Economics* 149-67.

²⁰⁰ Benjamin Gomes-Casseres, ‘Firm ownership preferences and host government restrictions: An integrated approach’ (1990) 21(1) *Journal of International business studies* 1 – 22, 1.

²⁰¹ Benjamin Gomes-Casseres, ‘Firm ownership preferences and host government restrictions: An integrated approach’ (1990) 21(1) *Journal of International business studies* 1 – 22, 1.

²⁰² Seyom Brown, *New Forces in World Politics* (Brookings Institutions 1974) 186.

negotiate ownership structure and profit distribution with TNCs before their entry in order not to compromise their sovereignty.

Sovereignty is the fundamental principle of international law, which also gives a state the right to grant trading privileges to the contracting parties under BITs. While sovereign states can impose restrictions on foreign investors in cases of taking of foreign assets compensation has to be paid under international law.²⁰³ Sovereignty can also give a state the ground for higher bargaining position vis-à-vis TNCs. It is however state's discretion to protect its nationals and its corporations across their national borders, which have become well spread in the past four decades and will be closely examined in the following chapters of this research.

To sum up, bargaining position takes centre stage while stability of global economy depends on the relationship between TNCs and host developing states.

²⁰³ UNGA Res. No.1803 of 1962 Permanent Sovereignty over Natural Resources.

Chapter 2: Aspirational Differences between Host Developing States, Transnational corporations (TNCs) and the United Nations (UN)

2.1 Introduction

The gap between aspirations of the UN, host developing states and TNCs are still quite large. Sauvants maintained that 'it should have been possible to bridge the different starting positions of developed and developing countries'.¹ The solution for closing these gaps has not yet been finalised. Aspirations are the key elements for formulating ideas and contributing to the socio-economic development. TNCs have grown significantly over the years in their number as well as in their size. Some TNCs profits are bigger than most developing countries GDP. Based on the significance of TNCs it is expected that more attention would be paid to the aspirations of host developing states. This does not seem to be the case at present or at least there is no evidence that would suggest otherwise. An attempt has been made to examine these aspirations more closely from the perspective of each party individually and in relation to each other. Based on the research findings some solutions have been recommended to bridge the aspiration gaps that have been identified.

The main issue with aspirations of TNCs is the focus on profit maximisation, which is not sustainable and should be reviewed in parallel with the aspirations of host developing states. At the same time the role and aspirations of the UN should be reviewed and redefined based on the previous experience of failed and successful initiatives and efforts such as Havana Charter 1948, Abs-Schawcross draft Convention on Investments Abroad 1959, UN Convention on Permanent Sovereignty over Natural Resources 1962, New International Economic Order (NIEO) 1974, UN Draft Code of Conduct for TNCs 1974 and Charter of Economic Rights and Duties of States 1974. NIEO Resolution did manage to establish the UN Commission on Transnational Corporations (CTC) 1974 to regulate

¹ Karl P. Sauvants, 'The Negotiations of the United Nations Code of Conduct on Transnational Corporations, Experience and Lessons Learned' (2015) 16 *The Journal of World Investment and Trade* 11-87, 26.

activities of TNCs.² However their attempt to adopt the UN draft Code of Conduct for TNCs were not successful.

Wells Sheffer argued that in order for economic development to be sustainable foreign investment alone is not sufficient, as it requires also the protection of human rights, especially by TNCs.³ The UN Special Representative John Ruggie on Business and Human Rights, proposed a framework to the UN Human Rights Council in June 2008 in which he claimed that foreign investment and TNCs constitute powerful forces capable of generating economic growth, reducing poverty, and increasing demand for the rule of law.⁴

The UN and TNCs have its own ideas for socio-economic development as do the host developing states. The gap in aspirations between the three parties is quite extensive. The recommendation is therefore to narrow down the aspirational differences between TNCs, host developing states and the United Nations (UN). The biggest issue with host developing states is that their aspirations are fundamentally based on the wrong assumptions by following the models of other developed states, notwithstanding the fact that the model of developed states cannot be replicated nor implemented in the host developing states. Another problem that developing states have is the lack of confidence and ability to develop their own model and this is exacerbated by their inability to implement such improvements. Achieving socio-economic development as a result and predominantly socio-economic independence is therefore at risk. Furthermore, developing states failed to take into account their natural resources, their capacity and ability not only to develop but also to implement in practice the required rules and regulations. Berliner et al. maintained that building state capacity, especially in the developing world 'has been linked to human rights improvements, economic development, and the enforcement of property rights'.⁵ Therefore, capacity building is the most crucial element that the host developing states should aspire towards in order to become socio-economically independent. Socio-economic development should be

² ECOSOC Resolutions 1908 (LVII) of 2 August 1974 and 1913 (LVII) of 5 December 1974.

³ Megan Wells Sheffer, 'Bilateral Investment Treaties, A friend or foe to human rights?' (2011) 39(3) Denver Journal of International law and policy.

⁴ A/HRC/8/5 (7 April 2008) <<http://www.reports-and-materials.org/sites/default/files/reports-and-materials/Ruggie-report-7-Apr-2008.pdf>> accessed 12 June 2015.

⁵ Daniel Berliner et al., Building Capacity, Building Rights? State Capacity and Labor Rights in Developing Countries (2015) 72 World Development 127-139.

focused on modernisation and capacity building. The same applies to the legal aspects and the ancillary laws and legislation. It has to be set and based on the capacity of the host developing states and especially the ability of its enforcement. Elliott and Freeman argued that ‘the problem of low standards often stems from a lack of capacity to enforce labor codes’.⁶ Dias maintained that one cannot discuss legal order if legislature, judiciary and executive do not exist.⁷ The International Court of Justice (ICJ) is the sole institution to make up for the fact that there is no system of courts in the international law as it states in the Statute of the International Court of Justice ‘The ICJ can only decide cases referred to but cannot enforce the compliance with their decisions’.⁸ Moreover there is no international institution to establish, clarify or determine consequence for parties breaking the rules,⁹ notwithstanding the UN Charter¹⁰ and other UN Resolutions, mainly Permanent Sovereignty over Natural Resources 1962 and Charter of Economic Rights and Duties of States 1974.

The reality of aspirations between different parties is that they have to meet at some point in order to create environment for mutual socio-economic development. Different directions are to be considered while examining these aspirations. Host developing states have expressed their aspirations in the Permanent Sovereignty over Natural Resources 1962 and Charter of Economic Rights and Duties of States 1974.¹¹ Clear need for the codes of conduct for TNCs was expressed but not executed.¹² In the US, the Congress, after a number of congressional hearings and legal actions against corporations, adopted the Sullivan Principles as law¹³ that should prevent bribing foreign officials in order to gain economic advantage. After the economic crisis, the US adopted Dodd-Frank Wall

⁶ Kimberly A. Elliot and Richard B. Freeman, *Can labor standards improve under globalization?* (Peterson Institute for International Economics 2003) 11 <<https://ideas.repec.org/b/iie/ppress/338.html>> accessed 12 June 2015.

⁷ Reginald W. M. Dias, *Jurisprudence* (5th edn, Butterworths Law 1985); See further H.L.A. Hart, *The Concept of Law* (OUP 1961).

⁸ Statute of the International Court of Justice, article 36.

⁹ Philippe Sands and Pierre Klein (eds), *Bowett's Law of International Institutions* (6th edn, Sweet & Maxwell 2009).

¹⁰ See The United Nations Charter, article 17(1); See further David Hugh Neville Johnson, ‘The Effect of Resolution of the General Assembly of the United Nations’ (1955-56) 32 BYIL 6/97.

¹¹ UNGA Res A/RES/29/3281, 1974.

¹² James K. Jackson, *Codes of Conduct for Multinational Corporations: An Overview Specialist in International Trade and Finance* (Congressional Research Service 2013).

¹³ The Law was informally adopted in 1977 and was amended in 1986

Street Reform and Consumer Protection¹⁴ Act 2010¹⁵ in order to address the issues of governance and regulation of the financial sector. Following the US, the EU also adopted numerous directives to improve oversight of the financial sector.¹⁶ According to the UN:

[C]odes of conduct have become increasingly significant for international investment, since they typically focus on the operations of large multinational corporations which, through their foreign investment and global value chains, can influence the social and environmental practices of businesses worldwide.¹⁷

The UN Draft Code of conduct on transnational corporations 1990 and the OECD Guidelines for multinational enterprises 1976 are discussed more in depth in chapter 3. OECD Guidelines are very clear and specific on the responsibility and the role of TNCs in host developing states. Furthermore, TNCs cannot be blamed for the latter, because as profit maximisers they are accountable to their shareholders and as such not accountable for socio-economic development of host developing states. Moreover, when there is no signed binding contract in existence, hence TNCs have no contractual obligations to fulfil. Therefore, it is the host developing states that should negotiate such binding provisions for TNCs, during the negotiations process on investment agreement.

2.2 Aspirations of Host Developing States

Meier and Rauch maintained that ‘there is no universally accepted definition of “less developed country (LDC)” or “developing country”’.¹⁸ Standard measuring methodology

¹⁴ The UN General Assembly resolution included guidelines on consumer protection, see UN Doc.ST/ESA/170 (1986); OECD also made an attempt with OECD, Guidelines for Multinational Enterprises and the Protection of Consumer Interests (1999).

¹⁵ H.R.4173 - 111th Congress of the USA at the second session (2009-2010) and signed by President Obama on 21st July 2010 < http://www.cftc.gov/idc/groups/public/@swaps/documents/file/hr4173_enrolledbill.pdf> accessed 21 March 2016.

¹⁶ James K. Jackson, Codes of Conduct for Multinational Corporations: An Overview Specialist in International Trade and Finance (Congressional Research Service 2013).

¹⁷ UNCTAD, World Investment Report 2011, 111.

¹⁸ Gerald M. Meier and James E. Rauch, *Leading issues in Economic Development* (7th edn, OUP 2000) 1.

is based on the US dollar and gross domestic product (GDP). The International Monetary Fund (IMF) argued that in order ‘to put themselves on a path of convergence with the advanced economies, developing countries must align their policies with the forces of globalization’.¹⁹ The ILO maintained that ‘rather than eliminating or attenuating differences and inequalities, the integration of national economies into a global system has on the contrary made those differences and inequalities more apparent and, in many ways, more unacceptable’.²⁰ Emmerji et al. maintained that ‘Growth was always promised as one of the results of structural adjustment, but it has often failed to materialize’.²¹ However, it seems as the aspirations of developing states are restricted as they feel they are without a voice due to their big debt from borrowing and dependency on the financial aid that they have been receiving over the years.

The root cause of the aspirations of host developing states is based on the quest to achieve socio-economic development towards socio-economic independence, while protecting their natural resources and sovereignty. The objective of the aspirations is to achieve such socio-economic development while being also independent and not dependant on resources or finances from the foreign investors. Permuter maintained that ‘The history of the relationship between transnational corporations (TNCs) and nation-state during the past half century and more may be characterized as a “tortuous evolution”’.²²

Since the decolonisation process and creation of many newly independent states their aspirations have reflected that:

In the mid-1970s, with the adoption of UN Resolutions calling for the establishment of a New International Economic Order (NIEO), with its emphasis on sovereign rights to regulate and control foreign investors and their investments, and on the recognition of permanent national sovereignty over natural wealth and resources.²³

¹⁹ IMF, *Forces of Globalization Must Be Embraced* (IMF Survey 26, No 10 1997) 154.

²⁰ ILO, *Defending Values, Promoting Change: Social Justice in a Global Economy*, an ILO Agenda (Geneva: ILO, 1994) 18.

²¹ Louis Emmerji, Richard Jolly, Thomas G. Weiss, *Ahead of the curve? UN Ideas and Global Challenges* (Indiana University Press 2001) 132.

²² Howard V. Permuter in Tagi Sagafi-Nejad and John Dunning, *The UN and Transnational Corporations, From Code of Conduct to Global Compact* (Indiana University Press 2008) foreword.

²³ Peter T. Muchlinski, ‘Policy Issues’ in Peter T. Muchlinski, Federico Ortino and Christoph Schreuer, *Oxford Handbook of International Investment Law* (OUP 2008) ch 1, 4.

Inequalities in the current global trading system have hurt developing states heavily.²⁴ According to Hill there were three waves of globalisation.²⁵ First wave it is assumed to have begun in the 1870s and ended with the beginning of the First World War.²⁶ Maddison maintained that in this period there were massive global migrations of the world population, especially from Europe to the United States (US).²⁷ After the Second World War the period was labelled as “reverse globalisation” due to stagnation on development and significant fall back to where the first wave had started.²⁸ It was not until the 1950s to the 1980s that the economic prosperity has started again as the Second wave of globalisation. The most important in this wave was the integration between developed states of Europe, North America and Japan via trade agreement such as GATT, NAFTA, OPEC, and others that have tried to facilitate international trade and promote global foreign investments.²⁹ The third wave of globalisation also known as mega-globalisation hosted innovations in communications technology and by opening international trade, which according to Stiglitz³⁰ was due to being forced and based on their own choice. Developing states were trying to attract foreign investment as ‘most developing countries came to embrace the idea that foreign investment was a necessity for economic development’³¹ during their economic turmoil in the 1990s.³²

The UNCTAD Resolution 45(III) 1972:

Stressed the urgency to establish generally accepted norms to govern international economic relations systematically and recognised that it is not feasible to establish a joint order and a stable order as long as a charter to protect the rights of all countries, and in particular the developing States, is not formulated.³³

²⁴ James Thomas Kunnanatt, ‘Globalization and developing countries: A global participation model’ (2013) 8(4) Economics, Management, and Financial Markets Volume 42-58.

²⁵ The challenges and misconception of the term “globalisation” have been referred to throughout the thesis.

²⁶ Charles W.L. Hill, *International Business* (9th edn, McGraw-Hill 2012).

²⁷ Angus Madisson, *The World Economy: A Millennial Perspective* (Paris: Development Centre Studies, OECD2001).

²⁸ Karl Moore and David Lewis, *The origins of Globalization* (Routledge 2009).

²⁹ Immanuel M. Wallerstein, *The Demise of Neoliberal Globalization* (Ferdinand Braudel Centre State University of New York 2008).

³⁰ Joseph E. Stiglitz, *Globalization and its Discontents* (Penguin Books 2002).

³¹ Surya P Subedi, *International Investment Law* (3rd edn, Hart Publishing 2016) 46.

³² George Ritzer, *Globalization: The Essentials* (John Wiley & Sons 2011).

³³ UNCTAD, Third Session, Vol. 1, UN Sales No. E.73.II/D.4.

The UN recognised the importance to protect developing states as early as 1972 as well as the need to govern international trade. Shaw maintained that ‘The role of the state in the modern world is a complex one’ and added that ‘each state is sovereign and equal’.³⁴ Keane³⁵ maintained that the role of states is in decline, while at the same time TNCs are becoming more powerful in the global civil society. Hence it should be the responsibility of the governments and international organisations to take the responsibility of setting rules that would manage, control and implement standards of internationalisation in terms of interaction between host developing states and TNCs as well as the United Nations and other important international institutions, namely ICCt (International Criminal Court), International Court of Justice (ICJ), International Monetary Fund (IMF), the World Bank (WB), and World Trade Organisation (WTO). It should be borne in mind that, while the TNCs are not dependent on civil society by election but by executives, the government of the host developing states on the other hand are elected by the civil society. Therefore, the civil society has enormous power, which it might not even be aware of, to elect the government that will govern the state. Governments should therefore become more accountable for the decisions that they are making while in power, and should be able to regulate the activities on their sovereign territory and make sure agreements are made in the interest of the state and not only of the TNCs. Government also have the power to regulate the legislation on all levels. As mentioned in the first chapter the importance of negotiations plays a crucial role in making decisions on regulations and legal framework as well as binding terms and conditions. Governments not only have the power to change the laws, but also the power to negotiate international agreements with other states and with TNCs as well as to enforce compliance with the agreed or negotiated terms and conditions and change regulations at any given time.

International law requires compensation payment by the newly formed and independent states to TNCs as foreign investors, which assets has been taken in the process of taking. Therefore, compensation payment has been heated topic of numerous international debates due to the fact that TNCs have been exploiting natural resources of host developing states, making substantial profits along the way and the host developing states are still required to pay compensation. Countries such as the UK have argued in the early

³⁴ Malcolm N. Shaw, *International law* (5th edn, CUP 2003).

³⁵ John Keane, *Global Civil Society?* (CUP 2003).

19th century that foreigners should be entitled to the same treatment as nationals, namely during the large-scale expropriation process.³⁶ The right of foreign investors to compensation payment on the grounds of national treatment was challenged, namely by newly independent and communist states, such as the Soviet Union, where during the large-scale nationalisation at the beginning of the 20th century no such right was granted to their nationals and therefore could not have been extended to foreigners. Southern states nationalised former colonial enterprises after becoming independent and did not think compensation payment was due on the ground that the colonial masters had been exploiting their natural resources for many years. Latin American states on the other hand claimed that compensation payment could not be justified because enormous profits have been made on their expense by the expropriated TNCs. Wortley and White believed that no compensation should be paid.³⁷ However, in reality the majority of developing states have in fact paid compensation, based on signed BITs and customary international law, however even in the absence of BITs the compensation payment still applies under international law. The main disagreement was on the type of compensation to be paid, such as prompt, adequate and effective³⁸ or just and appropriate.³⁹ When the states became independent in the process of decolonisation, the newly born sovereign states gained back the control over their natural resources from under the control of the former colonial masters that until recently had economic dominance. In such situations one can suggest that by paying compensation it only encourages unfair continuous profit-maximisation. Developing states should therefore steer their aspirations towards benefit-maximisation which includes capacity building. While TNCs are only interested in profit-maximisation and not recognising their responsibility for capacity building and socio-economic development of developing state in which they operate, notwithstanding their corporate social responsibility.⁴⁰ It is without a doubt that these two aspirations should be revisited under contractual terms in which developing states would have the majority of ownership

³⁶ Detlev C. Dicke (ed), *Foreign investment in the present and a new international economic order* (Freiburg University Press 1987).

³⁷ Ben A. Wortley, *Exploration in public international law* (CUP 1977) 96; Gillian White, *Nationalisation of Foreign Property* (Stevens & Sons, Ltd. 1961); Gillian M. White, *The use of experts by international tribunals* (Syracuse University Press 1965); Gillian White, *The foreign compensation Act 1969 and a nineteenth-century precursor* (1972) 35(6) *The Modern Law Review* 584-595.

³⁸ Following Hull formula.

³⁹ Following NAFTA and PSNR.

⁴⁰ See Peter T. Muchlinski, 'Corporate social Responsibility' in Peter T. Muchlinski, Federico Ortino and Christoph Schreuer, *Oxford Handbook of International Investment Law* (OUP 2008) ch 17.

and consequently control for making decision on their sovereign territory and most importantly regain the control over their natural resources.

During the initial period of decolonisation, the newly born independent states did not have any voice to control the operational matters of foreign companies working in their own jurisdiction. As stated earlier that they have developed the sense of submissiveness to the colonial master which hindered their creativity particularly in the first few decades after their independence. As far as TNCs are concerned they did not encounter opposition from the host developing states in negotiating investment agreements and host developing states failed to assert their rights vis-à-vis TNCs. This has been clearly demonstrated through BITs, which are extremely one sided and predominantly protect the interests of private foreign investors. TNCs should appreciate that circumstances have changed and that the developed world instead of creating confrontation should try to resolve them through balanced negotiation processes.

Sagafi-Nejad maintained that ‘Host countries were either colonial dependants or were too feeble (and corrupt) to exercise much control over the activities of foreign firms’.⁴¹ While the UNCTAD ‘recommended that developing countries should, with the assistance of developed countries and the UN adopt suitable means to supply all the necessary information about investment conditions, regulations, and opportunities to prospective foreign investors’.⁴² The UNCTAD also suggested to the foreign investors that:

[F]oreign private investment, based upon respect for the sovereignty of the host country, should co-operate with local initiative and capital, rely as far as possible on existing resources in developing countries, and should work within framework and objectives of the development plans with a view to supplying domestic markets and, in particular, expanding exports.⁴³

Unfortunately, as Haymar pointed out the foreign investors were blinded by making the highest return on their investment to be able to pay attention on the UNCTAD suggestions or take them into consideration. At the same time developing states, namely the newly

⁴¹ Tagi Sagafi-Nejad and John Dunning, *The UN and Transnational Corporations, From Code of Conduct to Global Compact* (Indiana University Press, 2008) 24.

⁴² Tagi Sagafi-Nejad and John Dunning, *The UN and Transnational Corporations, From Code of Conduct to Global Compact* (Indiana University Press, 2008) 26.

⁴³ UNCTAD, *Proceedings of the United Nations Conference on Trade and Development, vol. 1, Final Act and Report* (New York: UN 1964) 49-50.

formed ones started to become aware of their sovereignty and the power to control the activities on their territory. As a result, cases of nationalisation⁴⁴ and expropriation were becoming more and more frequent. This environment negatively affected foreign investments, TNCs and host developing states. Instead of working together on common objectives of socio-economic development the relationships turned into turmoil.⁴⁵ As the UN recognised as early as in 1950s that international trade and finance would be crucial for the socio-economic development in developing states. However, the:

[S]pecial vulnerability of developing countries to economic fluctuations arising outside their borders; instability and long-run decline in commodity prices, which formed the main exports of many developing countries; and fluctuations in flows of international capital, private and public.⁴⁶

These were issues identified that could stand in the way of achieving socio-economic development in developing states. Furthermore, the necessary actions required to be taken by the developing states were proposed in *Measures for International Economic Stability* 1951.⁴⁷

Developing states aspired towards the UNCTAD to 'become a forum through which they could improve their bargaining position more effectively than in other multilateral economic institutions in which the West was dominant'.⁴⁸ OECD maintained that states have liberalised their private foreign investment regimes in order to attract private foreign investment.⁴⁹ It is interesting to note, that it was actually Chileans, who were responsible for putting the activities of TNCs on the agenda of the UN, following the nationalisation of private foreign investments, namely copper mines, hotels, manufacturing, telecommunications, ITT affair⁵⁰ and political scandals of Allende government.⁵¹ These

⁴⁴ See Stephen J Kobrin, 'Expropriation as an Attempt to Control Foreign Firms in LDCs: Trends from 1960 to 1979' (1984) 28 ISQ 329–334.

⁴⁵ See UNCTAD, *Trends in International Investment Agreements: An overview* (Geneva: UN, 1999).

⁴⁶ Louis Emmerji, Richard Jolly, Thomas G. Weiss, *Ahead of the curve? UN Ideas and Global Challenges* (Indiana University Press 2001) 50.

⁴⁷ See The UN, *Measures for International Economic Stability Report* (UN 1951).

⁴⁸ Louis Emmerji, Richard Jolly, Thomas G. Weiss, *Ahead of the curve? UN Ideas and Global Challenges* (Indiana University Press 2001) 53.

⁴⁹ OECD, *Foreign Direct Investment for Development, Maximising benefits, minimising costs* (OECD 2002) 5.

⁵⁰ Anthony Sampson, *The Sovereign State of ITT* (Stein and Day 1973).

⁵¹ U.S.Senate, *Select Committee to Study Governmental Operations with Respect to Intelligence Activities, Covert Actions in Chile 1963-1973* (Washington, D.C.: Government Printing Office, 1975) <<http://www.derechos.org/nizkor/chile/doc/covert.html>> accessed 20 January 2016.

events laid the foundation for the UN to study the effects of TNCs on socio-economic development. De Seynes maintained that:

The decision of 1973 to create a focal point within the United Nations system for transnational corporations must be viewed as a landmark in the development of institutions needed for a New International Economic Order.⁵²

While Root maintained that:

[T]he attempt by the International Telephone and Telegraph Company (ITT) to get the U.S. government to exert economic pressure on the Allende government of Chile reinforced allegations throughout Latin America that the U.S. multinational enterprises pose a threat to national economic independence.⁵³

Developing states did demonstrate their strength, which reflected in the UN resolution the New International Economic Order 1974⁵⁴ that was based on equality, sovereign rights, interdependence, common interests and co-operation among all states. Developing states however unfortunately failed to materialise on their aspirations by translating them into laws and ‘without petroleum to export were obliged to set aside changes in the international economic system and give priority to implementing structural adjustment programs’.⁵⁵ At the same time industrialised developed states were strongly against redistribution of wealth and income with developing states. ‘Growth was always promised as one of the results of structural adjustment, but it has often failed to materialize’.⁵⁶

The main aspirations of host developing states manifested in the UN Resolutions such as the Permanent Sovereignty over Natural Resources 1962, New International Economic Order 1974, and the Charter of Economic Rights and Duties of States 1974, however it

⁵² Philippe de Seynes, *Transnational Corporations in the Framework of a New International Economic Order*, CTC Reporter 1, no.1 (December 1976) 15.

⁵³ Franklin R. Root, *International Trade and Investment* (5th edn, South-Western Publishing, 1984) 514.

⁵⁴ UNGA 3201 1 April 1974.

⁵⁵ Louis Emmerji, Richard Jolly, Thomas G. Weiss, *Ahead of the curve? UN Ideas and Global Challenges* (Indiana University Press 2001) 102.

⁵⁶ Louis Emmerji, Richard Jolly, Thomas G. Weiss, *Ahead of the curve? UN Ideas and Global Challenges* (Indiana University Press 2001) 132.

seems that in spite of the efforts they failed to materialise their aspirations, mainly due to the strong opposition from the developed states. It is also important to bear in mind the fact that there are fundamental differences between developing states as not all developing states are the same and also because there is no universally accepted definition.⁵⁷

2.3 Aspirations of TNCs

‘TNCs have an increasingly profound impact on the world we inhabit and therefore deserve serious attention’.⁵⁸ Over the years the responsibilities of foreign investors became a major topic of debates, which had significantly affected the development of international investment law. As from the very beginning of investment law the main focus of promotion and protection of private foreign investment has not changed. Muchlinski argued that international social responsibility ‘obligations may be seen as the *quid pro quo* for the protection of investors and investments under international investment protection agreements and international economic rules’.⁵⁹ The term corporate social responsibility (CSR) has been modified over the years of its inception and the UNCTAD associates ‘the term with the “social contract” between a corporation and its host society’.⁶⁰ However ‘The scope of corporate social responsibility is conceptually quite unbound at the present time’.⁶¹

The new topic of discussions is ‘what is the nature and extent of those obligations and how can they made accountable for any non-compliance’, because ‘if the regulatory regime can be arranged in such a way as to harness market forces and provide an

⁵⁷ Gerrard M. Meier and James E. Rauch, *Leading Issues in Economic Development* (7th edn, OUP 2000).

⁵⁸ Howard V. Permuter in Tagi Sagafi-Nejad and John Dunning, *The UN and Transnational Corporations, From Code of Conduct to Global Compact* (Indiana University Press 2008) foreword.

⁵⁹ Peter T. Muchlinski, ‘Corporate social Responsibility’ in Peter T. Muchlinski, Federico Ortino and Christoph Schreuer, *Oxford Handbook of International Investment Law* (OUP 2008) ch 17, 643.

⁶⁰ UNCTAD, *World Investment Report 1994: Transnational Corporations, Employment and the Workplace* (Geneva: United Nations), United Nations publication, Sales No. E.94.II.A.14.

⁶¹ UNCTAD, *The Social Responsibility of Transnational Corporations* (New York and Geneva, United Nations 1999) <http://unctad.org/en/Docs/poitetiim21_en.pdf> accessed 26 January 2016.

economic incentive to MNCs to meet their obligations, they will engage in effective self-regulation because it is in their interests to do so'.⁶²

Transnational corporations (TNCs) have become the most important actors in the global political economy arena, mainly due to the extent of their operations across the national borders of their home state's headquarters. The decision making process that takes place within such a corporation is purely based on making or maximising profits with no regard to the national interests or the interests of host developing states in which their operations are taking place, because their accountability is to their shareholders.

Research conducted by INSEAD (Institut Européen d'Administration des Affaires) explores in depth the question, if TNCs should be concerned with the global common good.⁶³ Since 1776, when Adam Smith⁶⁴ in his work the *Wealth of Nations* set a theory of an invisible hand that guides the individual interest into a common good. However, the UN Development Programme and World Bank reports have shown that the biggest one hundred economies in the world are in fact transnational corporations (TNCs). As an example, the Shell corporation accounted for \$268,9 billion in sales⁶⁵ in 2003, while Niger GDP of only \$2,7 billion. In the same year General Motors sales accounted for \$185,5 billion and GDP of Botswana was \$7,4 billion. Microsoft corporation accounted for \$32,2 billion in sales, while GDP of Guatemala was \$24,4 billion. Johnson & Johnson turnover in 2003 was \$41,9 billion and GDP of Kazakhstan was \$24,7 billion.⁶⁶ Mason⁶⁷ maintained that one can consider corporations to be the central institutions of our time in terms of their importance and relevance to shaping everyday life.

The phenomenon of global activities, have contributed to the fact that transnational corporations (TNCs) have gained not only economic but also social power. The fact that they operate in various countries gives them the opportunity to bypass national laws and

⁶² Mark Davison, 'Multinational Corporations Accountability for human rights obligations' (2004) 29(1) *Alternative L.J.* 20.

⁶³ Henri-Claude de Bettignies and Francois Lepineux, *Should multinational corporations be concerned with the global common good? An interdisciplinary exploration* (Working Paper Series 2005/28/ABCM 2005).

⁶⁴ Adam Smith, *The Wealth of Nations* (first published 1776, Penguin Books 1999).

⁶⁵ UNCTAD <http://unctad.org/en/Docs/poiteiitm21_en.pdf> accessed on 20 January 2016.

⁶⁶ All data acquired from The World Bank, World Development Indicators Series and well as Shell, Johnson&Johnson, General Motors, Microsoft websites.

⁶⁷ Kenneth Mason, 'The Multinational Corporations: Central Institution of Our Age' in R. Dickie & L. Rouner, (eds) *Corporations and the Common Good* (University of Notre Dame Press 1986).

regulations, and access international arbitration directly as the precedence for exhausting local remedies has not been set. TNCs enjoy the privilege of extraterritoriality. The supporters of TNCs claim that they create jobs and hire workers and contribute towards employment and technology transfer. The critics of TNCs claim they undermine national sovereignty in developing states, cause environmental degradation, destroy labour units, circumvent national and international law, support repressive regimes and do not contribute to technology transfer.⁶⁸ An example that technology transfer is possible to be obtained, exploited and adapted, without the private foreign investment can be seen in China, Hong Kong, North Korea, Singapore, South Korea, former Soviet Union, and Thailand. Moreover, TNCs supply developing states with the second-hand technology or even out-dated one as they feel very protective of their corporate secrets. TNCs have legitimate fear that technology could be copied and as a result TNCs would end up in competition and would lose their monopoly position, which would endanger their profit maximisation. Another reason for using second-hand technology is also cost minimisation. Technology transfer is put under question also because examples of only using the second-hand technology by the TNCs in the developing states have been numerous.⁶⁹

In his research Velasquez maintained that there is no moral obligation for transnational corporations (TNCs) to aspire towards a global common good, especially when it interferes with profit maximisation. Velasquez concluded that:

In the absence of an international enforcement agency, multinational corporations operating in a competitive international environment cannot be said to have a moral obligations to contribute to the international common good, provided that interactions are non-repetitive and provided effective signals of agent reliability are not possible.⁷⁰

⁶⁸ Kema Irogbe, 'Global Political economy and the power of multinational corporations' (2013) 30(2) *Journal of Third World Studies* 224.

⁶⁹ Kema Irogbe, 'Global Political Economy and the Power of Multinational Corporations' (2013) 30(2) *Journal of Third World Studies* 223.

⁷⁰ Manuel Velasquez, 'International Business, Morality, and the Common Good' (1992) 2(1) *Business Ethics Quarterly* 27.

Friedman⁷¹ stated that the social responsibility of corporations is to make profit by following the law. The paradox here is that while the legal system was founded on the grounds of being meant for the public good TNCs are dependent on efficient legal system, which does not seem to work in favour of the public good. Furthermore, the legal protection and rights gave TNCs ownership, security, right and the power to execute their activities and make enormous profits on the way. Without the ownership and security granted to TNCs by the legal system, the latter would not have been able to operate. At this point the role of law becomes open to interpretations, namely in the investment agreements made between TNCs and host developing states as well as when deciding on the investor-state dispute settlement be it following the international law or signed BITs.

The Judiciary Act 1789 that gave federal courts original jurisdiction stated that ‘The district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States’.⁷² The Act thereby allowed individuals and groups to sue TNCs for international law violations outside the USA. However, in 2004 the Supreme Court has restrained use of this Act to the applicability of international law violations. Furthermore, in 2013 in *Kiobel v Royal Dutch Petroleum Co.*⁷³ which further limited the scope of claims under the Alien Tort Statute (ATS) by assuming that suits based only on tortious conduct overseas do not stand on solid ground stating that ‘touch and concern the territory of the United States...with sufficient force’.⁷⁴ Such law would be worth to consider making universally applicable by becoming a part of customary international law.

TNCs motive for investing in the host developing states is clear, access to natural resources, cost reduction and profit maximisation. Given the fact that there are a number of developing states, TNCs could currently choose in which of them they are interested in investing. Developing states can improve their bargaining position by high quality infrastructure, skilled labour force and skilled negotiators. However it is very difficult to find any tangible proof that private foreign investment has in any way contributed to the

⁷¹ Milton Friedman, 'The Social Responsibility of Business is to Increase its Profits' *The New York Times Magazine* (New York, 13 September 1970).

⁷² 28 U.S.C. 1350 ATS (1789).

⁷³ *Kiobel v Royal Dutch Petroleum* (2013) 133 SCt 1659.

⁷⁴ *Kiobel v Royal Dutch Petroleum* (2013) 133 SCt 1669.

infrastructure development in the host developing states.⁷⁵ The UNCTAD report 2000 showed that the lack of skills and infrastructure is the major restraint to foreign investment, especially in African countries.⁷⁶ Report also stated that developing states cannot attract knowledge-based private foreign investment without the sufficient availability of technological and human resource capabilities. Vernon argued that the relationship between host developing states and TNCs can be analysed in terms of bargaining position, which determines the distribution of benefits.

To elaborate further on Vernon's "obsolescing bargain" that claimed the initial distribution of power favours the TNCs due to the generosity of host developing states and their hope to transfer wealth, technology and training in exchange of the access to their natural resources.⁷⁷ However, Vernon claimed that after some time there is a shift in the bargaining position to the host developing state, which creates the need for re-negotiation. Moreover, the only reason that TNCs even agree to the re-negotiations is when they have invested substantial amounts and when TNC is already deeply involved in the project, which makes it difficult to get out of the initial partnership agreement. The important issue to note is that this was only relevant in the 1970s and 1980s. New studies have proven that 'obsolescing bargaining is no longer appropriate as an analytical tool'.⁷⁸

Bennet and Sharpe noted that obsolescing bargaining did not apply to the private foreign investments in the Mexican automobile industry and high technology-intensive consumer goods manufacturing sector.⁷⁹ As their studies showed that in these two cases the situation was opposite as the host developing state had high bargaining position at the beginning, which declined over time. One can conclude that the obsolescing bargaining position cannot be applied across national boundaries as it varies and is case by case specific.

⁷⁵ Other than Peter Evans, 'Predatory, Developmental, and other Apparatuses: A Comparative Political Economy Perspective on the Third World State' (Sociological Forum 1989) 561-587, who maintained that TNCs can help in development of state capacity.

⁷⁶ UNCTAD, World Investment Report (Geneva 2000).

⁷⁷ Raymond Vernon, 'The Obsolescing Bargain: A Key Factor in Political Risk' in Mark B. Winchester (ed), *The International Essays for Business Decision Makers* (Center for International Business 1980) vol 5.

⁷⁸ Patrick JW Egan, 'Hard bargains: The impact of multinational corporations on economic reform in Latin America' (2010) 52(1) *Latin American Politics and Society* 1-32, 2.

⁷⁹ Douglas C. Bennett and Kenneth E. Sharpe, 'The World Automobile Industry and Its Implications' in Richard S. Newfarmer (ed) *Profits, Progress, and Poverty* (University of Notre Dame Press 1985) 22.

Vernon and Hymer⁸⁰ argued that in spite of the competitive world where there should be no room for bargaining, however the outcomes of negotiations is influenced by the bargaining position of both the parties.⁸¹ The impact of TNCs on sovereign states by means of distribution of the scarcity of the natural resources is yet to be seen. However, there is a lack of accountability of TNCs to any authority that would represent the interests of sovereign states and would govern TNCs through a treaty based international investment law administered by an international institution, which causes jurisdictional conflict.⁸² TNCs can offer and put on the table the resources that the host developing states do not have, such as capital, advanced technology and skills. TNCs combine equity capital, managerial talent, technology, brand image, marketing ties, distribution network and united they compete with other rivals.⁸³

Foreign investors were given protection extended to access the international tribunals, which are under the auspice of international law. Granting such access is a new phenomenon under the bilateral investment treaties (BITs), when TNCs can for the first time bring suits against governments of host developing states. While the conflict between the two parties can be internationalised, the investment agreement or BIT on the other hand cannot be internationalised as it remains bilateral between the two signing parties. By concluding BITs host developing states agreed to additional protection accorded to the foreign investors and as such they have also given consent to result to international arbitration in case of any investment legal disputes between the parties. BITs were nothing but ‘the result of a grand bargain between an investment-exporting state and investment-receiving state’.⁸⁴ Therefore host developing states should have included the obligations for foreign investors when negotiating bilateral investment treaties. However, the BITs and its provisions and standards of treatment are discussed more in depth in chapter 3.

⁸⁰ Stephen H. Hymer, *The International Operations of National Firms: A Study of Foreign Direct Investment* (MIT Press, 1976).

⁸¹ Stephen H. Hymer, *The International Operations of National Firms: A Study of Direct Foreign Investment* (MIT Press 1976).

⁸² Geroge W. Ball, ‘COSMOCORP: The Importance of Being Stateless’ (1968) *The Atlantic Community Quarterly* IV (Summer) 163-70.

⁸³ S. Venu, ‘The multinationals and developing societies: A profile of the future’ (1974) 6(2) *Elsevier* 133-141.

⁸⁴ Surya P Subedi, *International Investment Law* (3rd edn, Hart Publishing 2016) 105.

2.4 Aspirations of the United Nations

‘Since its inception, the United Nations and its various agencies have been at the forefront of understanding and studying the role of these corporations in development and international relations and on the well-being of the nation-states in which they operate’.⁸⁵ The UN has also supported the need for richer states to support developing states in their socio-economic development.⁸⁶

International organisations before the Second World War such as the League of Nations, included the World Intellectual Property Organization and the International Labour Organization (ILO), which later became specialised agencies of the UN. The UN were instrumental in establishing institutions to study activities of TNCs and in understanding the weight of the matter, since the 1975 when GEP was appointed through the UN commission and centre on TNCs that was later taken on the shoulders of the UNCTAD. However, in spite of the best efforts the main objective of creating the Codes of Conduct⁸⁷ did not see the light of day, notwithstanding that ‘ideas on competition, resource allocation, labor relations, the environment, and corruption survived’.⁸⁸ Codes of conduct on TNCs are critically analysed in chapter 3.

The following are the four principal aims of UNCTAD:

1. To promote international trade and economic development of developing countries;
2. To promote trade and economic co-operation, particularly between countries at different stages of economic development and between developing countries and between countries with different economic and social system;
3. To formulate principles and policies on international trade and development; and

⁸⁵ Howard V. Permuter in Tagi Sagafi-Nejad and John Dunning, *The UN and Transnational Corporations, From Code of Conduct to Global Compact* (Indiana University Press 2008) foreword.

⁸⁶ See Olav Stokke, *The UN and Development: From Aid to Cooperation* (Indiana University Press 2009).

⁸⁷ See Tagi Sagafi-Nejad and Howard V. Permuter, ‘Perception Gaps and Mistrust as Obstacles to Multilateral Solutions: Some Empirical Evidence’ in Surendra J. Patel, Pedro Roffe and Abdulghawi Yusuf (eds) *International Technology Transfer: The Origins and Aftermath of the United Nations Negotiations on a Draft Code of Conduct* (Kluwer Law International 2001) 247–256.

⁸⁸ Tagi Sagafi-Nejad and John H. Dunning, *The UN and Transnational Corporations, From Code of Conduct to Global Compact*, United Nations Intellectual History Project Series (Indiana University Press 2008).

4. To promote a more equitable international economic order, a larger voice for developing countries in decision making, and a development dimension and consensus in international institutions and policies.⁸⁹

It was in its very early years that the UN released three major publications, the National and International Measures for Full Employment 1949; Measures for the Economic Development of Under-Developed Countries 1951 and Measures for International Economic Stability 1951.

In his foreword speech in 2011 Ban Ki-moon, The Secretary General of the United Nations stated that:

The United Nations was founded on the conviction that the nations of the world can and should cooperate to resolve conflicts peacefully and change people's lives for the better.⁹⁰

Johnson maintained that the UN General Assembly resolutions have no binding effect and furthermore that there was no such aspiration.⁹¹ Aspirations of the UN are revealed in resolutions, however Sloan questioned the existence of their binding force by stating that:

There is, however, in the Charter no express undertaking to accept recommendations of the General Assembly similar to the agreement in Article 25 to accept and carry out decisions of the Security Council. On the other hand, it cannot be said that the Charter specifically negates such an obligation, and it may be possible to deduce certain obligations for the Charter as a whole which it would be impossible to establish from an express undertaking.⁹²

Higgins added that:

Resolutions of the Assembly are not per se binding: through those rules of general international law which they may embody are binding on member states, with or without the help of the resolution. But the body of resolutions

⁸⁹ Louis Emmerji, Richard Jolly, Thomas G. Weiss, *Ahead of the curve? UN Ideas and Global Challenges* (Indiana University Press 2001) 53.

⁹⁰ Basic Facts about the United Nations (United Nations Department of Public Information New York 2011).

⁹¹ David Hugh Neville Johnson, 'The Effect Resolutions of the General Assembly of the United Nations' (1955-56) 32 *British Year Book of International Law* 97.

⁹² F. B. Sloan, 'The Binding Force of a Recommendation of the General Assembly of the United Nations' (1948) 25 *British Year Book of International Law* 14.

as a whole, taken as indications of a general law, undoubtedly provide a rich source of evidence.⁹³

UN Resolutions are not taken into consideration with the same weight of authority as sources of international law by courts, unless they restate an existing legal principle. UN Resolutions are considered ‘nonbinding recommendations reflecting idealized international legal principles’.⁹⁴ Due to the fact that the UN General Assembly ‘powers are limited to making recommendations under the Charter of the UN’.⁹⁵

In 1972 the UNCTAD⁹⁶ affirmed ‘the sovereignty right of developing countries to take the necessary measure to ensure that foreign capital operates in accordance with the national development needs of the countries concerned’ and expressed ‘its concern [about certain aspects of FDI] that disrupt competition in the domestic markets, and their possible effects on the economic development of the developing countries’ and recognised ‘that the private foreign investment, subject to national decisions and priorities, must facilitate the mobilization of internal resources, generate inflows and avoid outflows of foreign exchange reserves, incorporate adequate technology, and enhance savings and national investment’ and last but not least it urged ‘developed countries to take the necessary steps to reverse the tendency for an outflow of capital from developing countries’.⁹⁷

In 1974 the UN General Assembly adopted two important resolutions that have contributed to setting up norms of international economic relations. One was the Declaration on the Establishment of a New International Economic Order 1974⁹⁸ and the other was the Programme of Action on the Establishment of a New International Economic Order 1974.⁹⁹ Chatterjee maintained that:

[T]he vast number of the former colonies attained their independence during the 1960s and 1970s, and that the principal purpose of the resolutions or declarations adopted by the General Assembly during 1969-74 was not only

⁹³ Rosalyn Higgins, *The Development of International Law through the Political Organs of the United Nations* (Clarendon Press 1963) 5.

⁹⁴ Gregory J. Kerwin, ‘The role of United Nations General Assembly Resolutions in determining principles of international law’ (1983) 32 *Duke Law Journal* 876.

⁹⁵ Surya P. Subedi, *International Investment Law* (3rd edn, Hart Publishing 2016) 42.

⁹⁶ UNCTAD adopted Resolution 56(III) in Santiago, Chile in 1972.

⁹⁷ The United Nations, *Proceedings of the United Nations Conference on Trade and Development* (New York: United Nations 1973) 89.

⁹⁸ UNGA Res.A/Res/3201 (S-VI) of 9 May 1974.

⁹⁹ UNGA Res.A/Res/3202 (S-VI) of 16 May 1974.

to register the aspirations of the newly born and/or developing countries; they were also relevant in many cases to developed States.¹⁰⁰

It is important to bear in mind that most of the developed states voted against or have abstained to the Charter of Economic Rights and Duties of States 1974, which was adopted as part of the NIEO. Australia was the only developed state at the time to vote in favour of this Charter.

In 1988 CTC formulated draft Codes of conduct for TNCs but owing to the opposition from developed states it became clear that the aspirations are too vast for the codes to be accepted. Based on the draft code of conduct fair and equitable treatment was accorded to TNCs in developing states together with most-favoured-nation treatment and national courts were proposed as the first port of call for settlement of investment dispute providing that they are competent enough to execute such proceedings. However, the UN attempts were not successful and as a result CTC ceased to exist in 1993, which also ended the UN efforts on the subject. Developed states took advantage of the turmoil of the 1990s, mainly the fact that developing states saw foreign investments as a solution to their economic difficulties and were consequently open to attracting foreign investments. Due to political instability in many developing states as well as in newly independent states together with the collapse of the Soviet Union, TNCs were demanding better protection for their investments. In fact, TNCs demanded higher protection from that available under the international law. As a result, the Energy Charter Treaty 1994 was adopted and clearly indicated the dominance of the developed states over the developing states in getting their aspirations translated in international agreements as legally binding.

In 2005 at The Millennium Summit meeting the UN made another attempt to balance socio-economic development between developed and developing states and has therefore set the following Millennium Development Goals (UNMDG):

- Goal 1: Eradicate extreme poverty and hunger.
- Goal 2: Achieve universal primary education.
- Goal 3: Promote gender equality and empower women.
- Goal 4: Reduce child mortality.
- Goal 5: Improve maternal health.

¹⁰⁰ S.K. Chatterjee, 'The Charter of Economic Rights and Duties of States: An Evaluation after 15 Years' (1991) 40(3) International and Comparative Law Quarterly 669-684, 671.

- Goal 6: Combat HIV/AIDS, malaria and other diseases.
- Goal 7: Ensure environmental sustainability.
- Goal 8: Develop a global partnership for development.

At the same time the UN also set the following UN Millennium Development Targets 2015:

- For Goal 1: Reduce by half the proportion of people living on less than a dollar a day and the proportion of people who suffer from hunger.
- For Goal 2: Ensure that all boys and girls complete a full course of primary schooling.
- For Goal 3: Eliminate gender disparity in primary and secondary education preferably by 2005, and at all levels by 2015.
- For Goal 4: Reduce by two-thirds the mortality rate among children under five.
- For Goal 5: Reduce by three-quarters the maternal mortality ratio.
- For Goal 6: Halt and begin to reverse the spread of HIV/AIDS and the incidence of malaria and other major diseases.
- For Goal 7: Reduce by half the proportion of people without sustainable access to safe drinking water.
- For Goal 8: Develop further an open trading and financial system that is ruled-based, predictable and non-discriminatory.

While Willis¹⁰¹ claimed MDGs have a clear statement of the nature and purpose of development, while Black and White¹⁰² strongly disagreed and questioned the basic usefulness of the goals and believed that the timeframes set in the MDGs are too ambitious and as such not achievable by the set deadline of 2015.

Failure of achieving the UNMDGs in the set timeframe by 2015, was mainly damaging for the world's poorest states that were not able to benefit from the MDGs, which would have significantly contributed towards their socio-economic development.¹⁰³ Furthermore, Salil Shetty,¹⁰⁴ the Secretary General of Amnesty International stated that the human rights have been violated by the contradiction of governments, namely of developing states in spite of their commitment to the MDGs framework. He also believed that public

¹⁰¹ Katie Willis, *Theories and Practices of Development* (Psychology Press 2005).

¹⁰² Richard Black and Howard White, *Targeting Development: critical perspective on the Millennium Development Goals* (Routledge 2006).

¹⁰³ Ashley Seager, 'World's poor suffer most in the credit crunch' *The Guardian* (London 5 March 2009) <<http://www.theguardian.com/business/2009/mar/05/poverty-credit-crunch-un-development>> accessed 12 June 2015.

¹⁰⁴ Salil Shetty, 'How can we achieve development goals if we ignore human rights?' *The Guardian* (London 28 February 2011) <<http://www.theguardian.com/global-development/poverty-matters/2011/feb/28/shetty-amnesty-human-rights-development>> accessed 12 June 2015.

awareness is essential, for which the MDGs should be less target oriented and based more on the principles of accountability instead. International debates involved strong discussions on the economic and social issues effectively between developed and developing states and the importance of finding the right balance.

Even the Millennium Development Goals Report¹⁰⁵ (UNMDG 2007) reported that while noticeable progress has been made in some areas there is still a long way to go in order to achieve these goals if at all feasible. As an example the UNMDG report voiced their concerns over the sub-Saharan African states as none of them have yet met the goals of extreme poverty reduction, primary education access or reducing HIV/AIDS epidemic.

Görg and Greenaway concluded that the effects of foreign investment on host developing states are mostly negative.¹⁰⁶ Alfaro et al.¹⁰⁷ argued that the well-developed and functioning financial institutions significantly gain from the foreign investments, when the less developed financial institutions lack the ability to use the full potential of foreign investment and added that well developed financial markets enable other domestic firms and entrepreneurs to capitalise on linkages with new TNCs.¹⁰⁸

Greenwood, Jovanovic¹⁰⁹ and McKinnon¹¹⁰ argued that the capital market development is crucial for adaptation of best practices in technology and learning by doing. However, according to Kose¹¹¹ not on the macroeconomic level. Furthermore, te Velde and Xenogiani¹¹² empirical analysis showed that foreign investment enhances skill development only in states that are already well skilled. Cross-country growth regression

¹⁰⁵ The UNMDG 2007, The Millennium Development Goals Report 2007

<<http://www.un.org/millenniumgoals/pdf/mdg2007.pdf>> accessed 25 January 2016.

¹⁰⁶ Holger Görg and David Greenaway, 'Much ado about nothing? Do domestic firms really benefit from foreign direct investment?' (IZA Discussion Paper 2003).

¹⁰⁷ Laura Alfaro and André Rodrigues-Clare, 'Multinationals and linkages: Evidence from Latin America' (2004) *Economia*.

¹⁰⁸ Alfrano A. Chanda, S. Kalemli-Ozcan and S. Sayek, 'How does foreign direct investment promote economic growth? Exploring the effects of financial markets on linkages' (NBER Working paper 2006).

¹⁰⁹ Jeremy Greenwood and Boyan Jovanovic, 'Financial Development, Growth, and the Distribution of Income' (1990) 98(5) *The Journal of Political Economy* 1076–1107.

¹¹⁰ Ronald McKinnon, *Money and Capital in Economic Development* (Brookings Institution Press 1973).

¹¹¹ M. Ayhan Kose, Eswar Prasad, Kenneth Rogoff and Shang-Jin Wei, 'Financial Globalization: A Reappraisal' (2006) WP/06/189 IMF Working Paper.

¹¹² Dirk Willem te Velde and Teodora B. Xenogiani, 'Foreign direct investment and international skill inequality' (2007) 35 *Oxford development studies* 83–104.

used by Borensztein et al.¹¹³ and Carkovic and Levine¹¹⁴, did not show that foreign investment has positive effect on socio-economic growth.

UN General Assembly Resolution on Permanent Sovereignty over Natural Resources 1962 declared that:

The right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their national development and of the well-being of the people of the State concerned.¹¹⁵

Chatterjee maintained that:

There seems to exist a perceived belief that the United Nations is primarily a forum or institution for developing countries, but the need for interdependence between developed and developing countries requires both groups of countries to meet at a common forum to discuss issues and formulate policies and principles the implementation of which might lead to a better world order, whether political, economic or legal.¹¹⁶

Chatterjee maintained that the need for interdependence is primarily due to the economic issues. While the developed states are on the look for trade and investment opportunities, the developing states on the other hand own their natural resources. The two can only meet on the platform that enables both parties to participate effectively in the international trading community for which an effective system is yet to be established, where both parties' interests will be equally represented.

Declaration of the Granting of Independence to Colonial Countries and Peoples 1960 identified the aspirations of developing states and colonies for their independence. The terms and conditions on which foreign companies should be invited to invest in states and identify by the United Nations General Assembly in its Resolution on Permanent

¹¹³ Eduardo Borensztein, Jose De Gregorio, Jong-Wha. Lee, 'How does foreign direct investment affect economic growth?' (1998) 45 *Journal of International Economics* 115–135.

¹¹⁴ Maria Carkovic and Ross Levine, 'Does Foreign Direct Investment Accelerate Economic Growth?' in Theodore H. Moran, Edward Montgomery and Magnus Blomstrom, *Does Foreign Direct Investment Promote Development* (Peterson Institute for International Economics 2005) ch 8.

¹¹⁵ UNGA Res 1803 (XVII) (1962) on 'Permanent Sovereignty over Natural Resources' 1962.

¹¹⁶ Charles Chatterjee, *International law and diplomacy* (Routledge 2010) 284.

Sovereignty over Natural Resources 1962.¹¹⁷ In reality foreign companies have been in breach of the philosophy on which these two Resolutions are based, while host developing states have failed to negotiate foreign investment contracts with developed states on the principles of this two Resolutions.

Many of the UN early suggestions have been dismissed in the beginning, due to misconception as being ideological, however the influence that the UN had on changing the mainstream thinking by constantly challenging the existing orders, cannot be denied. Ever since 1960s the focus of the UN became monitoring the activities of TNCs and its contribution to socio-economic development, predominantly in host developing states.

One of such observations was highlighted in the United Nations General Assembly resolutions on TNCs as early as 1965.¹¹⁸ A panel was formed on initiative of ECOSOC to review and evaluate contribution and consequences of private foreign investment.¹¹⁹ Result of discussions the following ‘Agreed Statement’¹²⁰ was adopted:

- For FDI to contribute to the development objectives of developing countries, it must find its place within the framework of the national development program and policies of each host country.
- Governments of host countries are the best judges of their own development objective and need to make opportunities for FDI more fully known to potential investors.
- Joint ventures provide a highly desirable arrangements for bringing together private capital, host governments, and local entrepreneurs.
- Transfer of technological and managerial know-how through foreign firms is frequently as important as capital.
- Steps are needed to increase the absorptive capacity of developing countries and their ability to develop new techniques for their own special needs.¹²¹

¹¹⁷ UNGA Res. 1803 (XVII), 17 U.N. GAOR Sup. (No.17) at 15, U.N. Doc. A/5217 (1962) Permanent Sovereignty over Natural Resources.

¹¹⁸ These resolutions were UNGA Resolution 2087 (XX) in 1965; UNCTAD resolution in 1964 and 1968; ECOSOC resolution 1286 (XLIII) in 1967.

¹¹⁹ See Sidney Dell, *The United Nations and International Business* (Duke University Press for UNITAR 1990).

¹²⁰ See United Nations , Report on the Panel on Foreign Investment in Developing Countries (Amsterdam, 16-20 February 1967), E.69.II.D.12

¹²¹ United Nations, Report on the Panel on Foreign Investment in Developing Countries (UN 1967), Manuel R. Agosin and Ricardo Mayer, ‘Foreign Investment in Developing Countries, Does it Crowd in Domestic Investment?’ (UN 2000); Sidney Dell, *The United Nations and International Business* (Duke University Press for UNITAR 1990) 175.

From the above the conclusion is that the panel had high hopes in host developing states to decide on the entry restrictions for private foreign investments in their own states and take control over their regulation.

The second meeting was held in 1970 and focused on benefits that private foreign investment might bring to the host developing states and examined the areas of conflict that might arise between TNCs and host developing states.¹²²

In 1971 the UN World Economic Survey initiated in depth research of activities of TNCs as well as ECOSOC resolution¹²³, which stated that:

While these corporations are frequently affective agents for the transfer of technology as well as capital to developing countries, their role is sometimes viewed with awe, since their size and power surpass the host country's entire economy. The international community has yet to formulate a positive policy and establish effective machinery for dealing with the issues raised by the activities of these corporations.¹²⁴

The activities of TNCs in terms of their contribution to the socio-economic development and capacity building in host developing states are still questionable. However, the aspiration of the UN is to become the platform to accommodate for the aspirational gaps to be closed between developed and developing states and as a consequence balance the interests between TNCs and host developing states. The UN were accused of being favouring the developing states and that might have been the reason that developed states opposed the proposed UN resolutions that tried to balance the interests between the two parties and close the aspirations gaps in the past.

¹²² Sidney Dell, *The United Nations and International Business* (Duke University Press for UNITAR, 1990).

¹²³ ECOSOC Resolution 1721, 1972

¹²⁴ ECOSOC Resolution 1721, 1972.

2.5 A Critical Analysis of the term “Aspirational Differences” as a factor of “control” and “development”

It is no coincidence that BITs were designed by the Western states and based on their aspirations of creating such bilateral investment treaties (BITs) in the wake of decolonisation in the 1960s in order to protect foreign investment in the host developing states.¹²⁵ Robock and Simmonds maintained that ‘Most developing countries favour regional integration as a promising strategy for accelerating their development aspirations’,¹²⁶ however, they did not gain much success on this issue. Despite the numerous challenges that the developing states are facing they have made some progress, especially in the field of integrating their economies into the global international trading system.

One must not forget that the UN is funded from assessed contributions of countries and that makes them dependent on the governments of the member countries and their ability to fulfil their financial obligations to the UN. Hence, also the entire UN operations, as well as development activities depend on the receiving of such funding.

Looking at the current situation one could argue that the WTO failed to fulfil its mission to supervise and liberalise international trade. Chatterjee maintained that the UN efforts over four decades for trade liberalisation have not been met with total success.¹²⁷ Another failure to date was the 2001 Doha Development Round, which was launched with a sole purpose to address the developing state’s needs. However, to the present day the issues have not been resolved. Developed states are keen to resolve the question of farm subsidies and domestic agricultural sector and the developing states are keener to resolve

¹²⁵ Kenneth J. Vandeveld, ‘A Brief History of International Investment Agreements’ in Karl P. Sauvant and Lisa E. Sachs (eds), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (OUP 2009) ch 1. ‘observing that the motivation for the developed country to conclude BITs ‘was to obtain protection for its foreign investment’; Patrick Juillard, ‘Bilateral Investment Treaties in the Context of Investment Law, Investment Compact Regional Roundtable on Bilateral Investment Treaties for the Protection and Promotion of Foreign Investment’ (OECD 2001) 1 <<http://www.oecd.org/dataoecd/44/41/1894794.pdf> > accessed 12 June 2015. Observing that BITs developed out of an emergency situation, which reached its peak in the late 60s and early 70s, and noting specifically that in the late 60s, ‘developing countries - former colonies of former major European powers - embarked upon extensive expropriation policies which involve at foreign held investment - i.e. investment owned by nationals of the former colonial powers’.

¹²⁶ Stefan H. Robock and Kenneth Simmonds, *International business and multinational enterprises* (Richard D. Irwin 1983) 152.

¹²⁷ See Charles Chatterjee, ‘Forty Years of International Action for Trade Liberalization’ (1989) 23(4) *Journal of World Trade* 45.

the international liberalisation of fair trade on agricultural products. Chatterjee added that two conditions have to be met in order to establish a truly international trade system: one is fundamental understanding and development of the rules between the North and the South and the other is liberalisation of international trade for the disadvantaged.¹²⁸

The UN have made numerous attempts to understand the relationship between the North and the South and more importantly to allow the developing states to equally participate in the international trade with developed states. In chronological order these attempts were the following:

- 1948 Havana Charter – 1948 International Trade Organization(ITO)
- 1948 The General Agreement on Tariffs and Trade (GATT)
- 1964 United Nations Conference on Trade and Development (UNCTAD)
- 1965 The General Agreement on Tariffs and Trade Part IV
- 1965 The International Development Strategy
- 1966 International Covenant on Economics, Social and Cultural Human Rights
- 1971 Generalized Systems of Preferences (GSP)
- 1974 Declaration on the Establishment of a New International Economic Order
- 1974 Programme of Action on the Establishment of a New International Economic Order
- 1974 Charter of Economic Rights and Duties of States
- 1994 Uruguay Round – World Trade Organization (WTO) replaced GATT
- 2001 Doha Development Round

The International Covenant on Economic Social and Cultural Rights in Article 1 and 2 refers to the right of self-determination and the right of all people to pursue their economic development. Via the Covenant many colonies got their independence especially in the 1960s. The resolutions adopted in 1974 were long time coming, however they came into effect mainly due to the oil crisis of 1973.

The Charter of Economic Rights and Duties of States 1974:

[S]tressed the urgency to establish generally accepted norms to govern international economic relations systematically and recognize that it is not feasible to establish a just order and a stable world as long as a charter to protect the rights of all countries, and in particular the developing States, is

¹²⁸ See Charles Chatterjee, 'Forty Years of International Action for Trade Liberalization' (1989) 23(4) Journal of World Trade 45.

not formulated...it reaffirmed its conviction of the urgent need to establish or improve norms of universal application for the development of international economic relations on a just and equitable basis...¹²⁹

The Charter was supposed to be an ‘effective instrument towards the establishment of a new system of international economic relations’. These relations were to be ‘based on equity, sovereign equity and interdependence of the interests of developed and developing countries’. Charter further supported ‘genuine co-operation among States’ for which it was believed should be ‘based on joint consideration of and concerted action regarding international economic problems’ which it identified as ‘essential for fulfilling the international community’s common desire to achieve a just and rational development of all parts of the world’. There was a clear understanding of the international community that ‘the need to develop a system of international economic relations on the basis of sovereign equality, mutual and equitable benefit and the close interrelationship of the interests of all States’ is crucial for further socio-economic development of less developed parts of the world.¹³⁰

In Article 2 of the Charter of Economic Rights and Duties of States 1974 does not oblige the expropriating states to pay compensation to investors in the event of their property expropriation.¹³¹ Declaration on the Establishment of a New International Economic Order 1974 states that ‘irreversible changes in the relationship of forces in the world necessitates the active, full and equal participation of the developing countries in the formulation and application of all decisions that concern the international community’.¹³²

In 1980s the United Nations Development Programme (UNDP) implemented alternative measurement of development to GDP and named it Human Development Index (HDI)

¹²⁹ The UN Resolution adopted by the General Assembly 3281 (XXIX). Charter of Economic Rights and Duties of States <<http://www.un-documents.net/a29r3281.htm>> accessed 12 June 2015.

¹³⁰ The UN Resolution adopted by the General Assembly 3281 (XXIX). Charter of Economic Rights and Duties of States

¹³¹ The UN Resolution adopted by the General Assembly 3281 (XXIX). Charter of Economic Rights and Duties of States, Art 2.

¹³² UNGA Res. A/RES/S-6/3201, Declaration on the Establishment of a New International Economic Order 1974.

and in 2001 Human Development Report was published, with the subtitle: making new technologies work for human development.¹³³

Wong agreed with Salacuse and Sullivan that after the Second World War the global leaders were striving towards normalising the global economy, also by promoting free flow of foreign capital and recognising the significance of the foreign investments.¹³⁴

However, Salacuse and Sullivan added that ‘applicable international law failed to take account of contemporary investment practices and address important issues of concern to foreign investors’ also due to the deficiency in the legal structure that included ‘scattered treaty provisions, few questionable customs, and contested general principles of law’.¹³⁵ Existing international law, was vague and open to various interpretations and ‘as a result, foreign investors had no assurance that investment contracts and arrangements made with host developing country governments would not be subject to unilateral change by those governments at some later time’.¹³⁶

One can conclude that the aspirational differences do in fact play a crucial role, given the fact that the past experiences taught little about what to avoid and which mistakes not to repeat. At least one would think that the government would at least try to act more responsibly in terms of the economy. However, the personal interest seems to have gained higher momentum than the common good did. TNCs are after all profit-maximisers while developing states are aspiring to achieve socio-economic development and socio-economic independence.

Equally, the aspirations of TNCs have not changed, they are still focused on profit-maximisation, mostly on the expense of cheap resources of the developing states and selling it on the free market for a high margin. In spite of the fact that private foreign

¹³³ UNDP Human Development Index Report

<http://hdr.undp.org/sites/default/files/reports/262/hdr_2001_en.pdf> accessed 12 June 2015.

¹³⁴ Jarrod Wong, ‘Umbrella clause in Bilateral Investment Treaties: Of Breaches of Contract, Treaty Violations, and the Divide between Developing and Developed Countries in Foreign Investment Disputes’ (2008) 14 *George Mason Law Review*.

¹³⁵ Jeswald W. Salacuse and Nicholas P. Sullivan, ‘Do BITs Really Work; An Evaluation of Bilateral Investment Treaties and their Grand Bargain’ in Karl P. Sauvant and Lisa E. Sachs (eds), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (OUP 2009) ch 5.

¹³⁶ Jeswald W. Salacuse and Nicholas P. Sullivan, ‘Do BITs Really Work; An Evaluation of Bilateral Investment Treaties and their Grand Bargain’ in Karl P. Sauvant and Lisa E. Sachs (eds), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (OUP 2009) ch 5.

investment should predominantly be used to benefit the developing state, first by the foreign investment, then by employment and also by technology transfer. The reality tends to shift from the original idea as the foreign investors soon start to reduce the local employability and bring in their own people instead of teaching and training the local staff and contributing to the capacity building. Also the involvement of the local businesses tends to decrease over time.

The fault is also of the governments of developing states that have failed to protect their natural resources, local businesses and local employment. Another failure of governments of host developing states was also in negotiating investment agreements that would be beneficial for their socio-economic development with binding provisions for TNCs.

The topic to be addressed is the aspirations that the three parties have in common and how they affect each other. International institutions, namely the UN had significant effect on activities of private foreign investments. Equally the former colonial powers had to adjust to the new situation of the newly born independent states. There is a negative connotation when it comes to socio-economic development, as Kothari argued that 'mainstream development studies neglects its colonial past and is, perhaps unwittingly, seeking to portray development as something distinct and "good"'.¹³⁷

While some scholars are disputing over the origins of development, Rist¹³⁸ claimed that the roots of western thought on development can be seen in the works of Aristotle (384 - 322 BC) and Saint Augustine (354 - 430 AD), while Cowen and Shenton¹³⁹ linked them with Auguste Comte (1798 - 1857) and Saint-Simon (1760 - 1825) as critical response to industrialisation.

Development in the contemporary sense appeared after the Great Depression and the Second World War or in other words the economic and political turmoil that they have caused and in connection to the creation of international institutions for reconstruction and economic stability, such as the UN, the World Bank (WB), and the International Monetary Fund (IMF). However, there were some development policies and practices

¹³⁷ Uma Kothari, 'From colonial administration to development studies: A postcolonial critique of the history of development studies' in Uma Kothari (ed), *A Radical History of Development Studies: Individuals, Institutions and Ideologies* (Zed Books 2005) 47-66, 50.

¹³⁸ Gilbert Rist, *History of development: From western origins to global faith* (2nd edn, Zed books 2002).

¹³⁹ M.P. Cowen and R.W. Schenton, *Doctrines of development* (Routledge 1996).

related to the colonial development before the Great Depression and the Second World War. More specifically in the UK the Colonial Development Act (CDA) as well as Colonial Development Fund (CDF), were passed in 1929 with the objective of allocating British government money for socio-economic development of their colonies. France was not far behind the UK. In 1946 they formed Fonds d'Investissement pour le Développement Economique et Social (FIDES). The UK and France have been investing in the transport infrastructure, education system, and agriculture production mainly of their African colonies.

Before the CDA 'assistance to the dependencies took the form of grants-in-aid to those in need' and 'emergency help to those in distress'.¹⁴⁰ In any case the Act stated that 'for the purposes of aiding and developing agriculture and industry in the colony or territory, and thereby promoting commerce with or industry in the United Kingdom'.¹⁴¹ One could argue that the motives were leaning more towards developing¹⁴² the colonies as trading partners that will be able to contribute to the economy of the colonial master. However, the contribution of the colonial masters towards their colonies in form of financial aid or services cannot be denied. Economic domination by default is exploration for profit and the question is if the same can be applied to the private foreign investment as well.

There is also the "behaviour attitude difference"¹⁴³ between the foreign investors and the host developing states. In this respect the UNCTAD has been established in 1964 at the Genève Conference 'to formulate principles and policies on international trade and related problems of economic development'. Cowen and Shenton tried to answer the

¹⁴⁰ British Aid -5, *Colonial Development* (ODI 1964) 10. There were also many reports produced during the period between 1919 and 1929 that were making recommendations for the improvement of services, agriculture, medical and other departments in the dependent territories as well as scholarships for science graduates.

¹⁴¹ Colonial Development Act 1929, 1(I).

¹⁴² Development is a very complex subject and various development theories have been developed by eminent scholars. There is also a broader institutional conceptualisation of development underway, unfortunately due to the word limitation any further discussion on various development theories had to be omitted. See further Peter B. Evans, *Dependant Development: The Alliance of Multinational, State, and Local Capital in Brazil* (Princeton University Press 1979); Peter B. Evans, *State-Society Synergy: Government and Social Capital in Development* (University of California 1997); Peter B. Evans, *Embedded Autonomy: States and Industrial Transformation* (Princeton University Press 2012); Stephen Cole, *Making Science: Between Nature and Society* (Harvard University Press 1992); Stephen Cole and Thomas J. Phelan, *The Scientific Productivity of Nations* (Minerva 1999) and Stephen Cole, *Whats Wrong with Sociology?* (Transaction Publishers 2001).

¹⁴³ There is controversy over the term cultural difference, which is a topic for another research.

question what is the objective of development. The latter is all but simple task to complete.

Firstly, because the concept of “development” has changed over time and secondly, because it applies to all the states not only to the developing states. All of the above makes development a complex phenomenon. In addition to this, there has been a shift in development from economic growth to the quality of life in terms of the living standards predominantly in developed states.

Development is complex also because it involves a variety of factors such as history, political stability, social awareness, geography, natural resources and economy not to mention reliable judiciaries. The difficult problem in terms of developing states is the lack of adequate or reliable data available, because it has not been gathered on a consistent or even regular basis. Reasons for this might be the lack of such institutions or mechanisms in place by the local governments to enable such data collection.

Given the numerous actors involved in the development, which are not only the local government and the local people, but also international institutions, NGO’s, aid agencies, charities and TNCs,¹⁴⁴ it is evident that development is not a stand-alone task. Development is in the hands of developers. Thomas agreed that these agencies contribute their share in reducing poverty, however he also raised his deep concern over the common belief that the development is entirely executed by these developing agencies and added that such belief diminishes the complexity of development itself.¹⁴⁵

The relationship between “development” and “economic growth” via trade has been a subject matter of many international debates. Developing states have made significant trade-offs on the expense of international free trade. Such as lower wages, longer working hours and hence cheaper production cost, child labour, sweatshops and human rights issues emerged. Riccardo was in favour of the open market as he claimed that it gives a

¹⁴⁴ Doug Porter, Bryant Allen and Gaye Thompson, *Development in practice: Paved with good intentions* (Routledge, 1991).

¹⁴⁵ Alan Thomas, 'Development as practice in a liberal capitalist world' (2000) 12(6) *Journal of international development* 773–787.

“competitive advantage” to the state that has the goods, resources or products that could be used by means of the open markets.¹⁴⁶

Smith was also in favour of free trade and claimed that the efficient use of scarce resources would encourage specialisation and hence give the developing states competitive advantage. Stiglitz however argued against the free trade and claimed that it does not help the developing or the poorer states to develop, moreover the free trade system is one of the factors that contributed to the poverty in the developing states.¹⁴⁷

Thomas pointed out that the key to achieving targets is the social transformation:

[W]hile the application of techniques designed to achieve such targets tends to simplify theory to the idea that large-scale social change may be achieved straightforwardly by deliberate actions, or even that poverty reduction may be achieved by targeting the poor without the need for broader social change, and thus provides an equality limited view of the historical process of development.¹⁴⁸

Thomas also criticised the UN Millennium Development Goals (MDGs), by saying that the UN adopted in 2000 as a synthesis of summits and conferences held during the 1990s and formed a universal framework for development and poverty reduction.

If contractual arrangements are not made in accordance with the aspirations of both parties, then in the financial analysis the expected progress to be achieved by means of foreign investment cannot succeed, which has been the case. It is therefore important that the attention of TNCs should be drawn to the principles of foreign investment to various UN Resolutions in drafting such contracts accordingly. As stated earlier the phenomenon of private foreign investments has attained a new dimension in terms of aspirations of developing states but TNCs seems to be disregarding that factor.

The biggest issue regarding private foreign investment to date has been the question of control, which has been pointed out by Hymer and the theory of investing the capital where the highest return can be earned. Hymer was very critical towards the activities of

¹⁴⁶ David Ricardo, *On the principles of political economy and taxation* (first published 1817, Liberty Fund 2004).

¹⁴⁷ Joseph E. Stiglitz, *Globalization and its discontents* (Penguin Books 2002).

¹⁴⁸ Alan Thomas, 'Development as practice in a liberal capitalist world' (2000) 12(6) *Journal of international development* 773–787.

TNCs and wrote on the “law of uneven development”, namely while analysing American business abroad.¹⁴⁹ Therefore a balance of interests has to be struck.

2.6 Balancing aspirational differences between the three parties

Bilateral investment treaties (BITs) are considered the most remarkable development in international law. Lehari and Licht claimed that BITs have transformed the global legal landscape of international investment. BITs allow investments between the developing and developed states, which is also the main cause for issues due to the lack of balancing the aspirational differences between the two parties.

From the case studies it is evident that the main issue is the imbalance and inequality between the developed and the developing states. After the Second World War Europe was in desperate need of financial investment in order to repair the devastation and destruction after the war. The Marshall Plan generated \$17 billion of foreign aid to Europe between the years of 1948 and 1952. Together with the rapid economic recovery in Europe and increased production, consequently the cost of labour force was increasing as well. ‘The era after the Second World War also known as postcolonial era included the victorious allies to agree on liberalizing trade’.¹⁵⁰ Legal framework was initially aimed to forming multilateral agreements for worldwide trade liberalisation.¹⁵¹

However, the attempts of forming a multilateral investment regime, based on a multilateral treaty failed¹⁵² and is therefore build on bilateral investment treaties (BITs). Kline argued that this is the reason that international economy is unbalanced.¹⁵³ Since

¹⁴⁹ Stephen H. Hymer, ‘The Multinational Corporations and the Law of Uneven Development’ in H. Alavi et al. (eds), *Introduction to the Sociology of “Developing Societies”* (Macmillan Publishers 1982) 128.

¹⁵⁰ Rondo Cameron and Larry Neal, *A Concise Economic History of the World: From Paleolithic Times to the Present* (4th edn, OUP 2002) 370–71.

¹⁵¹ John Croome, *Reshaping the World Trading System* (Diane Pub 1995).

¹⁵² Franziska Tschofen, ‘Multilateral Approaches to the Treatment of Foreign Investment (1992) 7(2) ICSID Review Foreign Investment Law Journal 384.

¹⁵³ John M. Klein, *Ethics fro international business decision-making in a global political economy* (2nd edn, Routledge 2010).

there is no global standard on investment agreements the element of control is open for discussion and interpretation.

As an example Google corporate philosophy in one of their ten points says that ‘you can make money without doing evil’.¹⁵⁴ However one could question if it is really possible to make net gross profit of \$33billion, as Google reported in 2013, without making any evil.¹⁵⁵

Human Rights Watch report 2006 stated that:

Many multinational, worried about the costs and consequences for their brand names if they were blamed for the human rights impact of their business practices, woke up and took notice. In response to their critics, some of the companies in the line of fire adopted human rights policies. Others, seeing the writing on the wall, pre-emptively did the same. Many prominent companies have now adopted voluntary codes of business conduct that include respect for basic human rights.¹⁵⁶

There is a growing concern over the question of human rights in international organisations and foreign policy circles in the recent years. However, thirty years ago, this was not the case as Schmitz and Sikkink claimed ‘human rights were considered a peripheral and even inappropriate topic for foreign policy’.¹⁵⁷ According to Donnelly this is due to the fact that states have to deal with various responsibilities that may be in contradiction, such as national responsibilities, international responsibilities and humanitarian responsibilities.¹⁵⁸

The relationship between the investor and the host state is based on the mutual interest. Investor has the capital, technical knowledge, and distribution channels while the host developing state has the natural resources, low-cost labour and desirable geographic

¹⁵⁴ Google corporate philosophy <<http://www.google.com/about/company/philosophy/>> accessed 12 June 2015.

¹⁵⁵ Google financials <<http://www.marketwatch.com/investing/stock/goog/financials>> accessed 12 June 2015.

¹⁵⁶ Human Rights Watch Report (World Report 2006) 41.

¹⁵⁷ Hans Peter Schmitz and Kathryn Sikkink, ‘International Human Rights’ in Walter Carlsnaes, Thomas Risse and Beth A. Simmons (eds), *Handbook of International Relations* (2nd edn, SAGE Publications 2013) ch 33, 827.

¹⁵⁸ Jack Donnelly, *Universal human rights. In theory & practice* (3rd edn, Cornell University Press 2013).

location. ‘The point of entry is the moment when these specific negotiating advantages will serve to inform the bargaining process between the investor and the host country’.¹⁵⁹ TNCs and foreign investments have always been and remained the subjects of great interest, while the UN and TNCs have been the two most powerful players in world’s economy. ‘Some see TNCs as exploitative and driven by profit at all costs; other view them as engines of growth, necessary for economic transformation’ the views are still split.¹⁶⁰

The international institutions such as the International Bank for Reconstruction and Development (IBRD or World Bank) the International Monetary Fund (IMF) and the General Agreement on Tariffs and Trade (GATT) were at the forefront of ‘international trade, foreign investment, and economic interdependence’ negotiations.¹⁶¹

The main question ‘for host countries was how to benefit from inbound foreign investment while minimising its negative effects, including its perceived or actual infringement on national sovereignty, exploitative behaviour, and political interferences and its disregard for local culture, norms, and laws’.¹⁶²

The answer is not straightforward, because the studies conducted have reached mixed conclusions. On one hand some argue that host developing states had benefited from foreign investments in terms of their socio-economic development, while others claimed that the effects of foreign investment in host developing states had the opposite effect.¹⁶³

¹⁵⁹ Ignacio Gómez-Palacio and Peter T. Muchlinski, ‘Admission and establishment’ in Peter T. Muchlinski, Federico Ortino and Christoph Schreuer (eds), *Oxford Handbook of International Investment Law* (OUP 2008) ch 7, 233.

¹⁶⁰ Tagi Sagafi-Nejad and John H. Dunning, *The UN and Transnational Corporations, From Code of Conduct to Global Compact*, United Nations Intellectual History Project Series (Indiana University Press 2008) 4.

¹⁶¹ Tagi Sagafi-Nejad and John H. Dunning, *The UN and Transnational Corporations, From Code of Conduct to Global Compact*, United Nations Intellectual History Project Series (Indiana University Press 2008) 21.

¹⁶² Tagi Sagafi-Nejad and John H. Dunning, *The UN and Transnational Corporations, From Code of Conduct to Global Compact*, United Nations Intellectual History Project Series (Indiana University Press 2008) 51.

¹⁶³ See also Sidney Dell, *The United Nations and International Business* (Duke University Press for UNITAR 1990) 61.

2.7 Conclusions

Bridging the gaps between aspirations of host developing states, the UN and TNCs is a long and ongoing process. The same applies in finding the solutions in the fast changing environment, which has changed significantly over the past few decades, namely in terms of TNCs. There has been a disproportionate growth of TNCs comparing to the developing states and their socio-economic development.

Over the course of increased private foreign investments, it has become obvious that it will not suffice as higher protection of human rights, properties and more reliable judiciaries are required to provide the foundations for socio-economic development that is the basis for socio-economic independence.

Attempts of the UN have not been met with success, such as the Charter of Economic Rights and Duties of States 1974, namely the Article 2 (c) has not gained the momentum it was intending, notwithstanding the fact that was initiated by developing states. Request for the New International Economic Order 1974 was also put forward when it became clear that the current economic order was not sustainable. The UN tariff negotiations were taking place, however not to the benefit of developing states until 1964 when the UNCTAD was formed that allowed developing states to take part in tariff negotiations for the first time.

Proposal for multilateral agreement on investment (MAI) between OECD members was heavily criticised by developing states as well as civil society and therefore did not receive the needed support to be adopted. It seems that the attempts to bridge the aspirational gaps, made them a bit wider. However, it is not a fault of a single party as they were all equally responsible for failing to make consensual agreements. It was indeed the lack of agreement and opposition that made most of the proposed changes fail and therefore could not take effect. Developing states were trying to copy other models instead of shifting the focus towards capacity building and gaining socio-economic independence and therefore TNCs refused to support their proposals.

There was also an attempt to draft agreement for a prompt, adequate and effective compensation payment with the UN General Assembly Resolution entitled Permanent

Sovereignty over Natural Resources 1962,¹⁶⁴ known as the Cordell Hull formula added for compensation payment. However, payment of compensation has been the main reason for disputes between foreign investors and host developing states that has made significant progress, which can be seen in the new BITs models, namely the UK-India, but has not yet been resolved on the global scale. The NAFTA for example recognises just and appropriate compensation payment, as do some of the newest BIT models in oppose to Hull formula.

The UN Codes of Conduct on Transnational Corporations¹⁶⁵ made an attempt to “monitor” the activities of transnational corporations in host developing states however they did not manage to gain the needed support to become part of customary international law.

In any case economic rights are directly connected to the socio-economic and political rights. The Charter of Economic Rights and Duties of States 1974 refers to three different types of obligations and rights, one is inherent rights used as “have the right”, second is the inherent duties or responsibility used as “have the duty or responsibility” and third is the non-obligatory duties “should”.¹⁶⁶

Corporations should care more about the environment where they are operating and review their expectations accordingly. In this quest the governments and States with their legal system should be better equip to serve the revision of expectations and not allow TNCs to continue making such enormous profits without capacity building or reinvesting a portion of their profits back to the host developing states. Significant progress can be seen on this front as many developing states are reviewing their BITs and some new ones are much clearer in their scope and provisions. Moving forward the buy-back should be included as well as re-negotiation clause in all investment agreements that should also be reviewed based on their performance and transfer of profits. The competition between TNCs should not be based on the measurement who makes more profit but on the basis of which company does more common good and reinvest more into the socio-economic development of developing states while still making sufficient profit to satisfy their

¹⁶⁴ UNGA Resolution on Permanent Sovereignty over Natural Resources 1962.

¹⁶⁵ UN Codes of Conduct on Transnational Corporations 1982.

¹⁶⁶ Charles Chatterjee, ‘The Charter of Economic Rights and Duties of States: An Evaluation after 15 Years’ (1991) 40(3) International and Comparative Law Quarterly 669, 678.

shareholders. TNCs should strive towards integration with social as well as economic environment of the developing states. In this attempt the international institutions from United Nations onwards play a crucial role to facilitate this co-operation. The United Nations (UN) have failed on many attempts to make themselves relevant to the point that they will be able to fully fulfil their main objectives, on which they have been founded. However, one cannot deny some of the successful attempts of the United Nations.¹⁶⁷

With the help of globalisation of telecommunication and internet revolution as well as technology that enabled access to numerous information and data that has never before been possible and as easy available, significant and accurate analysis can be made to set the grounds for the future courses of actions. As a consequence, to the data availability the public awareness became the highest as ever before and it is moving in the right direction. At this point one can question whether public awareness will be able to use their power and information to force their governments on national levels and pressure TNCs on a global level to act accordingly following the demands for common good. Again, international institutions will play a crucial role in facilitating communication between the civil society, governments of the states and senior management of TNCs to reach agreements and more importantly to ensure that these agreements are fulfilled. Last but not the least it is the role of law in these communications, negotiations and cooperation process as it is fundamental in achieving feasible success. Law has the power to enforce and impose sanctions in case of any violations. Therefore, one cannot deny the most important role that law has for each and every single party individually from national to international laws that apply to governments of states, the International institutions, and inter-governmental institutions as well as to the TNCs.

To reiterate that the needed judiciaries have to be built with the help of capacity building and properly trained staff in order to follow the rule of law and not engage in cases of bribery and corruption. Law should therefore offer the necessary protection and determine consequences in cases of its violation. However, these state institutions in order to facilitate and execute such actions have to be built from the ground and that should be the focus of the capacity building. However, there are limits to the law in solving disputes

¹⁶⁷ See further Louis Emmerji, Richard Jolly, Thomas G. Weiss, *Ahead of the curve? UN Ideas and Global Challenges* (Indiana University Press 2001); Tagi Sagafi-Nejad and John Dunning, *The UN and Transnational Corporations, From Code of Conduct to Global Compact* (Indiana University Press, 2008).

as not everything can be resolved by means of law. Which is why the negotiation process is of crucial importance between the parties for which aspirational differences have to be met in order to negotiate acceptable investment agreement that will be beneficial for both parties and facilitated by the international institutions, predominantly the United Nations, where the interest of all states, be it developing or developed are equally represented as equal members.

Chapter 3 The Limits of Law: Regulating the Conduct of Transnational Corporations and A Critical Analysis of some Bilateral Investment Treaties

3.1 Introduction

The Working Group on the Working Methods and Activities of Transnational Corporations recommended the Norms on the Responsibility of Transnational Corporations and Other Business Enterprises with Regard to Human Rights referred to as the Norms in 2001.¹ The complexity of the Norms led the Working Group to elaborate on the responsibilities of the Norms in a separate document called Commentary on the Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights 2003.²

The relationship between human rights and business enterprises contributed to the formation of a set of standards that were based on their conduct, such as international human rights law and best business practices. The objectives of the Norms were to combine the two into one applicable guideline of conduct that is mutually acceptable and beneficial to all parties involved. The leading issue remains to be the successful enforcement and the perception of legally binding resolutions and treaties in international law that are formed on principles of investment agreements and the principles of jurisdiction of investment treaty based international arbitration.³

The Norms are viewed as a basis for developing a treaty however the United Nations Draft Code of Conduct 1990⁴ were unfortunately not adopted. Relationship between the UN and TNCs were challenged with the start of negotiations on international investment agreements, when governments of host developing states tried to negotiate with developed states the Code of conduct for TNCs. Sauvart maintained that ‘The Code was meant to establish a multilateral framework to define, in a balanced manner, the rights

¹ UN Doc E/CN.4/Sub.2/RES/2001/3 and updated version E/CN.4/Sub.2/2002/13 (annex) (2002); Norms: E/CN.4/Sub.2/2003/12 (2003); Commentary: E/CN.4/Sub.2/2003/38 (2003).

² UN Doc E/CN.4/Sub.2/2003/38/Rev.2 (2003).

³ See Hazel Fox, *The Law of State Immunity* (OUP 2002).

⁴ UN Doc E/1990/94, 12 June 1990.

and responsibilities of transnational corporations and host country governments in their relations with each other'.⁵ The problem occurred when TNCs were asked to follow the Norms and good corporate practice when engaging in global economy and operating in host developing states. In the 1970s numerous crises emerged giving rise to the discontent between developing states and TNCs. This was primarily due to different views between host developing states and TNCs on the issue of negotiating a compromise in contracts, for which both TNCs and host developing states are equally responsible. Collapse of the Bretton-Woods model⁶ was one of the issues that led to the economic crisis, elevated oil prices caused the energy crisis in 1973 and numerous bribery scandals that were revealed globally by the US congressional committees among others.⁷

Furthermore, collapse of the Soviet Union, privatisation process, expropriation and nationalisation of natural resources, made the need for codes of conduct almost meaningless. While TNCs have become key actors in international economy, the governments of host developing states failed to supervise their activities or negotiate their responsibilities accordingly. In addition to the issue of regulating TNCs activities across the borders of the home states, issues relating to foreign investments and preservation of environment became important.⁸ This resulted in the Rio Declaration on Environment and Development 1992,⁹ which was produced by the United Nations Conference on Environment and Development (UNCED) that helped raise environmental awareness.

In 1966 the meetings started with the initial Group of 31 developing states that expanded to the Group of 77 developing states and by 1982 it already had 120 members all of which were developing states.¹⁰ Developing states started exploring their bargaining position

⁵ Karl P. Sauvart, 'The Negotiations of the United Nations Code of Conduct on Transnational Corporations, Experience and Lessons Learned' (2015) 16 *The Journal of World Investment and Trade* 11-87, 11.

⁶ International monetary system that was based on stable and convertible exchange rates, which was occasionally amended to adjust the balance of payments was functioning for 25 years after the Second World War. In 1971 the Bretton Woods monetary system was replaced with floating exchange rates

⁷ See further Thomas G. Weiss and Sam Daws (eds), *The Oxford Handbook on the United Nations* (OUP 2007).

⁸ Seymour J. Rubin, 'Transnational Corporations and International Codes of Conduct: A Study of the Relationship between International Legal Cooperation and Economic Development' (1995) 10(4) *American University International Law Review* 1275-1289.

⁹ UN Doc A/CONF151/26 (Vol. I), (1992) 31 *ILM* 874.

¹⁰ See Karl P. Sauvart, 'The collected documents of the Group of 77' *The UN Chronicle* (Vol LI No 1, May 2014).

and their socio-economic development options.¹¹ The next conference was held in Mexico, when the Charter of Economic Rights and Duties of the States 1974 was presented.¹² Leaders of developing states were very keen on setting the norms that would help with the socio-economic development and help balance the economic relations between them and the developed states. Aspirations of developing states were written in the 'Action Programme for Economic Co-operation'.¹³ The sequence of events could have been very different if it was not for the Middle East conflict, which caused the dramatic rise of oil prices by OPEC that endangered developing states chances of achieving their goals for socio-economic development and independence. Developing states continued to fight for balancing the economic differences, which produced Declaration on the Establishment of a New International Economic Order and Programme of Actions on the Establishment of a New International Economic Order 1974.¹⁴ The first agreement between developing and developed states was recorded in Development and International Economic Co-operation 1975.¹⁵

There is another relationship to be considered and that is the relationship between TNCs and the governments of host developing states.¹⁶ Problem of TNCs activities was given priority in terms of its importance in 1972,¹⁷ which led to appointment of the Group of Eminent Persons¹⁸ to study the impact of TNCs on development and on international relations. In the quest for a new international economic order the codes of conduct became

¹¹ See Charter of Algiers at Ministerial Meeting of the Group 77 on 24 October 1967 in UN Doc MM 77/I/20 (1967); The Lusaka Declaration was formed in 1970 in 10 Int'l legal Mat. 215 (1971); Declaration on Non-Alignment and Economic Progress; Lima Declaration 1971 and UN Doc MM/77/II/11.

¹² Charter of Economic Rights and Duties of States, GA Res 3281 (XXIX) of 12 December 1974 (A/9631) (1974)

¹³ UN Doc A/9330 at 85-100 (1973).

¹⁴ UNGA Res 3201, Spec. Sess. 6 UN GAOR Supp. (No.1) at 3; UN Doc A/9559 (1974); UNGA Res 3202, Spec. Sess. 6 UN GAOR Supp. (No.1) at 5; UN Doc A/9559 (1974).

¹⁵ UNGA A/RES/S-7/3362 Development and international economic co-operation. 16 September 1975.

¹⁶ It is deemed essential to note that the concept of nation-state might have become obsolete in the 20th century as states are no longer single nation states, mainly owing to the mass immigration processes and consequences of the two World Wars. Most of the states today are mixed nation states and it might be a good time in the light of recent events to review the nation-state concept, however the topic of this discussion is outside of the scope of this research.

¹⁷ International codes of conduct were the vehicle of control and guidance in the quest to regulate activities of TNCs namely in the host developing states under the auspice of the New International Economic Order (NIEC).

¹⁸ There were 20 people appointed to the Group, eight people came from less-developed states, two from communist states, and ten from the developed states. The Group produced the report UN ECOSOC, The impact of Multinational Corporations on Development and on International Relations, E/5500/Rev. I 1974.

a legal phenomenon and were intended as a tool that would control the activities of TNCs, predominantly in host developing states.

Some scholars¹⁹ believe that TNCs are standing in the way of developing states socio-economic development, which called for implementation of codes of conduct for TNCs. However, the issue is that the codes of conduct have been in the making for quite some time now and have not achieved much success in their implementation. The difficulties of codes of conduct became especially evident during the negotiation process. The UN General Assembly passed a resolution containing Codes of Conduct for Law Enforcement Officials in 1980.²⁰

The legal effect of the Codes of Conduct are examined more closely at 3.2.

3.2 A Critical examination of some of the major Codes of Conduct as means of controlling activities of transnational corporations (TNCs)

When the oil conglomerate Chevron was ordered to pay 18 billion dollars in damages it was ‘the largest judgment ever awarded in an environmental lawsuit’ the case was far from over and the media tagged it as local plaintiffs’ fruitless legal struggle with the help of a corrupt judiciary that was dependent politically as well as economically on the foreign oil companies.²¹

The incident of Chevron exposed the vulnerability of governing the transnational corporations (TNCs) in a manner appropriate to avoid abuses of human rights and conducting environmentally harmful activities. Therefore, corporate governance that will better control such activities is deemed necessary. The case of Chevron also exposed the failure of international as well as domestic law in handling such cases. Muchlinski

¹⁹ See for example R. Murray, Underdevelopment, international firms and the international division of labour In J. Tinberger (ed), *Towards a new world economy* (Rotterdam University Press 1972); Rhys Jenkins, *Transnational corporations and uneven development, The internationalization of Capital and the Third World* (Routledge 2013, first published in 1987).

²⁰ UNGA Res 34/169, 34 U.N. GAOR Supp. (No. 46) 185, UN Doc A/RES/34/169 (1980), reprinted in 19 INT’L LEGAL MAT. 526 (1980).

²¹ Patrick R. Keefe, ‘Reversal of Fortune’ *The New Yorker* (9 January 2012).

maintained that after 2010 there have been examples of ‘holding multinational enterprises (MNEs) accountable for harm caused by their overseas operations and, at the level of international law, calls for the extension of human rights responsibilities to corporate actors’.²² The suggested method would be to name and shame the TNCs that are engaging in harmful activities. As TNCs are concerned with their corporate image as bad reputation might have a negative impact on the value of their shares. While Friedman maintained that ‘there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits’ as long as it ‘engages in open and free competition without deception or fraud’.²³ Studies have shown that in the long-term CSR can be beneficial to the TNCs.²⁴ Reputational approach might therefore be more effective way towards TNCs self-regulation.

As an alternative is the notion of “soft law” concept. Syracuse maintained that “soft law” is conceptually and substantively inadequate and misleading in filling the voids’.²⁵ In addition to “soft laws” being considered as legally non-binding more like a moral compass rather than the rule. It is essential to reiterate that the codes of conduct are much needed and it is unfortunate that after all the attempts to finalise them over the years they have not yet materialised.²⁶ There are also no legal repercussions in cases of any violations apart from the imposed sanctions.²⁷ However, the importance of codes should not be

²² Peter T. Muchlinski, ‘The Changing Face of Transnational Business Governance: Private Corporate Law Liability and Accountability of Transnational Groups in a Post-Financial Crisis World’ (2011) 18(2) *Indian Journal of Global Legal Studies* 665.

²³ Milton Friedman, *Capitalism and Freedom* (University of Chicago 1970) 112.

²⁴ See Philip Kotler & Nancy Lee, *Corporate social responsibility: doing the most good for your company and your cause* (Wiley 2005) 14.

²⁵ Harri Kalimo and Tim Staal, ‘Softness in International Instruments - The Case of Transnational Corporations’ (2015) 42(2) *Syracuse Journal of International Law* 365.

²⁶ The UN are not a state and as such have no parliament to enforce the laws. Therefore the conclusion is that there is a lack of understanding on the definition and concept of a state. Regardless of that fact, the members of the UN are however sovereign states and as such should be obliged to follow the binding resolutions that have been adopted by the majority members. As an example France did not sign the Limited Test Ban Treaty (LTBT) the Treaty Banning Nuclear Weapon Tests in the Atmosphere, in Outer Space and Under Water however they are still not allowed to violate the conditions agreed in the treaty in spite of the fact that they have not signed the treaty. Failure of following the resolutions or treaties can result in sanction, which have unfortunately not proven to be effective. The question to answer is whether international organisations have law making powers.

²⁷ See further case studies on the UN sanctions <<https://www.globalpolicy.org/global-taxes/41751-un-sanctions-case-studies.html>> accessed 26 February 2016.

disregarded just yet as they have the potential to form the basis for new standards that could potentially become a customary part of international law.²⁸

Shortcomings of the “hard law” and its inability to adequately govern the activities of TNCs called for assistance of “soft laws”. Olsson maintained that ‘Soft law rests on the idea that the binary nature of law (law is either hard or not law at all) is not suitable to accommodate the growing complexity of contemporary international relations’.²⁹ Some scholars have come to ‘the conclusion of an agreement in treaty form does not ensure that a hard obligation has been incurred’.³⁰

However, the “hard laws” cannot take credit in solving the issues, as there have been many examples of ‘provisions concerning controversial social issues have been put into very general and probably meaningless, hortatory language, simply to show that something has been done, but where is little intention to see these provisions having any real legal effect’.³¹

The question that one should ask is, if the “hard law” and the “soft law” both fail, what should then be implemented instead, if “no law” is not an option. The possible answer to that question could be the codes of conduct, effectively Draft Code of conduct which:

[C]ontains obligations ranging from respect for the sovereignty and political system of the host state, respect for human rights, abstention from corrupt practices, full disclosure or observance of tax and competition laws, to obligations on TNCs not to abuse their economic power in a manner damaging to the economic well-being of the countries in which they operate.³²

Conduct of TNCs has been under review especially in regards to the environmental and the human rights protection. More importantly conduct of TNCs questions their liability

²⁸ See Chin Leng Lim and Olufemi A. Elias, *The Paradox of Consensualism in International Law* (Developments in International Law (Martinus Nijhoff 2012).

²⁹ Ilhami Alkan Olsson, ‘Four Competing Approaches to International Soft Law’ (2013) 58 *Scandinavian Studies in Law* 177 <<http://www.scandinavianlaw.se/pdf/58-9.pdf>> accessed 1 March 2016.

³⁰ See Christine Chinkin, ‘Normative Development in the International Legal System’ in Dinah Shelton (ed), *Commitment and Compliance: The Role of Non-Binding Norms in the International Legal System* (OUP 2003) 25.

³¹ Peter T. Muchlinski, ‘Human Rights, Social Responsibility and the Regulation of International Business: The Development of International Standards by Intergovernmental Organisations’ (2003) 3 *Non-State Actors and International Law* 123-152, 129.

³² Peter T. Muchlinski, ‘Human rights, social responsibility and the regulation of international business: The development of international standards by intergovernmental organisations’ (2003) 3 *Non-State Actors and International Law* 123-152, 130.

under international law.³³ Johns maintained that ‘Transnational corporations (“TNC”) does not have a concrete presence in international law’³⁴ and asked ‘Why then has international law traditionally not recognised the TNC as an international actor and a legal subject?’³⁵ However ‘the juristic personality of the TNC was confirmed in the *Barcelona Traction, Light and Power Co* Case as analogous to that of individuals, that is, as a national of a state.’³⁶ In 1970 Alvarez maintained that ‘a corporation seems as much a subject of international law as an individual or an international organization’.³⁷ However, in cases ‘outside of ATCA³⁸ decisions by U.S. courts, corporations have generally not been found liable under international law and are therefore not “subject” of international law’.³⁹ There are five characteristics that a corporation have in legal terms; legal personality, limited liability, transferable shares, delegated management under a board structure, and investor ownership.⁴⁰ International legal status of TNCs is still quite unclear in spite of the fact that it has legal personality in international law, to some degree.⁴¹ As such TNCs cannot take part in international institutions, however that does not exclude their participation in front of the international tribunals under the International Convention on Settlement of Investment Disputes⁴² (ICSID) 1965 or the North American Free Trade Agreement (NAFTA) 1994. Nye expressed his concern by maintaining that

³³ See Menno T. Kamminga and Suman Zia-Zarifi (ed), *Liability of Multinational Corporations under International Law* (Martinus Nijhoff 2012); see also the Human Rights Watch < <https://www.hrw.org/>> accessed 24 October 2015.

³⁴ Fleur E. Johns, ‘The Invisibility of the Transnational Corporation: An Analysis of International and Legal Theory (1994) 19 Melbourne University Law Review 893.

³⁵ Fleur E. Johns, ‘The Invisibility of the Transnational Corporation: An Analysis of International and Legal Theory (1994) 19 Melbourne University Law Review 894.

³⁶ Fleur E. Johns, ‘The Invisibility of the Transnational Corporation: An Analysis of International and Legal Theory (1994) 19 Melbourne University Law Review 894; see also *The Barcelona Traction, Light and Power Co Ltd Case (Belgium v Spain)*, ICJ Reports, 1970, 3 para 70 (*Barcelona Traction*).

³⁷ José E. Alvarez, ‘Are Corporations “Subjects” of International Law?’ (2011) 9 Santa Clara Journal of International Law 3.

³⁸ ATCA is Alien Tort Claims Act.

³⁹ José E. Alvarez, ‘Are Corporations “Subjects” of International Law?’ (2011) 9 Santa Clara Journal of International Law 3.

⁴⁰ See Reinier Kraakmaan, John Armour, Paul Davies, Luca Enriques, Henry B. Hansman, et al. *The Anatomy of Corporate Law A Comparative and Functional Approach* (2nd edn, OUP 2009) 1.

⁴¹ See Amanda Perry-Kessaris, *Multinational enterprises and the law* (University of London Press 2012); see further Statute of the international court of justice <http://www.icj-cij.org/documents/?p1=4&p2=2#CHAPTER_II> accessed on 27 October 2015.

⁴² Muchlinski has expressed his concern over the relationship between investor-state in regards to the dispute settlement, where the investor can choose the method of dispute settlement that is national or international system, which automatically gives the investor the superior position to exclude the national legal system of the host country, during the course of investment and as provision in the bilateral investment treaty (BIT) in Peter T. Muchlinski, ‘The Changing Face of Transnational Business Governance: Private Corporate Law Liability and Accountability of Transnational Groups in a Post-Financial Crisis World’ (2011) 18(2) Indian Journal of Global Legal Studies 665.

‘hundreds of organizations and legal regimes exist to manage the global dimensions of trade, telecommunications, civil aviation, health, environment, meteorology and many other issues⁴³ which poses the danger to the autonomy of sovereign states.⁴⁴

The relationship between TNCs and host developing states has always been a subject of research of many academics namely Hymer, Vernon, Huntington and others.⁴⁵

Muchlinski maintained that:

[T]he World Trade Organisation (WTO) and the World Bank, are doing little to regulate such practices while, at the same time, creating a deregulated global space in which MNEs will be increasingly free to act as they will, and in which there is little by way of democratic accountability for the actions of these powerful private actors.⁴⁶

As maintained in the draft UN Code of Conduct for TNCs that contain obligations of TNCs ranging from respect for the sovereignty of host developing state, human rights, political systems, refraining from corrupt practices, not abusing its economic power⁴⁷ to contribution to the sustainable development and local capacity building.⁴⁸ ‘TNCs are expected to conduct their economic affairs in good faith and in accordance with proper standards of economic activity, while also observing fundamental principles of good socio-political and ethical conduct’.⁴⁹

Activities of TNCs are mainly problematic due to the fact that they operate in multiple jurisdictions. As Stiglitz maintained that ‘An increasing fraction of commerce within each

⁴³ Joseph S. Nye, Jr., ‘Parliament of Dreams’ (World Link 2002)

<<http://bazaarmodel.net/phorum/read.php?1,133>> accessed 27 October 2015; Joseph S. Nye, *The Paradox of American Power: Why the World's Only Superpower Can't Go It Alone* (OUP 2003).

⁴⁴ The same concern has been expressed by Raymond Vernon, *Sovereignty at Bay: The Multinational Spread of US Enterprises* (Basic Books 1971).

⁴⁵ See further Susan Strange, Big Business and the State in Multinationals in the global political economy in Lorraine Eden and Evan H. Potter (eds), *Multinational in the Global Political Economy* (first edition 1993, Palgrave Macmillan 2014) 104-07.

⁴⁶ Peter T. Muchlinski, ‘Human Rights, Social Responsibility and the Regulation of International Business: The Development of International Standards by Intergovernmental Organisations’ (2003) 3 Non-State Actors and International Law 123-152, 124.

⁴⁷ See UNCTAD Social Responsibility UNCTAD Series on issues in international investment agreements (New York and Geneva, UN 2001).

⁴⁸ OECD Guidelines for Multinational Enterprises (Paris, OECD 2000) Ch2.

⁴⁹ UNCTAD Social Responsibility UNCTAD Series on issues in international investment agreements (New York and Geneva, UN 2001) 11.

country is conducted by corporations that are owned and controlled from outside its borders and that often conduct business in dozens of countries'.⁵⁰ While some domestic laws are in line with the international law, there is still a big gap between them, which leads to gaps in the legal consequences⁵¹. Therefore, TNCs are powerful enough to be able to choose to operate in the host developing state where legislation is more beneficial.⁵² This situation *a priori* gives TNCs an advantage with better bargaining position, effectively in negotiating investment agreements.

Over the years the concern over the social dimension of international business was raised effectively owing to the lack of existing regulations. Moreover, international agreements have not included any social issues in their agreements. The Multilateral Agreement on Investment (MAI) did not include any labour or environmental standards, which could have also been the reason for their collapse.⁵³ A 'failure to follow the terms of a voluntary code could be evidence of a breach of contract'⁵⁴ however if the terms and conditions are not negotiated and agreed in the investment contract there could be no breach. While the Multilateral Agreement on Investment (MAI) failed, bilateral investment treaties (BITs) proliferated, namely in the 1990s and would on the other hand, in most cases, include:

[N]on-discrimination, based on most-favoured-nation and national treatment standards; investment guarantees against expropriation or civil unrest and in support of free transfer of funds and dispute settlement.⁵⁵

⁵⁰ Joseph E. Stiglitz, 'Regulating Multinational Corporations: Towards Principles of Cross-Border Legal Framework in a Globalized World Balancing Rights with Responsibilities' (2007) 23(3) *American University International Law Review* 451–558.

⁵¹ For example, average enforcement of a contract in OECD countries is 351 days, while it takes local courts 880 days in Pakistan and 1,442 days in Bangladesh, see Report on 'Business and Governance', *Financial Times*, 14 March 2007, 5.

⁵² See further Thomas Donaldson, *The Ethics of international Business* (OUP 1992).

⁵³ Multilateral Agreement on Investment (MAI) initiative failed in October 1998. The most interesting thing to note was the fear allegedly from the developing states that MAI would impose obligations to the developing states without any benefits. The loudest opponents to the MAI were actually the developed states. What followed the MAI were the BITs, which were in terms even more disadvantageous for the developing states. The number of signed BITs has been increasing rapidly ever since the first one was signed to 2,928 in 2015, out of which 2,276 are in force; International Investment Agreements <<http://investmentpolicyhub.unctad.org/IIA>> accessed on 27 October 2015.

⁵⁴ Peter T. Muchlinski, 'Human Rights, Social Responsibility and the Regulation of International Business: The Development of International Standards by Intergovernmental Organisations' (2003) 3 *Non-State Actors and International Law* 123-152, 129.

⁵⁵ Peter T. Muchlinski, 'Human Rights, Social Responsibility and the Regulation of International Business: The Development of International Standards by Intergovernmental Organisations' (2003) 3 *Non-State Actors and International Law* 123-152, 127.

However, developing states have not taken the initiative to include provisions that would define the terms of the capacity building requirements, local management participation, succession clause, re-negotiation clause, performance evaluation clause, transfer of profits clause or joint venture terms and conditions in the BITs. Equally BITs contain no provision on the obligations of foreign investors towards host developing states, as well as preservation of the environment or protection of human rights. A ‘contractual commitment to sell technology, equipment, or a plant in exchange for the purchase of a certain quantity of the products produced as a result in full or partial payment’⁵⁶ can be reflected in compensation or a buy-back.⁵⁷ Buy-backs are high financial commitments over a longer time period. Chatterjee maintained that ‘a transfer of capital plant or equipment is required to buy-back a pre-determined quantity of manufactured product in a predetermined currency’.⁵⁸ In terms of buy-back agreements it is also determined which currency to repay the ‘debt occasioned by the acquisition of the capital plant or equipment’.⁵⁹ An important supplement to the buy-back method are “turn-key contracts” that ‘allow the local people in the country into which the capital plant / equipment has been transferred, to have training in order to ensure that over a period of time (which becomes a term of the contract) the local people would be able to operate and manage the industry’.⁶⁰ Such contracts include “product-in-hand”⁶¹ or “market-in-hand”⁶², but preferably both. However, buy-backs are not without the risk, such as fluctuation of the exchange rate if not included in the clause on agreed rate during the negotiations process, time line between contract and manufacturing for the market demand and possible delays in production. In any case ‘the advantages of buy-back seem to outweigh its disadvantages’.⁶³

⁵⁶ Leo G.B. Welt, Unconventional forms of financing: Buy-back/compensation/barter (1989-1990) 22 N.Y.U.J. Int’l L. & Pol. 461, 462.

⁵⁷ See Leo G.B. Welt, *Trade Without Money: Barter and Countertrade* (Aspen Law & Business 1984) 8-9.

⁵⁸ Charles Chatterjee, *Legal aspects of trade finance* (Routledge 2006) 11.

⁵⁹ Charles Chatterjee, *Legal aspects of trade finance* (Routledge 2006) 11.

⁶⁰ Charles Chatterjee, *Legal aspects of trade finance* (Routledge 2006) 12.

⁶¹ With product-in-hand the local people are trained to manufacture the final products.

⁶² With market-in-hand the transferor helps the host states to enter the foreign markets with their products.

⁶³ Charles Chatterjee, *Legal aspects of trade finance* (Routledge 2006) 12.

The UN Guiding Principles on Business and Human Rights points out the ‘governance gaps created by globalisation’⁶⁴ based on legal void, which is created in cases when TNCs avoid the control and influence decisions. Kalimo and Staal wrote about the ‘legal void as a regulatory situation in violation of the laws of the TNC home state or of international law’.⁶⁵

De Feyter argued that ‘the home state is faced with the difficulty that, in principle, the reach of domestic law is limited to its own territory’.⁶⁶ However, ‘at the level of national law, a non-binding code of conduct can acquire legal force in private law’.⁶⁷

Activities of TNCs are of significant importance due to the fact that they are spread over a number of host developing states and have significant impact on the global economy. Consequently, their jurisdictions fall under a number of different jurisdictions that are not compatible among themselves. One of the rare legally binding Conventions is the Convention on Combating Bribery of Foreign Officials in International Business Transactions 1998.⁶⁸

The above is not always the case as TNCs tend to identify the host developing states that for example have softer laws on labour force, such as the number of working hours, which TNCs explore since efficiency is considered to be of crucial importance, together with cost reduction. Moreover, some states may have very low taxes or none at all on the enormous profits that the TNCs can sometimes achieve, which makes the decision of TNCs very easy when choosing their headquarters and subsidiaries around the globe. However, Muchlinski maintained that ‘the real problem may be a lack of proper

⁶⁴ Report of the Special Representative of the Secretary General of the UN Human Rights Council, 8th Sess., Protct, Respect and Remedy 6-7, 15, UN. Doc. A/HRC/8/5 2008.

⁶⁵ Harri Kalimo and Tim Staal, ‘Softness in International Instruments - The Case of Transnational Corporations’ (2015) 42(2) Syracuse Journal of International Law 365.

⁶⁶ Koen De Feyter, Globalisation and Human Rights, in International Human Rights in a Global context, 68, 81/82 (Filipe Gomez Isa & Koen de Feiter eds, 2009).

⁶⁷ Peter T. Muchlinski, ‘Human Rights, Social Responsibility and the Regulation of International Business: The Development of International Standards by Intergovernmental Organisations’ (2003) 3 Non-State Actors and International Law 123-152, 129.

⁶⁸ OECD Doc DAF/IME/BR(97) 20 8 April 1998 <http://www.oecd.org/daf/anti-bribery/ConvCombatBribery_ENG.pdf> accessed on 24 October 2015.

regulation in the host country of local businesses and institutions for which MNEs may not be responsible'.⁶⁹

The question of limits of law becomes even more relevant now than ever before. Mainly because umbrella clause enables foreign investment law to extend to contractual dispute in terms of allowing breach of contractual obligation to be elevated to breach of BITs, which is protected with a set of standards and gives access to international arbitration. That directly contradicts international law which maintains that a breach of a contract of a state does not give rise to direct international responsibility.⁷⁰

Conference on transnational corporations (CTC) maintained that:

[N]on-binding Codes of Conduct may become a course of law for national authorities as well as for transnational corporations themselves, since both can rely upon and utilise the Code to fill the gaps in the relevant laws and practices...[and transnational corporations] may help to shape pertinent legal principles through their continuous practice.⁷¹

Charney explored the role of universal rules to fill the gap of domestic legislation⁷² because the developing states tend to have their standards set very low comparing to the developed states. In some rare cases the developing states recognise universal jurisdiction outside the borders of their territories. Donovan and Roberts argued that these cases are not very common and that they are also very limited.⁷³ While international law has the ability to allow states to exercise jurisdiction of their nationals abroad with the help of the nationality principle, which conflicts with the territoriality principle.

Knox⁷⁴ suggested that the human rights could be implemented directly, almost directly, indirectly or transposed into domestic law. In the case of environmental laws, it can only

⁶⁹ Peter T. Muchlinski, 'Human Rights, Social Responsibility and the Regulation of International Business: The Development of International Standards by Intergovernmental Organisations' (2003) 3 *Non-State Actors and International Law* 123-152, 135.

⁷⁰ J Wong, 'Umbrella Clauses in Bilateral Investment Treaties Of Breaches of Contract, Treaty Violations and the Divide between Developing and Developed Countries in Foreign Investment Dipsutes' (2006) 14 *George Mason Law Review* 135.

⁷¹ CTC, *Certain Modalities for Implementation of a Code of Conduct in Relation to Its Possible Legal Nature*, UN Doc. E/C 10/AC 2/9, 22 (1978) 8.

⁷² Jonathan I. Charney, 'Universal International Law' (1993) 87(4) *The American Journal of International Law* 529.

⁷³ Donald F. Donovan and Anthea Roberts, 'The Emerging Recognition of Universal Civil Jurisdiction' (2006) 100 *AM. J. INT'L L.* 142.

⁷⁴ John H. Knox, 'Horizontal Human Rights Law' (2008) 102 *AM J. INT'L L.* 1.

be done by transposition or indirect application of international law. Knox also added that TNCs have a limited set of obligations. The only case in which TNCs would have been bound by the international law is when host developing state and home state of TNCs would directly adopt international law.

It is interesting to note that as from 1979, the global economy has been growing at a high rate, while the developing states have become even poorer.⁷⁵ In the early 1970s it became obvious that this situation cannot continue and that intervention of the international community via international institutions, namely the UN would be needed in order to establish the balance between developed and developing states. One of the important items on the agenda was to start controlling and regulating activities of TNCs, especially in the host developing states. To that effect the UN Economic and Social Council adopted the Resolution⁷⁶ in 1974 by which the UNCTC was created and started with its operations a year later, in 1975. 'Rightly or wrongly, transnational corporations (TNCs) or multinational business enterprises (MNEs) are perceived to be the major obstacles standing in the way of the economic development and progress of the lesser developed nations of the world'.⁷⁷ The effects of TNCs on socio-economic development of host developing states is still inconclusive.

Many countries individually have been trying to implement codes of conduct in their domestic legislation that would regulate the activities of TNCs inside their judiciaries. By implementing such codes, the objective of the host developing states was to become economically independent, and more importantly would help to create the environment for their socio-economic development to achieve socio-economic independence.

3.3 Limits of Law and application of Codes of Conduct

⁷⁵ See Thomas H. Reynolds, 'Clouds of Codes: The New International Economic Order through Codes of Conduct: A Survey' (1982) 75 Law Libr. J. 315.

⁷⁶ UN Doc A/PV/2315 (1974).

⁷⁷ Thomas H. Reynolds, 'Clouds of Codes: The New International Economic Order through Codes of Conduct: A Survey' (1982) 75 Law Libr. J. 315, 321.

It has been over four decades ago that the UN Convention on Transnational Corporations drafted the UN Code of Conduct on TNCs. The objective of this code was to specify the rights and duties, together with responsibilities of TNCs in their relations with host developing states. Unfortunately, the code of conduct does not seem to have achieved much success. Therefore, the question to what extent should the rules and responsibilities for TNCs be followed remains open and unanswered. The situation of balancing the interests is still open for discussion on the international level between all three parties.

In 1998 the UN Sub-Commission on the Promotion and Protection of Human Rights established the Working Group.⁷⁸ It was the Working Group that came up with the idea of writing the codes of conduct for enterprises that would have their origins in human rights. The problem came when the name “Codes of Conduct” was changed numerous times to “Guidelines”, “Principles”, “Draft Norms and Responsibilities”, which uses binding as well as non-binding norms, all of the subsequent failed to grasp the importance of the mission and the objective to create the needed legal grounds. The discrepancy was also in the terminology that used the term “companies”, which included ‘any business enterprise, regardless of the international or domestic nature of its activities; the corporate, partnership, or other legal form used to establish the business entity; and the nature of the ownership of the entity, including any privately-owned or government-owned entity’.⁷⁹ This definition avoided making distinctions between different entities be it international or domestic and it also prevented TNCs abusing the options of distinction and finding ways to register and operate as a domestic entity in opposed to TNC in host developing state.

The draft code of conduct suggested that governments would be responsible for maintaining human rights standards in their states by stating that:

States have the primary responsibility to promote, secure the fulfilment of, respect, ensure respect of and protect human rights, transnational corporations and other business enterprises, as organs of society, are also responsible for

⁷⁸ S.C.Res 1998/8 of 20 August 1998. The Working Group was based on the Working Methods and Activities of Transnational Corporations in Principles Relating to the Human Rights of Companies, U.N. Doc E/CN.4/Sub.2/2000/WG

⁷⁹ In draft Guidelines at section I, para. 21.

promoting and securing the human rights set forth in the Universal Declaration of Human Rights,...⁸⁰

In this respect TNCs have the obligation to respect human rights.⁸¹ The UN have been on the forefront of recognising human rights and incorporating them in their documents and resolutions. The UN International Bill of Human Rights (IBHR) is a document, consisting of the Universal Declaration of Human Rights (UDHR), the International Covent on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights.⁸² The importance of the UN resolutions was the fact that the global community's awareness was building up in recognition of the growing power and influence of TNCs, effectively via the private foreign investments, which was initiated by the ITT scandal in Chile.⁸³ At the General Assembly President Allende asked for help and warned about the dangers of TNCs increasing their economic power, political influence and corruption.⁸⁴ In the 1970s it was also the time when many developing states freed themselves from their colonial masters and became independent sovereign states and members of the United Nations. The non-aligned developing states⁸⁵ organised numerous meetings with

⁸⁰ Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights, UN Doc E/CN.4/Sub.2/2003/12/Rev.2 (2003) preamble.

⁸¹ It is interesting to note that Human Rights have not become Fundamental Rights and moreover were not adopted in any of the constitutions to make them legally binding.

⁸² William H. Meyer, Human rights and international political economy in third world nations: multinational corporations, foreign aid and repression (Praeger 1998) 9.

⁸³ UN Doc E/SR 1822 (1972) was created on request of Mr. Santa Cruz a representative from Chile, who asked that the activities of transnational corporations have to be closely reviewed and studied due to the recent ITT scandal. This paper was followed by a resolution that formulated policies in E.S.C. Res. 1721, 53 UN ESCOR Supp. (No.1) at 3 and UN Doc E/5209 (1972). The Resolution was followed by the GEP Report UN Doc ST/ECA/190 (1973) and UN Doc ST/ESA/15 (1973). Two decades earlier 1954, there was the United Fruit company scandal in Guatemala, when the US CIA intervned and overthrown democratically elected President Jacobo Árbenz and replaced him with military dictator Carlos Castillo Armas. See further Marcelo Bucheli, *Good dictator, bad dictator: United Fruit Company and Economic Nationalism in Central America in the Twentieth Century* (University of Illinois at Urbana – Champaign 2006) <https://business.illinois.edu/working_papers/papers/06-0115.pdf> accessed 20 February 2016.

⁸⁴ Many corporations have been discovered to make illegal payments, paying foreign government officials, politicians and political parties, and other corporate bribery activities, which was highlighted in the U.S. Securities and Exchange Commission Investigation findings report 1977. Estimated 400 corporations voluntarily disclosed their wrongdoing. See U.S. House of Representatives, Unlawful Corporate Payments Act of 1977, Report No. 95-640, <<http://www.usdoj.gov/criminal/fraud/fcpa/history/1977/houseprt.html> accessed 20 February 2016> accessed 16 March 2016; See also U.S. House of Representatives, Report on Questionable and Illegal Corporate Payments and Practices 1976; See further Committee on Banking, Housing, and Urban Affairs, Foreign Corrupt Practices and Domestic and Foreign Investment Improved Disclosure Acts of 1977; U.S. Senate Report No.95-114 (1977)

<<http://www.usdoj.gov/criminal/fraud/fcpa/history/1977/senaterpt.html>> accessed 20 February 2016.

⁸⁵ Developing states with natural resources were thinking of the possibility of joining in cartels, following the OPEC example, which was discussed by Fred Bergsten, 'One, two, many OPECs ... ? The threat is real' *Foreign Policy* (No.14 Spring 1974) 84–90.

the purpose to stimulate the economic cooperation and where the idea of New International Economic Order came about. The Declaration on the Establishment of a New International Economic Order 1974 provided for the:

[R]egulation and supervision of the activities of transnational corporations by taking measures in the interest of the national economies of the countries where such transnational corporations operate on the basis of the full sovereignty of these countries.⁸⁶

A similar request was made by the UN Charter on Economic Rights and Duties of States 1974.⁸⁷ The two mentioned UN Declarations were instrumental in creating the Commission on Transnational Corporations (UNCTC) and its secretariat.

The OECD guidelines for Multinational Enterprises are very clear, especially in chapter II “General Policies” it stated that ‘Enterprises should take fully into account established policies in the countries in which they operate, and consider the views of other stakeholders’.⁸⁸

Among the areas specific for the TNCs conduct it included also that TNCs should ‘Contribute to economic, environmental and social progress with a view to achieving sustainable development’ while respecting ‘the internationally recognised human rights of those affected by their activities’. TNCs should also ‘Encourage local capacity building through close co-operation with the local community’. One very relevant requirement, especially at present, was the requirement on ‘creating employment opportunities and facilitating training opportunities for employees’ which clearly instructs the expectation from TNCs in terms of the local employment and capacity building. In the quest to ensuring the above it also instructs TNCs to ‘Refrain from seeking or accepting exemptions’ because it is rightfully expected that TNCs would ‘apply good corporate governance practices’ during the course of their conduct as well as an ‘effective self-regulatory practices and management systems’. The main critics addressed the

⁸⁶ UNGA Res A/RES/S-6/3201 1974 <<http://www.un-documents.net/s6r3201.htm>> accessed 23 October 2015.

⁸⁷ UNGA Res A/RES/29/3 1974.

⁸⁸ OECD Guidelines for Multinational Enterprises (OECD Publishing 2011) Ch II, 19.

disassociation between TNCs and civil societies for which it was recommended that TNCs should ‘foster a relationship of confidence and mutual trust’.⁸⁹

The Guidelines go further and specifically instruct TNCs to ‘Promote employee awareness’ by means of training and further skill development. TNCs should also ‘Refrain from discriminatory or disciplinary action against employees who make bona fide reports to management’ which would suggest that TNCs are expected to operate under full transparency and any deviation from the good corporate practice should be immediately addressed and resolved. Such corporate practice should also be promoted and advocated. Last but not least the Guidelines advice against ‘any improper involvement in local political activities’ for obvious reasons, while the co-operation with local communities and authorities is strongly advisable any potential coercion on decision-making is however not tolerated.⁹⁰

‘[T]NCs are expected to conduct their economic affairs in good faith and in accordance with proper standards of economic activity, while also observing fundamental principles of good socio-political and ethical conduct’.⁹¹ ‘The basic problem and main concern of all guidelines for MNE's is to integrate the transnational business activities of MNE's into the national economic and social systems of the host countries in which they operate’.⁹² However, from the codes of conduct one can conclude that these codes are actually directed to the states and not to the TNCs, while the OECD Guidelines are specifically addressed to TNCs. The process of implementing codes of conduct in domestic legislation should first have to be created and then adopted by all member states and incorporated into their domestic legislation.

There exists a significant gap in aspirations between the economic objectives of TNCs and those of host developing states. The reached agreement included additional protection under international minimum standards for foreign investors instead of creating mechanism to control the activities of TNCs in host developing states. These standards

⁸⁹ All references from OECD, OECD Guidelines for Multinational Enterprises (OECD Publishing 2011) Ch II, 19.

⁹⁰ OECD, OECD Guidelines for Multinational Enterprises (OECD Publishing 2008) <<http://www.oecd.org/corporate/mne/1922428.pdf>> accessed on 24 October 2015.

⁹¹ UNCTAD, Social Responsibility UNCTAD Series on issues in international investment agreements (New York and Geneva, United Nations 2001) 11.

⁹² Norbert Horn, ‘International Rules for Multinational Enterprises: The ICC, OECD, and ILO Initiatives’ (1981) 30 The American University Law Review 923, 928.

include fair and equitable, MFN and national treatment, full protection and security, protection against expropriation, access to technology, abolishing cartels, access to international arbitration and restrictive business practices. However, the question if the TNCs are violating the law by using their competitive advantages, remains to be undetermined. However, all of the existing standards seems to protect the interests of the foreign investors more favourably than those of host developing states.

International law applicable to TNCs is rather a new phenomenon.⁹³ Therefore an attempt was made to examine the conduct of TNCs in host developing states. As stated in the codes the objective was to ‘maximise the contributions of transnational corporations to economic development and growth and to minimise the negative effects of the activities of these corporations’. Draft codes also instruct TNCs not to interfere with the policies of host developing states in any way. Developing states were in favour of the *ius cogens* principle for the right to permanent sovereignty over natural resources.⁹⁴

The control of transnational corporations (TNCs) is mainly exercised via national level, which offers the most effective control over activities of TNCs. Schachter maintained that nation-state concept will start to fade away and new structures will emerge in order to control the activities of TNCs.⁹⁵ He also predicted the expansion of communication technology that will result in greatest involvement of civil society that will cause overlap of private and public international law. The latter has potential for continuous growth as the property gains new dimensions and international “persons” emerge.⁹⁶

The most known are the “Sullivan Principles” created in 1977 for TNCs activities in South Africa.⁹⁷ The Sullivan Principles were not mandatory for TNCs, but were strongly encouraged.⁹⁸ They have later evolved in Global Sullivan Principles of Social

⁹³ Peter T. Muchlinski, *Multinational Enterprises and the Law* (2nd edn, OUP 2007); Cyntia Day Wallace, *The Multinational Enterprise and Legal Control: Host State Sovereignty in an Era of Economic Globalization* (Martinus Nijhoff 2002); Stefan D. Amarasingha and Juliane Kokott, ‘Multilateral Investment Rules Revisited’ in Peter T. Muchlinski, F. Fortino and C. Schreuer (eds), *The Oxford Handbook of International Investment Law* (OUP 2008) 119.

⁹⁴ See Ian Brownlie, *Principles of Public International Law* (6th edn, OUP 2003).

⁹⁵ Oscar O. Schachter, *The Decline of the Nation-State and its Implications for International Law* (1997) 36 *Columbia Journal of Transnational Law* 7, 23.

⁹⁶ Oscar O. Schachter, *The Decline of the Nation-State and its Implications for International Law*, 36 *Columbia Journal of Transnational Law* 7, 23 (1997).

⁹⁷ American Society of International Law, ‘Sullivan Principles for U.S. Corporations Operating in South Africa’ (1985) 24(5) *International Legal Materials* 1496.

⁹⁸ It is believed that about 150 TNCs complied with the Sullivan Principles. See further S. Prakash Sethi and Oliver F. Williams, ‘Creating and Implementing Global Codes of Conduct: An Assessment of the

Responsibility in which TNCs committed to ‘respect our employees’ voluntary freedom of association’, ‘compensate our employees to enable them to meet at least their basic needs’, and ‘provide a safe and healthy workplace; protect human health and the environment; and promote sustainable development’.⁹⁹

Codes of conduct are voluntary in nature and as such are not imposed on TNCs. With the increased number of TNCs the number of codes has also increased. The United Nations (UN) draft code of conduct unfortunately was never finalised due to numerous disagreements among developed and developing states. Hence the consensus on the codes of conduct was not reached. In any case the draft codes provided some guidance to be followed in the future, however they were not adopted by TNCs.¹⁰⁰

The Organization of Economic Cooperation and Development (OECD) adopted set of guidelines for TNCs.¹⁰¹ The guidelines provided for standards that TNCs should follow while conducting their activities, including employment, environmental protection and human rights stating that ‘respect the human rights of those affected by their activities consistent with the host government’s international obligations and commitments’.¹⁰² The OECD guidelines received mixed reviews.

The report stated that:

Whatever the ultimate fate of the entire Code of conduct may be, it is very significant that a global body, composed of representatives of a wide variety of political and economic systems, and countries at various levels of

Sullivan Principles as a Role Model for Developing International Codes of Conduct—Lessons Learned and Unlearned’ (2000) 105(2) *Business and Society Review* 169; S. Prakash Sethi, *Setting Global Standards: Guidelines for Creating Codes of Conduct in Multinational Corporations* (John Wiley & Sons 2003) 95-109.

⁹⁹ In 1999 The Global Sullivan Principles of Social Responsibility was created by Rev. Leon Sullivan and UN Secretary-General Kofi Annan <<http://berkeleycenter.georgetown.edu/publications/global-sullivan-principles-of-social-responsibility>> accessed 20 December 2015; <<https://www1.umn.edu/humanrts/links/sullivanprinciples.html>> accessed 20 December 2015.

¹⁰⁰ UNGA Res A/RES/45/186 of 21 December 1990.

¹⁰¹ Organization for Economic Cooperation and Development, *OECD Guidelines for Multinational Enterprises* (OECD 2008) < <http://www.oecd.org/corporate/mne/1922428.pdf>> accessed 15 September 2015; see Daniel J. Plaine, ‘The OECD Guidelines for Multinational Enterprises’ (1977) 11(2) *The International Lawyer* 339.

¹⁰² OECD Guidelines, Ch II, para 2, 14.

development, have agreed, albeit ad referendum, on the basic principles of a Code of Conduct to be observed by TNCs in international business.¹⁰³

The report was a product of drastic shift in the international environment, where for the first time TNCs and developing states were not in a conflicting relationship, but started working on mutual benefits.

3.4 A Critical Analysis of some of the provisions of Bilateral Investment Treaties (BITs) with reference to Aspirational Differences

Multilateral treaties were taken over by bilateral investment treaties (BITs) in the late 1970s, mainly due to the lack of international investment treaties on protecting and regulating foreign investment. As Schill stated that:

[D]espite the earlier failure of multilateral approaches in establishing substantive obligations on the treatment of foreign investment and parallel to the wave of uncompensated expropriations in many developing countries in the decades following their independence, the ICSID Convention.¹⁰⁴

International investment treaties were meant to protect against expropriation, requiring protection and security, and fair and equitable treatment (FET) and to build on closer commercial and political relations.¹⁰⁵ It was important to access the global market and the US was therefore developing rights to protect private foreign investors. The purpose of the investment treaties was economic,¹⁰⁶ however the actual reason was to protect the investors in host developing states.¹⁰⁷ Moreover, the treaties should have also helped

¹⁰³ UNCTC, *Transnational Corporations in World Development: The Third Survey* (New York: UN, 1983) 353.

¹⁰⁴ Stephen W. Schill, *The Multilateralization of International Investment Law* (CUP 2014) 45.

¹⁰⁵ Kenneth J. Vandeveld, 'A Brief History of International Investment Agreements' (2005) 12 U.C. Davis J. Int'l L. & Pol'y 157, 158.

¹⁰⁶ Objective of BITs was to attract FDI in developing states. See further Jeffrey H. Bergstrand and Peter Egger, 'What determines BITs?' (2013) 90(1) *Journal of International Economics* 107.

¹⁰⁷ The requirement for implementing the rules for economic non-discrimination, such as the international minimum standard, was based on commercial grounds.

reduce differences and contribute to peaceful relationships between the states, which is the condition for equal access to international trade and investment.

After the Second World War the Havana Charter of 1948 was another attempt to renew the multilateral investment treaties, which ‘contained no provision on the regulation of foreign investment’¹⁰⁸ but it only recognised the need for investment and not for the protection of foreign investment¹⁰⁹ to:

[P]rovide reasonable opportunities for investment acceptable to them and adequate security for existing and future investment, and...to give due regard to the desirability of avoiding discrimination as between foreign investments.¹¹⁰

Article 12(1) (c) of the Havana Charter states *inter alia* that:

A Member State has the right: (i) to take any appropriate safeguards necessary to ensure that foreign investment is not used as a basis for interferences in its internal affairs or national policies, (ii) to determine whether and to what extent and upon what terms it will allow future foreign investment; (iii) to prescribe and give effect on just terms to requirements as to the ownership of existing and future investment; (iv) to prescribe and give effect to other reasonable requirements with respect to existing and future investments.¹¹¹

The above article does not explain how to implement these actions nor does it provide any guidelines as to how to monitor the implementation process. Article 46 of the Havana Charter only refers to restrictive business practices in international trade, which involved restricting competition and fostering monopolies.¹¹²

Vernon argued that BITs do not promise much, also they can easily be breached and therefore represent fragile investment arrangements.¹¹³ ‘National markets are held together by shared values and confidence in certain minimum standards. But in the new

¹⁰⁸ Surya P Subedi, *International Investment Law* (3rd edn, Hart Publishing 2016) 36.

¹⁰⁹ Havana Charter in UNCTAD, *International Investment Instruments: A Compendium, Volume I – Multilateral Instruments* 1996, 3.

¹¹⁰ Havana Charter, Article 12(2).

¹¹¹ Havana Charter, Article 12(1)(c).

¹¹² Havana Charter, Article 12(1).

¹¹³ Raymon Vernon, *In the Hurricane's Eye: the troubled prospects of multinational enterprises* (Harvard University Press 1998).

global market, people do not yet have that confidence'.¹¹⁴ The objective of a BITs¹¹⁵ is to promote as well as protect foreign investment¹¹⁶ through market-orientated policies, transparent and non-discriminatory investment practice and international law.¹¹⁷ In spite of the fact that the number of bilateral investment agreements (BITs), international investment agreements (IIAs) and free trade agreements (FTAs) have been growing with an exponential rate over the past four decades, since the first bilateral investment treaty was signed in 1959 between Pakistan and Germany.¹¹⁸ While confidence in their success in terms of promoting and protecting the foreign investment is not questionable, their contribution to the socio-economic development of host developing states is still vague. Dolzer and Schreuer suggested that in 2008 there has been over 2,500 BITs in force.¹¹⁹ Since 1959 the BITs become one of the most widely used types of international investment agreements for protecting and influencing foreign investment.¹²⁰ BITs have been the fundamental tool that contributed to the transformation of international investment law over a very short period of time.¹²¹

The phenomenal proliferation of the BITs occurred in the mid-1990s with over 1,300 treaties negotiated among over 160 states.¹²² The provisions of BITs are very similar to

¹¹⁴ Kofi Annan, Press Release SG/SM/6881 1 February 1999.

¹¹⁵ Most of BIT have been concluded without a proper market orientated value.

¹¹⁶ Investment Instruments Online: What are BITs?, United Nations Conference on Trade and Development <http://www.unctadxi.org/templates/Page_1006.aspx> accessed 4 September 2015; 'Treaties typically cover the following areas: scope and definition of investment, admission and establishment, national treatment, most-favoured-nation treatment, fair and equitable treatment, compensation in the event of expropriation or damage to the investment, guarantees of free transfers of funds, and dispute settlement mechanisms, both state-state and investor state'.

¹¹⁷ Efraim Chalamish, 'The Future of Bilateral Investment Treaties: A De Facto Multilateral Agreement?' (2009) 34 Brooklyn Journal of International Law 303, 309; Kenneth J. Vandeveld, 'The Economics of Bilateral Investment Treaties' (2000) 41 Harv. Int'l L.J. 469, 488-91.

¹¹⁸ Beviglia Zampetti and Americo Sauvé Pierre, 'International Investment' in Andrew T. Guzman and Alan O. Sykes (eds), *Research handbook in international economic law* (Cheltenham 2007) 215.

¹¹⁹ Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (OUP 2008) 2; UNCTAD, World Investment Report (2006) XVII, 26.

¹²⁰ UNCTAD, World Investment Report 2003: FDI Policies for Development: National and International Perspectives 89; UN Doc UNCTAD/WIR/2003 (4 September 2003) stated that 2,181 BITs were in effect as of the end of 2002.

¹²¹ Jeswald W. Salacuse and Nicholas P. Sullivan, 'Do BITs really work? An evaluation of Bilateral Investment Treaties and Their grand bargaining' in Karl P. Sauvant and Lisa E. Sachs, *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (OUP 2009) ch 5.

¹²² The United Nations Conference on Trade and Development (UNCTAD), Bilateral Investment Treaties in the mid-1990s, annex I, 159-217; UN Doc UNCTAD/ITE/IIT/, UN Sales No. E98.II.D.8 (1998); ICSID, BILATERAL INVESTMENT TREATIES 1959-1996 (1997).

each other.¹²³ There are many reasons for the similarities. The use of the model, drafted by the developed states based on the 1967 Organization for Economic Co-operation and Development (OECD) Draft Convention on the Protection of Foreign Property, being the main one.¹²⁴ Developing states were keen on attracting the foreign investments¹²⁵ notwithstanding that initially they objected to the format of BITs, but have conceded to its use.

Treaties have a very long history, dating back to the Colonial era when they have concluded treaties of “Friendship, Commerce and Navigation” (FCN) to establish trade relations with its treaty partners. The first such agreement was the Treaty of Amity and Commerce,¹²⁶ negotiated with France in 1778.¹²⁷ Other agreements include Treaty of Amity and Commerce, with the Netherlands¹²⁸, Sweden¹²⁹ and Prussia.¹³⁰ Treaty of Peace and Friendship,¹³¹ Treaty of Amity, Commerce and Navigation,¹³² and Treaty of Friendship, Limits and Navigation.¹³³

Disputes between the foreign investors and host developing states were initially taken to the local courts.¹³⁴ Developed states concerns of the legal system and protection of their investments in the host developing states resulted in dispute resolution being conducted in front of international arbitration, which opened a new set of challenges.¹³⁵ The main

¹²³ See Ibrahim El. Shihata, Preface to Rudolf Dolzer and Margrete Stevens, *Bilateral Investment Treaties* (1995); see Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (2nd edn, CUP 2004) ch 3.

¹²⁴ See further Kenneth J. Vandeveld, *U.S. International Investment Agreements* (OUP 2009).

¹²⁵ See Kenneth J. Vandeveld, *Sustainable Liberalism and the International Investment Regime* (1998) 19 MICH. J. INT'L L. 373.

¹²⁶ U.S.-Fr., July 16, 1782, 8 Stat. 12.

¹²⁷ In 1776 Benjamin Franklin, Silas Dean and Arthur Lee were elected as agents of the diplomatic commission that will be sent to secure a formal alliance and negotiate a treaty between the United States and France.

¹²⁸ U.S.-Neth., Oct. 8, 1782, 8 Stat. 32;

¹²⁹ U.S.-Swed., Apr. 3, 1783, 8 Stat. 60;

¹³⁰ U.S.-F.R.G. (Prussia), July 9–Sept. 10, 1785, 8 Stat. 84;

¹³¹ U.S.-Morocco, June 23–July 6, 1786, 8 Stat. 100;

¹³² U.S.-G.B., Nov. 19, 1794, 8 Stat. 116;

¹³³ U.S.-Spain, Oct. 27, 1795, 8 Stat. 138; see Karl P. Sauvant and Lisa E. Sachs, *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (OUP 2009).

¹³⁴ See Chen Huiping, ‘The Investor-State Dispute Settlement Mechanism: Where To Go In The 21st Century?’ (2008) 9 *The Journal of World Investment & Trade*, 467, 467.

¹³⁵ Rodrigo Polanco Lazo, ‘International Arbitration in Times of Change: Fairness and Transparency in Investor-State Disputes’ (2010) 104 *American Society of International Law*, 591, 591.

reason was the need to revisit the negotiation process, change the drafting of BITs and include comprehensive treaty provisions, leaving no room for interpretations.¹³⁶

Many states stressed that international law does not offer adequate mechanisms to protect foreign investment.¹³⁷ For that reason states in Latin America adopted the Calvo doctrine, which enabled the foreign investors the treatments that were given to its own national investors¹³⁸ and required ‘aliens to submit disputes arising in a country to that country’s courts’.¹³⁹ In international law international minimum standards are binding as stated by the arbitral tribunal that ‘It should be kept in mind that the customary minimum standard is in any case binding upon a State and provides a minimum guarantee to foreign investors...’¹⁴⁰ ‘A state is not subject to the jurisdiction of an international tribunal without its consent’¹⁴¹ however many signed bilateral investment treaties (BITs) included provision that under the ICSID convention 1965 ‘Each Contracting Party hereby consents to submit’ to the ICSID¹⁴² ‘for settlement by conciliation or arbitration’ for ‘any legal disputes arising between that Contracting Party and a national or company of other Contracting Party concerning an investment of the latter in the territory of the former’.¹⁴³ This provision establishes unconditional consent of the parties to submit investment disputes before ICSID upon request of an investors, who is in this instance a national of

¹³⁶ Dispute settlement provisions are very common in the BITs and allow the foreign investors to take host states in front of the ICSID, which has been heavily criticised as being in favour of the foreign investors and also due to the numerous cases put in front of the international courts, unable to cope with the volume in respectable timely matter. The situation resulted in Bolivia, Ecuador and Venezuela terminating their BITs and withdrew from the ICSID, while Australia and India in their BITs and FTAs no longer use the ICSID, according to Ling Ling He, Razeen Sapideen, 'Investor-State Arbitration under Bilateral Trade and Investment Agreements: Finding Rhythm in Inconsistent Drumbeats' (2013) 47 *Journal of World Trade*, 215-216, see also August Reinisch, 'The Scope of Investor-State Dispute Settlement in International Investment Agreements' (2013) 21 *Asia Pacific Law Review* 3, 4.

¹³⁷ Ian Brownlie, *Principles of Public International Law* 527–28 (5th ed. 1998)

¹³⁸ Donald R. Shea, *The Calvo Clause: A Problem of Inter-American and International Law and Diplomacy* (1955) 17–20.

¹³⁹ Surya P Subedi, *International Investment Law* (3rd edn, Hart 2016) 30.

¹⁴⁰ *Saluka Investment BV (the Netherlands) v the Czech Republic*, para 292, Partial Award, IIC 210 (2006), 17 March 2006, Permanent Court of Arbitration (PCA).

¹⁴¹ *Reparation for Injuries Suffered in the Service of the United Nations*, Advisory Opinion, 1949 I.C.J. 174, 177–78 (April 11).

¹⁴² ICSID was primarily formed to protect foreign investors, by ensuring due process, non-discriminatory treatment, and compensation for expropriation and by enforcing the rule of law; see Steffen Hinderlang, 'Study on Investor-State Dispute Settlement (ISDS) and Alternatives of Dispute Resolution in International Investment Law' (2014) 2 *Study for European Parliament's Committee on International Trade* 39, 40 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2525063> accessed 25 February 2016.

¹⁴³ BIT, 13 February 1980 Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Sri Lanka for the Promotion and Protection of Investments, Article 8(1).

the other contracting state. The problem as it seems was in the fact that developing states did not negotiate terms and conditions for TNCs in the investment agreements.¹⁴⁴ Unfortunately there was no established mechanism in place to protect the foreign investment in host developing states, because during the colonial period there was no need for such mechanism. Therefore, the developing states should have developed one, which they did not seem to be able to do.

‘At its most basic level, a BIT is an agreement between two countries (Contracting States) that ‘governs the treatment of investments made in the territory of each state by individuals or companies from the other state’.¹⁴⁵ Wong argued that the driving force behind ever-increasing percentage of disputes over foreign investments are being resolved through international arbitration or domestic lawsuits is the proliferation of the bilateral investment treaties (BITs).¹⁴⁶

Salacuse and Sullivan argued that most of the BITs provide for two distinct dispute resolution systems, in addition to the obligations of the Contracting States, BITs also contain provision for dispute settlement system in the event of the violation of the treaty or investment contract(s)/agreement(s)¹⁴⁷ to allow investor-state dispute settlement.¹⁴⁸ According to Salacuse and Sullivan the first type of dispute arises between the two contracting states (state to state arbitration) and the second type of disputes arises between

¹⁴⁴ Samuel Flagg Bemis, *A Diplomatic History of the United States* (H.Holt and company 1942).

¹⁴⁵ 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’ (2006) 14(1) *George Mason Law Review* 135, 141; noting that all ‘BITs are remarkably similar in their organization and content’ and many BITs ‘cover both existing and future investments’; Rudolf Dolzer and Margaret Stevens, *Bilateral Investment Treaties* (Martinus Nijhoff 1995); UN Conference on Trade and Development (UNCTAD), *Bilateral Investment Treaties, 1959-1999*, Geneva, Switz., Dec. 2000, UN Doc UNCTAD/ITE/IIA/2; UNCTAD, *Bilateral Investment Treaties In The Mid-1990s*, Geneva, Switz., Nov. 1998, UN Doc UNCTAD/ITE/IIT/7; Kenneth J. Vandevelde, *United States Investment Treaties: Policy and practice* (Kluwer Law International 1992).

¹⁴⁶ Jarrod Wong, ‘Umbrella clause in Bilateral Investment Treaties: Of Breaches of Contract, Treaty Violations, and the Divide between Developing and Developed Countries in Foreign Investment Disputes’ (2008) 14 *George mason Law Review* 135.

¹⁴⁷ Contract is not the best word to be used and it would be better to use agreement instead. The reason is that the way the BITs are currently conducted are almost set to be breached and as such the consequences are severe and result into disputes, which outcomes could have damaging effects to all parties included, due to the fact that any breach of contract should not go unpunished. If agreements would have been conducted instead of the contract, there would not have been so many breaches. In addition, the re-negotiation clause in contract could have the same effect.

¹⁴⁸ Jeswald W. Salacuse and Nicholas P. Sullivan, ‘Do BITs really work? An evaluation of Bilateral Investment Treaties and Their grand bargaining’ in Karl P. Sauvant and Lisa E. Sachs, *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (OUP 2009) ch 5.

the host developing state and foreign investor, independent from their home country with their grievance against the host developing state directly to international arbitration.¹⁴⁹

Over the last 50 years a number of international investment treaties was signed in the form of bilateral investment treaties (BITs).¹⁵⁰ Developing states have been struggling to develop and overcome the transition period and were looking to take example from the developed states to which they have aspired. Intervention of TNCs into developing states and their contribution to socio-economic development received mixed reviews. That also bring into question the role of diplomatic intervention and peacekeeping missions, which contain coercive elements that should not have been used.¹⁵¹ If the parties making investment agreements would have been less ambitious the objectives would have been more realistically achieved and the possibility of socio-economic development would have been much greater and would avoid having dominance of any of the state over another. Durkheim maintained that there is no such thing as natural integration, only a coercive one.¹⁵²

Sornarajah argued that there is no added value or additional benefits that BITs bring to the table other than regulating the foreign investments.¹⁵³ Hinderlang¹⁵⁴ was one of the

¹⁴⁹ Dispute resolution and investment disputes could be avoided by implementing the re-negotiation clause. The main cause of disputes is the imbalance of interest and BITs tend to protect the interest of TNCs more than they protect the developing states. Another issue is also the lack of training for international lawyers dealing with such disputes resolutions and are fundamentally unable to identify the real causes of disputes, current or potential ones that might occur in the future. Re-negotiation clause could have avoided all of that. Moreover, the BITs should be contributing to the socio-economic development of the developing states and capacity building and where there is no such mechanism in place to review the impact of the TNCs activities on the developing states, there is no way to accurately estimate and make conclusions. For this reason, re-negotiation clause would have the ability not only to re-negotiate the agreement but firstly to review the progress of the agreement and compared with the set objectives and realistically evaluate the benefits of the agreement to both parties involved. Only on this ground it can be reviewed and decided upon the new terms of the arrangements.

¹⁵⁰ Efraim Chalamish, 'The Future of Bilateral Investment Treaties: A De Facto Multilateral Agreement?' (2009) 34 *Brooklyn Journal of International Law* 303, 309; Kenneth J. Vandeveld, 'The Economics of Bilateral Investment Treaties' (2000) 41 *Harv. Int'l L.J.* 469, 488-91.

¹⁵¹ Montevideo Convention on the Rights and Duties of States, signed on 26 December 1933.

¹⁵² Emil Durkheim coined the term "social fact" by 'a category of facts which present very special characteristics: they consist of manners of acting, thinking, and feeling external to the individual, which are invested with a coercive power by virtue of which they exercise control over him'. He argued that the concept of "ingenious system" introduced by Gabriel Tarde claiming that "general" is seen as a consequence and not as a cause of the coercive nature of Durkheim's social fact; see Emil Durkheim, *The Rules of Sociological method* (W.D. Halls tr, The Macmillan Press Ltd. 1982) 52.

¹⁵³ Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (2nd edn, CUP 2004) ch 3.

¹⁵⁴ Steffen Hinderlang, 'Study on Investor-State Dispute Settlement (ISDS) and Alternatives of Dispute Resolution in International Investment Law' (2014) 2 *Study for European Parliament's Committee on International Trade* 39, 56.

critics of investor-state dispute settlement (ISDS), together with the host developing states.¹⁵⁵ As a response to the criticism the UNCTAD proposed some reforms in 2013 Report, one of which is re-negotiating concluded investment agreements.¹⁵⁶

Salacuse and Sullivan claimed that investors take treaties into consideration before making their investment choice.¹⁵⁷ According to Neumayer and Spess,¹⁵⁸ empirical research showed that developing states that sign numerous BITs can count on doubling their foreign investments. On the other hand, Tobin and Rose-Ackerman¹⁵⁹ claimed that BITs do not have much, if any, positive effect on foreign investment. Moreover, their study from 2005 showed that BITs may actually reduce foreign investments to host developing states. The relationship issues between the host developing state and foreign investor has been ongoing since Vernon¹⁶⁰ “obsolescing bargain”, through “credible commitment” by North¹⁶¹ and as “political risk” by Henisz.¹⁶² Muchlinski¹⁶³ argued that BITs make promises in the form of vague standards and uncertain meaning and hence the

¹⁵⁵ There is a sense of hostility towards the ISDS on a number of issues, such as the fair and equitable treatment, which allows the foreign investors to use the third party tribunal but not the domestic investors. The same applies to the relationship between the foreign investor and the host developing states’ government, while the foreign investor can sue the government, it is not a two-way process and the government cannot sue the foreign investor in case of misconduct. See further the case of Indonesia and its Open pit mines; see Paul Jepson, James K. Jarvie, Kathy MacKinnon and Kathryn A. Monk, ‘The End for Indonesia’s Lowland Forests?’ *Science* (Vol 292, Issue 5518, 4 May 2001) <<http://science.sciencemag.org/content/292/5518/859.full>> accessed on 25 February 2016; see *Pac Rim v El Salvador*, ICSID Case No ARB/09/12 (dismissed jurisdiction) <<http://icsidreview.oxfordjournals.org/content/28/1/15.short>> accessed 25 February 2016; see Organization of Economic Cooperation and Development, *Investor-State Dispute Settlement, Summary report by expert at 16th Freedom of Information Roundtable (OECD) 2012* <<http://www.oecd.org/daf/inv/investment-policy/50241347.pdf>> accessed 25 February 2016.

¹⁵⁶ UNCTAD, ‘Reform of Investor-State Dispute Settlement: In Search of a Roadmap’ (United Nations 2013) 4-10 <http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d4_en.pdf> accessed 26 February 2016.

¹⁵⁷ Jeswald W. Salacuse and Nicholas P. Sullivan, ‘Do BITs really work? An evaluation of Bilateral Investment Treaties and Their grand bargaining’ in Karl P. Sauvant and Lisa E. Sachs, *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (OUP 2009) ch 5.

¹⁵⁸ Eric Neumayer and Laura Spess, ‘Do bilateral investment treaties increase foreign direct investment to developing countries?’ (2005) 33 *World development* 1567–1585.

¹⁵⁹ Jennifer L. Tobin and Susan Rose-Ackerman, ‘Foreign Direct Investment and the Business Environment in Developing Countries: the Impact of Bilateral Investment Treaties’ (William Davidson Institute Working Paper No 587 2003).

¹⁶⁰ Raymond Vernon, *Sovereignty at Bay: The multinational spread of US enterprises* (Basic Books 1970).

¹⁶¹ Douglas C. North, *Institutions, institutional change and economic performance* (CUP 1990).

¹⁶² Wrold Jerzy Henisz, Oliver Williamson, *Politics and International Investment: Measuring Risks and Protecting Profits* (Edward Elgar Publishing 2002).

¹⁶³ Peter T. Muchlinski, ‘The Framework of Investment Protection: The Content of BITs’ in Karl P. Sauvant and Lisa E. Sachs, *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (OUP 2009) ch 2.

need for arbitration to give meaning to the treaty language. UNCTAD reported that BITs signed between Switzerland with Egypt and Sudan was one of the very few to have concretely defined the sector for promotion and protection of the foreign investment, which was ‘production, commerce, tourism, and technology’.¹⁶⁴ The preamble to the Korea-Trinidad and Tobago BIT, of 2002 provides *inter alia* that ‘Convinced that these objectives can be achieved without relaxing health, safety and environmental measures of general Application’,¹⁶⁵ and the US-Uruguay BIT that was signed in 2005 stated that ‘Desiring to achieve these objectives in a manner consistent with the protection of health, safety, and the environment, and the promotion of consumer protection and internationally recognized labour rights’.¹⁶⁶ Most of the BITs have fairly the same structure, in their preambles they set down the general objectives and purpose and hence the suggestion would be to make the preambles clearer and more specific as to their purpose on the case by case examples.

Muchlinski also stressed that there are no international standards that could force a state to allow private foreign investment if they so wish, because ‘countries are free to set the limits of permissible entry in their national laws as they see fit’¹⁶⁷ and their sovereign power enables them to regulate the entry of foreign investors. Entering into a country with private foreign investment according to Gómez-Palacio and Muchlinski can be done via two models, one is “controlled entry” and the other is “full liberalization”. In the former the host state controls the entry of private foreign investments and in the latter non-discrimination standards applies, which include also the most-favoured-nation (MFN) and fair and equitable treatment (FET) standards.¹⁶⁸ Lavieć argued that the reference to fair and equitable treatment (FET) should not be interpreted as international minimum standards.¹⁶⁹ BITs usually contain the two most common standards of

¹⁶⁴ UNCTAD, *Bilateral Investment Treaties in the Mid 1990s* (UN 1998) 31.

¹⁶⁵ Korea – Trinidad and Tobago BIT, 2002 < <http://investmentpolicyhub.unctad.org/Download/TreatyFile/1838>> accessed 15 February 2016.

¹⁶⁶ US – Uruguay BIT, 2005 < <http://investmentpolicyhub.unctad.org/Download/TreatyFile/2380>> accessed 16 February 2016.

¹⁶⁷ Peter T. Muchlinski, ‘The Framework of Investment Protection: The Content of BITs’ in Karl P. Sauvant and Lisa E. Sachs, *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (OUP 2009) 3.

¹⁶⁸ See Ignacio Gómez-Palacio and Peter T. Muchlinski, ‘Admission and establishment’ in Peter T. Muchlinski, Federico Ortino and Christoph Schreuer (eds), *Oxford Handbook of International Investment Law* (OUP 2008) ch 7, 240.

¹⁶⁹ Jean-Pierre Lavieć, *Protection et promotion des investissements: Etude de droit international économique* (Geneva: Publications de l’Institut Universitaire de Hautes Etudes Internationales 1985) 331.

treatment, one is most-favoured-nation treatment and the second is fair and equitable treatment.¹⁷⁰

Critical analysis of some of the BITs examined some of the selected provisions, which will support the ideas developed in this research. The BITs signed between the UK with Bangladesh¹⁷¹ and the US with Bangladesh¹⁷² as an example to show that there is not much difference between the BITs. Namely some of the provisions that will be closely reviewed will reveal that there is no difference in the provisions between the two, notwithstanding the differences between the states. The latter questions the contribution of BITs to the developing states and suggests that there should be noticeable differences in the provisions between the two and should include additional provisions that might be taken for granted by the developed states. Bergstrand and Egger¹⁷³ argued that the main purpose of BITs is encouraging private foreign investment. However, the contribution of BITs namely for host developing states is inconclusive¹⁷⁴ and yet the number of signed BITs was growing.¹⁷⁵

¹⁷⁰ FET is a form of *lex specialis*, which is found in many but not all of the investment treaties. However it is important to note that the circumstances play a crucial role in this respect because the tribunal will respect the treaty text and rules of international law. *Saluka Investment BV (Netherlands) v Czech Republic* partial award, ICC 210 (2006), 17 March 2006, Permanent Court of Arbitration (PCA) <<http://ita.law.uvic.ca/documents/Saluka-PartialawardFinal.pdf>> accessed 20 February 2016 tribunal stated that ‘There is agreement between the parties that the determination of the legal meaning of the “fair and equitable treatment” standard is a matter of appreciation by the Tribunal in light of all relevant circumstances’. In *Mondev International Ltd v United States*, ICSID Case No ARB(AF)/99/2, NAFTA Ch 11 Arbitral Tribunal, 11 October 2002 (2003) 42 ILM 85, stated that ‘a judgment of what is fair and equitable cannot be reached in the abstract; it must depend on the facts of the particular case’.

¹⁷¹ UK – Bangladesh BIT, 1980 <<http://investmentpolicyhub.unctad.org/Download/TreatyFile/277>> accessed 16 March 2016.

¹⁷² US – Bangladesh BIT, 1986 <<http://investmentpolicyhub.unctad.org/Download/TreatyFile/278>> accessed 16 March 2016.

¹⁷³ Jeffrey H. Bergstrand and Peter Egger, ‘What determines BITs?’ (2013) 90(1) *Journal of International Economics* 107-122.

¹⁷⁴ Based on the empirical evidence by Todd Allee, and Clint Peinhardt, ‘Contingent Credibility: The Reputational Effects of Investment Treaty Disputes on Foreign Direct Investment’ (2011) 65(3) *International Organization* 1-26; Andrew Kerner, ‘Why should I Believe You? The Costs and Consequences of Bilateral Investment Treaties’ (2009) 53(1) *International Studies Quarterly* 73-102; Lisa E. Sachs and Karl P. Sauvant, ‘BITs, DTTs, and FDI flows: An overview’ in Karl P. Sauvant and Lisa E. Sachs, *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (OUP 2009); Jennifer L. Tobin and Susan Rose-Ackerman, ‘When BITs have some bite: The political-economic environment for bilateral investment treaties’ (2011) 6(1) *Review of International Organizations* 1-31.

¹⁷⁵ See Beth A. Simmons, ‘Bargaining over BITs, arbitrating awards: The regime for protection and promotion of international investment’ (2014) 66(1) *World Politics* 12-46.

The UK has signed the BIT with the People Republic of Bangladesh with ‘Desire to create favourable conditions for greater investment by nationals and companies of one State in the territory of the other State’ added that:

Recognizing that the encouragement and reciprocal protection under international agreement of such investments will be conducive to the formulation of individual business initiative and will increase prosperity in each States; ¹⁷⁶

In the BIT between the UK and Bangladesh provision has been made ‘for the Promotion and Protection of Investments’ one cannot help but wonder how the protection of investment can be applied equally for the UK investments in Bangladesh as the Bangladesh investments are protected¹⁷⁷ in the UK as discussed in the AAPL case.¹⁷⁸ The High Commission for Bangladesh London reports that the biggest source of FDI for Bangladesh is coming from the UK, which amounted to 88.08 million USD in 2009, out of total FDI to Bangladesh 700.16 million USD. Majority of British investment go to oil, gas, textile, tea, financial and other service sectors. The reason is that ‘Bangladesh offers the most liberal investment climate in South Asia’.¹⁷⁹ The Foreign Private Investment (Promotion and Protection) Act 1980, which deals with promotion and protection of investment in Bangladesh, ‘ensures equal treatment for local and foreign investors and legal protection to foreign investment in Bangladesh against nationalisation and expropriation’.¹⁸⁰

BIT signed between the US and Bangladesh stated that: ‘Desiring to promote greater economic cooperation between them, with respect to investment by nationals and companies of one Party in the territory of the other Party; and:

¹⁷⁶ BIT The United Kingdom and Government of the People’s Republic of Bangladesh, 19 June 1980.

¹⁷⁷ See John H. Dunning and Rajneesh Narula, *Foreign Direct Investment and Governemnts: Catalysts for Economic Restructuring* (Routledge 1996) 36.

¹⁷⁸ AAPL case is discussed and referred to in fn334 ch4.5 at 222.

¹⁷⁹ High Commission for Bangladesh, London < <http://www.bhclondon.org.uk/InvestInBangladesh.html>> accessed 16 February 2016.

¹⁸⁰ Trade and investment opportunities in Bangladesh, *Business recorder* (26 March 2013) <<http://www.brecorder.com/supplements/0:g/1167586:trade-and-investment-opportunities-in-bangladesh?date=2013-03-26>> accessed 16 January 2016, see Board of Investment of Bangladesh <www.boi.gov.bd> accessed 16 January 2016.

Recognizing that agreement upon the treatment to be accorded such investment will stimulate the flow of private capital and the economic development of the Parties'; the provision is referring to the economic development of both parties for which there is no clear definition of the sort of economic development nor monitoring to check that in fact such economic development has indeed taken place.¹⁸¹

As seen from the above examples there is not much variation among the terminology used, unless the contracting parties decide to clearly specify the sectors for which the protection and promotion of the investment applies or a specific public policy, goals such as protection of health, safety, environment, consumers or promotion of labour rights.¹⁸² The main element of the treaty is the provision defining the terms and the scope. The following provision of the BITs is usually concerned with definitions. Newer BITs also include intellectual property rights in addition to assets and equity in order to capture the non-equity investments. However, the entry restrictions have not extended to the “performance requirements” other than in the US-Albania BIT by ‘prohibiting four specific types of performance requirements’¹⁸³ that were negotiated during the negotiation process.

The following provision focuses on the fact that states are free to set their own entry limits as well as their national laws.¹⁸⁴ The “full liberalisation” model implies the non-discrimination standards, which can be seen in the US – Uruguay¹⁸⁵ and Canada and Uruguay¹⁸⁶ BITs for example.

Regarding the ‘Promotion and Protection of Investments’ in the UK-Bangladesh BIT as stated in Article II:

¹⁸¹ US – Bangladesh BIT, 1986.

¹⁸² Peter T. Muchlinski, ‘The Framework of Investment Protection: The Content of BITs’ in Karl P. Sauvant and Lisa E. Sachs, *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (OUP 2009) ch 2.

¹⁸³ See the US – Albania BIT, 11 January 1995, Art VI of Treaty Concerning the Encouragement and Reciprocal Protection of Investment.

¹⁸⁴ See Ignacio Gómez-Palacio and Peter T. Muchlinski, ‘Admission and establishment’ in Peter T. Muchlinski, Federico Ortino and Christoph Schreuer (eds), *Oxford Handbook of International Investment Law* (OUP 2008) ch 7.

¹⁸⁵ The United States of America and The Oriental Republic of Uruguay, 4. November 20005 <<http://investmentpolicyhub.unctad.org/Download/TreatyFile/2380>> accessed 20 February 2016.

¹⁸⁶ The Government of Canada and The Oriental Republic of Uruguay, 29 October 1997 <<http://investmentpolicyhub.unctad.org/Download/TreatyFile/642>> accessed 20 February 2016.

Each Contracting Party shall encourage and create favourable conditions for nationals or companies of the other Contracting Party to invest capital in its territory, and, subject to its right to exercise powers conferred by its laws existing when this Agreement enters into force, shall admit such capital.¹⁸⁷

As seen from the above article the main objective of BIT is to encourage and create favourable investment conditions, which adds a layer of protection and provides for a legal remedy through international arbitration. Initially BITs were intended to stimulate socio-economic development, which should also protect investment with higher standards. All signed BITs include fairly the same provisions on creating favourable investment conditions, including protecting the private foreign investment against any mistreatment or violation of BITs.

Article (2) provides *inter alia* that parties ‘shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Contracting Party’.¹⁸⁸

Fair and equitable treatment is the most common article included in the BITs, together with “full protection and security”. These provisions accord higher protection for the foreign investors than those of international law. The other common provision of BITs is most-favoured-nation treatment (MFN), which grants foreign investors the same standards as it would to its own nationals or no less favourable to any other nation.

Developing states are free to set their own entry restrictions for foreign investments that are subject to international minimum standards under international customary law and additional treatment standards under BITs. Such treatments are known as the obligation of the host developing state to foreign investors. Full protection and security and fair and equitable treatment are considered to be absolute in their nature. While most-favoured-nation treatment is not, because the treatment depends on the situation and state discretion, as such is therefore relative. Strict liability also applies as in *AAPL* case¹⁸⁹ for example.

¹⁸⁷ UK – Bangladesh BIT, Art II (1).

¹⁸⁸ UK – Bangladesh BIT, Art II (2).

¹⁸⁹ *Asian Agricultural Products Ltd. (AAPL) v Republic of Sri Lanka*, ICSID Reports 254, final award of 27 June 1990, discussed in fn336, ch4.5 at 220.

In the US – Bangladesh BIT on article II stated on Treatment of Investment:

Each Party shall maintain favourable conditions for investment in its territory by nationals and companies of the other Party. Each Party shall permit and treat such investment, and activities related therewith, on a basis no less favourable than accorded in like situations to investment or related activities of its own nationals or companies, or of nationals or companies of any third country, whichever is the more favourable...¹⁹⁰

As seen in the previous BIT of UK – Bangladesh the articles 1 are very similar in its contents with the US – Bangladesh BIT, which in Article 3 provides that:

Investment of nationals and companies of either Party shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Party. The treatment, protection and security of investment shall be in accordance with applicable. National laws, and shall in no case be less than that required by international law. Neither Party shall in any way impair by arbitrary and discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investment made by nationals or companies of the other Party...¹⁹¹

Fair and equitable treatment is the most common and mandatory standard of BITs.¹⁹² Notwithstanding the compulsory nature of the FET standard it remains open to interpretations. While the host developing state cannot be accountable and liable for all injuries, but only when due diligence was not followed or if the government did not take reasonable measure to protect the foreign investor.¹⁹³ The terminology of reasonable and unreasonable is also ambiguous.

The most-favoured-nation protection of investments and investors as in examples below. Some countries even extend the clauses to prior investments made, before the BIT was signed, however not all. The UK – Bangladesh BIT includes provision on MFN treatment in Article 3.

¹⁹⁰ US – Bangladesh BIT, Art 2 II (1).

¹⁹¹ US – Bangladesh BIT Art 3.

¹⁹² See M. I. Khalil, 'Treatment of Foreign Investment in Bilateral Investment Treaties' (1992) 7 ICSID Rev – FILJ 339; UNCTC, Bilateral Investment Treaties (UN Doc ST/CTC/65 1988); Rudolf Dolzer, 'Fair and Equitable Treatment: A key standard in investment treaties' (2005) 39 Int'l Law 87.

¹⁹³ APPL v Sri Lanka case is an example.

UK-Bangladesh states in Article 4 on Compensation for Losses:

Nationals or companies of one Contracting Party whose investments in the territory of the other Contracting Party suffer losses owing to war or other armed conflict, revolution, a state of national emergency, revolt, insurrection or riot in the territory of the latter Contracting Party shall be accorded by the latter Contracting Party treatment, as regards restitution, indemnification, compensation or other settlement, no less favourable than that which the latter Contracting Party accords to its own nationals or companies or to nationals or companies of any third State.¹⁹⁴

As seen from the above article, compensation is due in cases when damages or losses occur. The BIT further states if the foreign investor ‘suffer losses in the territory of the other Contracting Party resulting from:

- (a) requisitioning of their property by its forces or authorities, or
- (b) destruction of their property by its forces or authorities, which was not caused in combat action or was not required by the necessity of the situation, shall be accorded restitution or adequate compensation. Resulting payments shall be freely transferable as soon as possible.¹⁹⁵

Compensation for losses can be due to armed conflict or internal disorder and it is a clause that most of the BITs contain, however not as an absolute right but more of a treatment such as the most-favoured-nation treatment in terms of just and appropriate¹⁹⁶ compensation payment. These standards however have not been universally accepted. A large number of BITs include ‘just’ or ‘appropriate’ compensation payment following NAFTA and the UN.¹⁹⁷ However a number of BITs include full compensation payment, which means ‘prompt, adequate and effective’, but as stated earlier neither has been universally agreed.¹⁹⁸ Most BITs do include free transfer of compensation. The clause on “full security and protection” covers physical integrity of an investment against interference by use of force.

¹⁹⁴ UK – Bangladesh, Art 4 (1).

¹⁹⁵ UK-Bangladesh BIT Art 4.

¹⁹⁶ UK-India BIT 1994, Netherlands-Poland BIT Art. 5.

¹⁹⁷ UNGA Res 1803 of 1962, Permanent Sovereignty over natural resources, Article 4.

¹⁹⁸ Canada – Peru BIT 2006, Art. 13.

US-Bangladesh states in Article 3 on Compensation for expropriation:

No investment or any Part of an investment of a national or a company of either Party shall be expropriated or nationalized by the other Party or subjected to any other measure or series of measures, direct or indirect tantamount to expropriation (including the levying of taxation, the compulsory sale of all or part of an investment, or the impairment or deprivation of its management, control or economic value), all such actions hereinafter referred to as "expropriation", unless the expropriation:

- (a) is done for a public purpose;
- (b) is accomplished under due process of law;
- (c) is not discriminatory;
- (d) does not violate any specific provision on contractual stability or expropriation contained in an investment agreement between the national or company concerned and the Party making the expropriation; and
- (e) is accompanied by prompt, adequate¹⁹⁹ and effective compensation. Compensation shall be equivalent to the fair market value of the investment...²⁰⁰

This provision of BIT is specific on its stands against taking, with some exceptions as seen in the above provisions also support non-discrimination. The rulings of tribunals on expropriations have been mixed. There was not a unified rule that could be applied to the expropriation exemptions as it depends heavily on the circumstances under which expropriation or nationalisation took place.

In the following article of the same BIT it states that:

If either Party expropriates the investment of any company duly incorporated, constituted or otherwise duly organized in its territory, and if nationals or companies of the other Party, directly or indirectly own, hold or have other rights with respect to the equity of such company, then the Party within whose territory the expropriation occurs shall ensure that such nationals or companies of the other Party receive compensation in accordance with the provisions of the preceding paragraph.²⁰¹

One of the main objectives of BITs is protection of foreign investments from taking or other interference with property rights.²⁰² Taking of an investment is considered violation

¹⁹⁹ The term adequate is used by the developed countries as the term suggests.

²⁰⁰ US – Bangladesh BIT Art 3(1).

²⁰¹ US – Bangladesh BIT Art 3(2).

²⁰² Most of the BITs follow the Hull formula, see for example Green Haywood Hackworth, 'Property Rights: General Considerations' (1942) 3 Digest of International Law 655-665.

of customary international law even when there is no such provision in the BITs or when no BIT is signed. The core provision of BITs are the standards of treatment. The investor states were the one that have requested the clause to be included in the BITs in order to protect against taking of assets owned by foreign investors. Muchlinski argued that ‘sovereignty-oriented challenges appear to have been mitigated and replaced by an acceptance of international standards of treatment’.²⁰³

Disputes between the parties are usually done via negotiations or ad hoc arbitration. Negotiation process between the developing and developed states became more and more relevant in the sphere of international trade for conducting transnational business.

While the USA – Bangladesh BIT states in Article II regarding Treatment of Investment:

Each Party shall maintain favourable conditions for investment in its territory by nationals and companies of the other Party. Each Party shall permit and treat such investment, and activities related therewith, on a basis no less favourable than accorded in like situations to investment or related activities of its own nationals or companies, or of nationals or companies of any third country, which is the more favourable.²⁰⁴

BIT ‘treaty between the United States of America and the people Republic of Bangladesh concerning the reciprocal encouragement and protection of investment’ was signed in 1986 and came into force in 1989. The concern is over the use of the term reciprocity used in the BITs between developed and developing states as there is little evidence to support that reciprocity between developed and developing states exist.

The purpose of BITs to promote greater economic co-operation, stimulating the flow of private capital as well as economic development and more importantly should be based on reciprocity. However, the BIT between USA and Bangladesh it also states in Article I (ii) ‘Each party reserves the right to deny to any of its own companies or to a company of the other Party the advantages of this Treaty’.

²⁰³ Peter T. Muchlinski, Federico Ortino and Christoph Schreuer (eds), *Oxford Handbook of International Investment Law* (OUP 2008) 4.

²⁰⁴ US – Bangladesh BIT, 1986 Art 2(1); See for example UK, US spot problems for investing in Bangladesh, bdnews24.com (22 October 2014) <<http://bdnews24.com/business/2014/10/22/uk-us-spot-problems-for-investing-in-bangladesh>> accessed 15 October 2015.

The role of law in this case should be set to protect the interest of the developing states on the same level as it does developed states and foreign investors. It should therefore not allow the developing states to sign and commit to the investment agreements that do not include the clear and specific provisions on the benefits for the developing states, such as capacity building, succession clause, re-negotiation clause, distribution of profits and performance review. The role of law should therefore work on the behalf of the developing states and should protect them more from hazards, namely environmental and not allow exploration of their natural resources or labour force. For that purpose, the terminology used in BITs should also be reviewed. Rich and developed states aspirations should be reviewed, because they expect the developing states to not only act but to be the same as the developed states are, which is fundamentally not possible and questions the feasibility of reciprocity.

The role of law should also include the protection of people, that is the local people of the developing state in order to ensure their involvement in the decision making process and management participation, which should be included in the number of local senior executives as well as the number or percentage of local people employed by the foreign company and more importantly to be involved in capacity building as the main objective. It is important to review the contribution of TNCs to the developing states in which they operate in a balanced way as the existing reviews came to mixed conclusions on the contribution of TNCs activities in terms of capacity building in host developing states.

The role of the most favoured nation treatment is supposed to ensure a better standards of protection. Schwarzenberger maintained that international minimum standards are needed and should apply to foreign investors. Notwithstanding that some states negotiated lower custom duty rates or another benefit, which fell under the WTO, the state that granted such special treatment is not allowed to discriminate and should therefore offer any such special treatment to all other WTO members. Hence the MFN treatment has been a subject of strong criticism. On the basis of the MFN treatment and Hull standards states could potentially argue for higher compensation payment.²⁰⁵ Dolzer

²⁰⁵ UNCTAD (1999). Most-Favoured-Nation Treatment. UNCTAD Series on Issues in International Investment Agreements (New York and Geneva: United Nations), United Nations publication, Sales No. E.99.II.D.11.

and Stevens²⁰⁶ maintained that fair and equitable standards of treatment carries obligation to full compensation payment and not appropriate as it should.

The biggest criticism of BITs provisions is the questionable reciprocity, which should be a two-way process by which both parties would derive benefits from signing such investment agreements, however as it seems BITs were favouring foreign investors over host developing states. Therefore, the balance has to be found in order for both parties to equally benefit.

3.5 Controlling foreign investments through BIT provisions and general treatment standards

Since the Second World War the question of rules governing the behaviour of TNCs has been on the table for discussion. The negotiations however only began in the 1970s with the UN Codes of Conduct on TNCs. The assets of TNCs are protected under the international law, investment treaties or customary international law. However, the obligations of TNCs are not yet clearly defined by the force of law in terms of their legally binding obligations.

It was not only the scholars, but the United Nations itself who were very much aware of the global business practices that could harm the international socio-economic development, especially of the least developed countries (LDCs).

Investment has been defined from the profit making standing point and not with capacity building in mind. Each of the concluded BITs are concerned by transfer of profits and therefore lack human element. BITs do not mention that domestic law of host developing states will be the law to resolve any disputes that might arise between developing state and foreign investors. This leads to believe that TNCs do not have the confidence or faith in their judiciaries. BITs give international law to settle any disputes that arises, which is opposite to the main element of the Calvo doctrine.

²⁰⁶ Rudolf Dolzer and Margaret Stevens, *Bilateral Investment Treaties* (Martinus Nijhoff 1995).

However, if the government of the host developing state changes, the BITs will stay in force provided a succession clause has been incorporated into the BIT or the State Contract. The question therefore is what happens when states dissolve. Such examples have been seen recently in Timor and Sudan. From the legal perspective the BITs would have to be modified as the BIT that has been signed with a state that no longer exists and therefore would have to be re-negotiated with the new state(s).

Under international law states have the right to regulate and control the entry and activities in their sovereign territory. It is economic right of a states and its discretion to allow foreign investment in their territory.²⁰⁷ Sovereign states have full authority to decide on the restrictions that they will impose on the foreign investments within the state.²⁰⁸ Legislative jurisdiction give the states the right to evaluate the importance of foreign investments and its implications on the socio-economic development and well-being of their citizens, notwithstanding the potential risks that such foreign investment might entail. Hence the investment laws of a state must be created with the potential risks in mind to control the activities of foreign investor inside their borders as well as codes of conduct and some additional policies. This is especially important when the developing states are trying to attract and promote foreign investment.²⁰⁹

Sornarajah maintained that:

[T]here is now an increasing expectation, particularly among developing countries and non-governmental organisations (NGOs), that home states of multinational corporations should exert control over the activities of their corporate nationals operating overseas.²¹⁰

It is expected from the developed states that they will take over the control of their TNCs and their operations abroad, especially in terms of legal control over their actions. ‘The argument is that it is therefore incumbent on the home state to ensure that these benefits

²⁰⁷ See further Ian Brownlie, *Principles of Public International Law* (6th edn, OUP 2003) 498.

²⁰⁸ See Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (2nd edn, OUP 2012).

²⁰⁹ See Jeswald W. Salacuse, ‘Host Country regulation and Promotion of Joint Ventures and Foreign Investment’ in David N. Goldsweig and Roger H. Cummings (eds), *International Joint Ventures: A Practical Approach to Working with Foreign Investors in the U.S. and Abroad* (Amer Bar Assn 1990) 107-136.

²¹⁰ Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (3rd edn, CUP 2010) 144.

are not secured through injury to other states or to the welfare of the international community as a whole'.²¹¹ It is important to bear in mind that while states have rights they also have duties.

Developing states have expressed their aspirations and maintained *inter alia* that:

Multinational Enterprises should strictly abide by all domestic laws and regulations in each and every aspect of the economic and social life of the host members in their investment and operational activities.²¹²

Developing states called for TNCs to respect domestic laws and regulations as a dominant legal system. The involvement of government was recognised as being of crucial importance to ensure that TNCs are respecting and following the domestic regulations with the role to 'undertake obligations, including to ensure that the investor's behaviour and practices are in line with and contribute to the interests and development policies'.²¹³ The main objective was very clear and that is contribution of foreign investment to the socio-economic development of the host state, effectively contributing to the capacity building. A balanced manner was specified as the way forward for cooperation between TNCs and host developing states in order to create mutually beneficial investment agreements. The most important observation was that government of host developing states have to address the obligations of private foreign investment vis-à-vis host developing state in a balanced way.

Sornarajah maintained that:

[T]he subject can ever be discussed without taking into account the responsibility of the multinational corporations or the responsibility of their host states to ensure that they are held accountable for the violations of norms relating to their conduct in several areas such as human rights or the environment.²¹⁴

²¹¹ Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (3rd edn, CUP 2010) 144.

²¹² WT/WGTI/W/152 (2003), this document is available on the WTO website.

²¹³ WT/WGTI/W/152 (2002)

<http://commerce.nic.in/trade/international_trade_papers_nextDetail.asp?id=105> accessed 25 May 2016.

²¹⁴ Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (3rd edn, CUP 2010) 145.

In spite of the existing prohibition of TNCs to get involved in the political affairs of host developing states, there were speculations that TNCs have interfered. As a reference point it is often the engineered coup that overthrows the democratically elected presidents.²¹⁵ Investment laws vary between developing and developed states. As an example the US with strong liberal economic politics have restricted foreign investment in some industries such as commercial aviation, telecommunication, maritime industry, and real-estates.²¹⁶

There is a noticeable difference between investment laws among states, which also tends to change over time. Between the years 1991 and 2002 there was a strong trend towards liberalisation ‘Despite growing concerns and political debate over rising protectionism, the overall policy trend continues to be toward greater openness towards FDI’.²¹⁷ In spite of liberalisation trend there was still great suspicion regarding the complete liberalisation for foreign investment for obvious reasons concerning national security, competition, safety, environment, health issues and effect on society. All of the above had significantly influenced the negotiation process, which was leaning in support of removing the barriers of foreign investments. Foreign investment was promised to contribute to socio-economic development on a global scale, which is the reason that all investment treaties have in their title or preamble to either “promote” or “encourage” Protection of Investment. There is also provision known as “admission clause” which means that the investor has to comply with the host developing state’s laws and regulations when such clause exists.²¹⁸

²¹⁵ See M. Lippmann, ‘Multinational Corporations and Human Rights’ in Ved Nanda and George W. Shepsher (eds), *Human Rights and Third World Development* (Praeger 1985); Barbara A. Frey, ‘The Legal and Ethical Responsibilities of Transnational Corporations in the Protection of International Human Rights’ (1997) 6 *Minnesota Journal of Global Trade* 153; see David Weissbrodt and Marci Hoffman, ‘The Global Economy and Human Rights: A Selective Bibliography’ (1997) 6 *Minnesota Journal of Global Trade* 189; Martin A. Geer, ‘Foreigners in Their Own Land: Cultural Land and Transnational Corporations—Emergent International Rights and Wrongs’ (1998) 38 *Virginia Journal of International Law* 331. For a denial of a linkage between human rights violations and multinational corporations, see William H. Meyer, ‘Human Rights and MNCs: Theory Versus Quantitative Analysis’ (1996) 18 *Human Rights Quarterly* 368. A survey of the subject may be found in Michael K. Addo (ed), *Human Rights Standard and the Responsibility of Transnational Corporations* (Martinus Nijhoff 2012); and Nicola Jägers, *Corporate Human Rights Obligations: In Search of Accountability* (Intersentia 2002).

²¹⁶ See for example Roger H. Cummings, ‘United States Regulations of Foreign Joint Ventures and Investment’ in David N. Goldsweig and Roger H. Cummings (eds), *International Joint Ventures: A Practical Approach to Working with Foreign Investors in the U.S. and Abroad* (1990) 137, 139.

²¹⁷ UNCTAD, *World Investment Report 2008*, 11. See also UNCTAD, *World Investment Report 2003: FDI Policies for Development: National and International Perspective 2003*; World Bank, *World Development Report 2005: A Better Investment Climate for Everyone 2004*.

²¹⁸ See UNCTAD, *Bilateral Investment Treaties 1995 – 2006: Trends in Investment Rulemaking* (2007). See also *Agnus del Tunari SA v Bolivia*, ICSID Case No ARB/02/3 decision on respondent’s objections to jurisdiction 21 October 2005 stating that ‘the obligation to admit investments was subject to the decision of Bolivia to exercise powers conferred by its laws or regulations’ and ruled in favour of Bolivia; another example of such clause is *Fraport AG Frankfurt Airport Services Worldwide v Philippines*,

The two types of entry seen negotiated in the BITs as mentioned earlier is the controlled entry model in which the local law prevails and the liberalised entry model, in which the treatment is no less favourable to the investor from third party than it is to the nationals as seen in the US – Uruguay BIT.²¹⁹

Foreign investors would like to protect their investments inside the host developing states from any risks that might occur during the course of their investment. For that purpose, the general standards of treatment are used to restrict the governments of developing states to act irrationally and violate these standards for which the compensation must be paid in case injuries occur. These general standards of treatment include fair and equitable treatment, full protection and security, most-favoured-nation treatment and national treatment in accordance with international law. The most important thing to note is ‘that while investment treaties specify standards for state behaviour towards investors, they generally do not impose standards for the behaviour of investors towards the host country or its government’.²²⁰ In NAFTA Article 1105 it is stated that ‘Each Party shall accord to investment of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security’.²²¹

There were some discussions regarding the “fair and equitable treatment” ‘whether the fair and equitable treatment mandated by the Treaty is a more demanding standards than that prescribed by customary international law’ the tribunal concluded that ‘the BIT standards was not different from the minimum standard required under customary international law concerning both the stability and predictability of the legal and business framework of the investment’.²²²

The question remains if the two standards are part of customary international law, should they be included separately in the BITs.²²³ In *Pope & Tablot*²²⁴ case, the tribunal discussed in length the relationship between customary international law and NAFTA Article 1105.

ICSID Case No ARB/03/25 Award 16 August 2007

<<http://www.italaw.com/documents/FraportAward.pdf>> accessed 25 February 2016.

²¹⁹ UNCTAD, *Bilateral Investment Treaties 1995 – 2006: Trends in Investment Rulemaking* (2007).

²²⁰ Jeswald W. Salacuse, *The Law of Investment Treaties* (OUP 2013) 206.

²²¹ NAFTA, Article 1105(1) Minimum Standard of Treatment.

²²² *Occidental Exploration and Production Company v Republic of Ecuador*, LCIA Case No UN 3467, award of 1 July 2004.

²²³ See Christoph Schreuer, *Fair and Equitable Treatment in Arbitral Practice* (2005) 6(3) *Journal of World Investment & Trade* 357.

²²⁴ *Pope & Tablot v Canada* of 10 April 2001, 7 ICSID Reports, 102, 105-18.

The tribunal found that the fair and equitable treatment extends beyond the minimum international law standards by saying that ‘the language and evident intention of the BITs makes the discrete (i.e. additive) standards of interpretation the proper one’.²²⁵ ‘Compliance with the fairness elements must be ascertained free of any threshold that might be applicable to the evaluation of measures under minimum standard of international law’.²²⁶

The main objective of the investment treaties is protection and ‘foreign investors in many parts of the world are protected primarily by international treaties...For all practical purposes, treaties have become the fundamental source of international law in the area of foreign investment’.²²⁷ According to Puchala and Hopkins international regimes ‘constrain and regularize the behaviour of participants, affect which issues among protagonists are on and off the agenda, determine which activities are legitimized or condemned, and influence where, when, and how conflicts are resolved’²²⁸ in international law, when states meet the non-state foreign investor. There are a number of topics that are present in all investment agreements, which makes them remarkably similar to one another in their structure. Sornarajah maintained that ‘First, applicable international law failed to take account of contemporary investment practices {and needs, and did not} address important issues of concern to foreign investors’.²²⁹

In US – Estonia BIT the tribunal concluded that ‘BIT required the signatory governments to treat foreign investment in a ‘fair and equitable’ way. Under international law, this requirement is generally understood to ‘provide a basic and general standard which is detached from the host State’s domestic law’. While the exact content of this standard is not clear the Tribunal understands it to require an ‘international minimum standard’ that is separate from domestic law, but that is, indeed, a minimum standard’.²³⁰

²²⁵ Pope & Tablot v Canada of 10 April 2001, 7 ICSID Reports, 102, 105-18 at 13.

²²⁶ Pope & Tablot v Canada of 10 April 2001, 7 ICSID Reports, 102, 105-18 at 111.

²²⁷ Jeswald W. Salacuse, ‘The Treatification of International Investment Law’ (2007) 13 Law & Business Review AM. 155, 157.

²²⁸ Donald J. Puchala and Raymond F. Hopkins, ‘International Regimes: Lessons for Inductive Analysis’ (1982) 36(2) International Organization 245, 246.

²²⁹ Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (2nd edn, CUP 2004) 89.

²³⁰ Genin, Eastern Credit Limited, Inc and AS Baltoil (US) v Republic of Estonia, ICSID Case No ARB/99/2, award of 25 June 2001, 367.

In *SD Myers* the Tribunal stated that ‘In some cases, the breach of a rule of international law by a host Party may not be decisive in determining that a foreign investor has been denied ‘fair and equitable treatment’, but the fact that a host Party has breached a rule of international law that is specifically designed to protect investors will tend to weigh heavily in favour of finding a breach of Article 1105’.²³¹

In 2001 NAFTA Free Trade Commission (FTC) issued Note of Interpretation:

Minimum standard of Treatment in Accordance with International Law

1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.
2. The concepts of ‘fair and equitable’ and ‘full protection and security’ do not require treatment in addition to or beyond that which is required by customary international law minimum standard of treatment of aliens.
3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).²³²

Saracuse maintained that ‘While developed countries have strongly supported the existence of a minimum international standard, many developing countries have denied its very existence in customary international law’.²³³ The reason for which is that the right of developing states to regulate foreign investment under their national law and exercise of their sovereignty rights had to be balanced with the principles of international minimum standards. International minimum standards were accorded paramountcy over national law. Based on this conclusion it is surprising that developing states would want the minimum standard to be taken for granted in investment treaties without explicitly including it as a clearly defined provision of BITs.²³⁴

In *Azurix v Argentine Republic* the tribunal stated that ‘The purpose of the third sentence²³⁵ is to set floor, not ceiling, in order to avoid a possible interpretation of these standards

²³¹ *SD Myers v Government of Canada* (Partial Award 12 November 2000, 2001 40 ILM 1408) 64.

²³² Note of Interpretation of Certain Chapter 11 Provisions (NAFTA Free Trade Commission, 31 July 2001).

²³³ Jeswald W. Salacuse, *The Law of Investment Treaties* (OUP 2013) 227.

²³⁴ See further UNCTAD, *Fair and Equitable Treatment* (1999) 13.

²³⁵ Referring to Art II.2(a) of the Argentina and US BITs, which states that ‘investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than required by international law’.

below what is required by international law'. The conclusions were based on the analysis of the text of the provision and the Tribunal concluded that it is not 'of material significance for its application of the standard of fair and equitable treatment to the facts of the case'. Tribunal added that 'The minimum requirement to satisfy this standard has evolved' and therefore 'its content is substantially similar whether the terms are interpreted in their ordinary meaning, as required by the Vienna Convention or in accordance with customary international law'.²³⁶

Due to the lack of clear definition of the fair and equitable treatment standard it is therefore open for interpretation based on the case by case studies as indicated in the examples of Tribunal decisions in different cases.²³⁷ In a way it gives the flexibility, which might not necessarily be needed in practice as might be better off with a precise definition. Arbitral decisions mainly rely on the Vienna Convention on the Law of Treaties 1969 and namely on "good faith", objectives and purpose.²³⁸ 'What is unfair or inequitable need not equate with the outrageous or the egregious. In particular, a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith'.²³⁹ There have been no such examples where the State would be found to have acted in bad faith. The most important thing remains balanced approach to the interpretation as well as to the cooperation between the parties and bearing in mind the previous decisions made by the Tribunals on similar cases.

Essential element of the rule of law is due process as the opposite is classified as "denial of justice"²⁴⁰ and therefore 'the tendency of the jurisprudence of international tribunals and of previous codifications of the law of responsibility of States has been to give only a generalised meaning to "denial of justice" and to refrain from establishing a list of those wrongful acts and omissions which would constitute a "denial of justice"'.²⁴¹

²³⁶ Azurix v Argentine, ICSID Case No ARB/01/12, award of 14 July 2006, 361.

²³⁷ See P Weil, 'The State, the Foreign Investor, and International Law: The no Longer Stormy Relationship of a Ménage Á Trois' (2000) 15 ICSID Rev-FILJ 401.

²³⁸ Vienna Convention on the Law of Treaties (adopted 22 May 1969, entered into force 27 January 1980) Article 31(1).

²³⁹ Middle East Cement Shipping and Handling Co SA v Arab Republic of Egypt (ICSID Case No ARB/99/6 Award 12 April 2002) 116.

²⁴⁰ See further Ian Brownlie, *Principles of Public International Law* (6th edn, OUP 2003) 506.

²⁴¹ F.V. García-Amador, Louis B. Sohn and Richard Baxter, *Recent Codification of the Law of State Responsibility for Injuries to Aliens* (Springer 1974) 180.

Fair and equitable treatment is open to interpretation. However as shown in some of the case examples the restriction of behaviour is only addressed in regards to the host developing states. The restriction of behaviour of private foreign investor should be considered in the future and might result in a provision added in the BITs that would set behaviour standards and obligations for the foreign investors and not only for the host developing states.

The Most-Favoured-Nation Treatment is a widely used provision in the investment treaties. Its main purpose is non-discrimination of foreign investments. Host developing states did not see the MFN treatment in any way endangering their sovereignty. In The Energy Charter 1994 the MFN treatment is covered in terms of management, maintenance, use, enjoyment, and disposal. There are some variations of MFN treatment in the investment treaties that grant such treatment to the foreign investors, which means that it is not uniform for all.²⁴² The purpose of MFN treatment is also aimed at increasing the bargaining position of the host state.²⁴³ At the same time MFN treatment limits freedom of one state to according more favourable treatment to one other state, without according it to every other state.

While there is no specific or clear definition in the BITs regarding the MFN treatment it is left to the Tribunals to interpret if the host state is obliged to offer such treatment to the foreign investors or not. Furthermore, there have been cases with ruling on both sides of the argument, which only reiterates that there is no uniform consensus on the MFN treatment. The trend of extending MFN clause to international arbitration for foreign investors started in 1963 with *Ambatielos*²⁴⁴ case, *Maffezini*²⁴⁵ case, *Tecmed*²⁴⁶ case,

²⁴² See Brunei-Korea BIT (14 November 2000) Art 3.2.; Malaysia-Chile BIT (11 November 1992) Art 3(1); Turkey – Pakistan BIT (16 March 1995), namely the case *Bayindir Insaat Turizm Ticaret Ve Sanayi AS v Islamic Republic of Pakistan*, ICSID Case No ARB/03/29 (Decision on Jurisdiction 14 November 2005) in which the tribunal decided that Pakistan was obliged to offer fair and equitable treatment even if there was no such provision in the BIT; *Maffezini (Emilio Augustin) v Kingdom of Spain*, ICSID Case No ARB/97/7, award on Jurisdiction of 25 January 2000; All of the cases were allowed the MFN treatment based on the similar treaties that the host state has signed with other parties. However this was not the case in *Salini Costruttori SpA v Hashemite Kingdom of Jordan*, ICSID Case No ARB/02/13, decision on Jurisdiction of 9 November 2004 and *Plama Consortium v Bulgaria*, ICSID Case No ARB/03/24, decision on Jurisdiction of 8 February 2005.

²⁴³ See UNCTAD, *Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking* (2007) 38.

²⁴⁴ *Ambatielos* case (Greece v UK) (1963) RIAA 107.

²⁴⁵ *Emilio Augustin Maffezini v Kingdom of Spain*, ICSID Case No ARB/97/7, 25 January, 2000 (decision on jurisdiction) namely para 54-56, 64.

²⁴⁶ *Tecnicas Medioambientales Tecmed SA v The United Mexican States*, ICSID Case No ARB (AF)/00/2, award of 29 May 2003.

*Siemens v Argentina*²⁴⁷ case, but did not apply to 1952 *Anglo Iranian Oil Company*²⁴⁸ case it seems as if the trend ended with *Salini v Jordan*²⁴⁹ and *Plama v Bulgaria*²⁵⁰ case.

National treatment was referred in the UN Montevideo Convention 1933 in Article 9, which stated *inter alia* that:

The jurisdiction of States within the limits of national territory applies to all the inhabitants. Nationals and foreigners are under the same protection of the law and the national authorities and the foreigners may not claim rights other or more extensive than those of the nationals.²⁵¹

Under the law of the land foreign investors are not entitled to any greater, but the same protection as accorded to the nationals of the state.

Another provision that would require further clarification is the compensation requirement in case of the breach of the treatment standards. It is interesting to note that ‘no investment treaty specifically addresses these questions or even provides that contracting parties who breach these treatments standards are liable to compensate either the injured investor or its home state’.²⁵² Topic of taking has been reviewed in more depth in Chapter 4.

In general the state is liable to pay reparations for wrong doing under customary international law.²⁵³ This decision by the Permanent Court of International Justice was primarily based on *Chorzów Factory* case²⁵⁴ regarding compensation payment stating that it should ‘wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that had not been committed’.²⁵⁵ The

²⁴⁷ *Siemens AG v The Argentine Republic*, ICSID Case No ARB/02/8, decision of 3 August 2004.

²⁴⁸ *Anglo-Iranian Oil Company* case (Iran v UK), ICJ Reports 1952, 109.

²⁴⁹ *Salini Cotruttori SpA and Italstrade SpA v The Hashemite Kingdom of Jordan*, ICSID Case No ARB/02/13, decision of 15 November 2004.

²⁵⁰ *Plama Consortium Ltd v Republic of Bulgaria*, ICSID Case No ARB/03/24, decision of 8 February 2005.

²⁵¹ The Convention on the Rights and Duties of States (Montevideo Convention, 1933), (1976) 70 AJIL 445.

²⁵² Jeswald W. Salacuse, *The Law of Investment Treaties* (OUP 2013) 255.

²⁵³ See Matthew Weiniger, ‘The Standard of Compensation for Violation of the Fair and Equitable Treatment Standard’ in Federico Ortino et al (eds), *Investment Treaty Law: Current Issues II “Nationality and Investment Treaty claims” and “Fair and Equitable Treatment in Investment Treaty Law”* 2 (British Institute of International and Comparative Law 2007) 197.

²⁵⁴ *Factory at Chorzów (Germany v Poland) (Indemnity) (Mertis)*, PCIJ (1928), Series A No 17, 29.

²⁵⁵ *MTD v Chile*, ICSID Case No ARB/01/7, award of 25 May 2004, 238.

amount of compensation payment again depends on the case by case examples, which the Tribunals took in consideration when deciding on the compensation amounts. In any case this is a complex process, which is unfortunately outside the scope of this research.

3.6 Conclusions

Treaties as instruments of international law and defined in the Vienna Convention on the Law of Treaties 1969²⁵⁶ are similar in its structure, while some specific provisions might vary.

States make agreements for investments by means of investment treaties or investment agreements, which are designed to promote and protect foreign investment as part of the international law.²⁵⁷ Investment treaty drafting has not yet been defined in full and is open to improvements. The next problematic element is the requirement to exhaust local remedies of local courts included in 'exit' or 'opt out' clause, which is only present in some of the most recent BITs and as such is open to interpretations.

When the investment law does not exist in a state, that state has to therefore offer the same status, benefits and privileges to the foreign investors as to their own nationals, because the customary international law applies. However, the provisions of BITs do not always take precedence over the customary international law as was evident from the number of cases and decisions rendered by the international courts, predominantly ICSID. By signing BITs, the commitment is made by the host developing state to offer higher protection to the private foreign investors from that available under international law. As long as best efforts are made even when the same level of protection cannot be offered, the host developing states cannot be criticised. Therefore, the problem is in terminology,

²⁵⁶ Vienna Convention on the Law of Treaties (adopted 22 May 1969, entered into force 27 January 1980).

²⁵⁷ See for example Treaty Concerning the Reciprocal Encouragement and Protection of Investment, U.S.- Arm., Sept. 23, 1992, S. TREATY DOC. No. 11 (1993) <http://www.unctad.org/sections/dite/ia/docs/bits/us_armenia.pdf> accessed 25 February 2016.

such as “reciprocity”, as there simply cannot be such reciprocity due to obvious reasons based on fundamental differences between the contracting states, however best efforts in this case suffice.

Increase in international business put pressure on the conduct of TNCs and therefore transparency and accountability was called for, due to the socio-economic impact that the activities of TNCs have mainly on host developing states. Such concerns have helped to increase the standards of treatment. TNCs are accountable to the domestic law of the host developing states as well as to the international law, International Labour Organization (ILO), the Universal Declaration of Human Rights (UDHR) and best practices, however there is a lack of clarity on the extend of TNCs accountability.

The main question remains open, which is what is the main problem of socio-economic development. It could be the lack of policy-making, unreliable judiciaries, lack of democracy or even ineffective government structure in the host developing states. Host developing states might also lack the confidence in their own abilities. One thing is clear and that is that not all developing states are the same. In any case the terms of BITs should be better negotiated and more clear and specific in defining its provisions. That would also avoid leaving them open to interpretations.

The biggest issues are the fact that there is no clause in BITs that clearly requests the support of development in terms of socio-economic development and capacity building. There is also no requirement for local management participation, profit distribution, performance review or re-negotiation clause. As most of the BITs are very similar to one another none contains the above mentioned clauses. Having these clauses included in the BITs it would make them legally binding. Therefore, host developing states should have negotiated terms and conditions, including codes of conduct for foreign investors in the provisions of BITs. High aspirations of host developing states should have been translated in legislation and included in BITs during the negotiations.

Reasons that developing states did not voice their concerns during the negotiation process could be related to their big borrowing debt and thinking that therefore they do not have a voice. Continuous and limitless borrowing and financial aid dependency is also not the solution. The solution should be capacity building towards socio-economic development that will enable socio-economic independence in terms of economic self-sufficiency. In

any case there are initiatives recently taken by Latin American states to include such clauses in the new BITs. Both the parties are to be blamed for not taking such actions earlier. Another question open for discussion is how to regulate contracts with TNCs. The question of binding resolutions remains unanswered. BITs have contractual character but not law making abilities. International organisations should therefore effectively take over the role of monitoring the conduct between TNCs and host developing states.²⁵⁸ As only parliament can pass laws the question is if the soft law in this case would suffice? Policy-makers have to strike a balanced agreement acceptable to both, developed and developing states.

BITs are, regardless of the fact that there is no proof that they help increase foreign investments flow in host developing states, still important for regulating and protecting foreign investments, until an alternative is found. In the meantime, BITs are setting standards of protection, provide investor-state arbitration and protect foreign investments. Significant progress in new models of BITs has been made, however the impact of BITs on capacity building and socio-economic development in host developing states remains to be seen.

²⁵⁸ See Peter Van den Bossche, *The Law and Policy of the World Trade Organization: Text, Cases and Materials* (CUP 2006).

Chapter 4: A Critical Examination of the system of protection of the interests of TNCs and host developing states

4.1 Introduction

Law regulates the conduct of human beings and corporate entities. The main difference between specialised areas of law and international law is that international law governs the relationships between states. States were given legal personality and as such became subject of international law and able to possess international rights and duties, including the right to bring international claims.¹ The origins of international investment law may be formed on the principle of state responsibility for wrongful acts, protection of aliens, and protection of the right to property of foreigners. The main note is on protection of aliens and their property.

There have been many discussions among scholars on the topic of international investment law in the past few years.² Roberts maintained that ‘The greatest criticism of modern custom is that it is descriptively inaccurate because it reflects ideal, rather than actual, standards of conduct’.³ The international investment law is ever evolving and is faced with the challenge to find the balance between states sovereignty and the protection of foreign investments.⁴

¹ Peter Malanczuk, Akehurst’s Modern Introduction to International Law (7th edn, Routledge 1997) 1.

² Georg Schwarzenberger, *Foreign Investment and International Law* (Praeger 1969); Rosalyn Higgins, ‘The taking of Property by the State: Recent Developments in International Law’ (1982-1983) 176 *Recueil des Cours* 259; Muthucumaraswamy Sarnarajah, *The International Law on Foreign Investment* (CUP 2010); Santiago Montt, *State Liability in Investment Treaty Arbitration: Global Constitutional and Administrative Law in the BIT Generation* (Hart Publishing 2011); Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (OUP 2008); Peter T. Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (OUP 2008); Jeswald W. Salacuse, *The Law of International Investment Treaties* (OUP 2010); Louis T. Wells and Rafiq Ahmad, *Making Foreign Investment Safe, Property Rights and National Sovereignty* (OUP 2006); Martins Paparinskis (ed), *Basic Documents on International Investment Protection* (Hart Publishing 2012); Muthucumaraswamy Sarnarajah, *Resistance and Change in the International Law of Foreign Investment* (CUP 2015).

³ Anthea Elizabeth Roberts, ‘Traditional and Modern Approaches to Customary International Law: A Reconciliation’ (2001) 95 *AM. J. INT’L L.* 757, 769.

⁴ See Brigitte Stern, ‘The Future of International Investment Law: A Balance Between the Protection of Investors and the States’ Capacity to Regulate’ in Jose E. Alvarez, Karl P. Sauvant, Kamil Girard Ahmed and Gabriela P. Vizcamno (eds), *The Evolving International Investment Regime: Expectations, Realities, Options* (OUP 2011); José E. Alvarez and Kathryn Khamsi, ‘The Argentine Crisis and Foreign Investors - A Glimpse into the Heart of the Investment Regime’ in Karl P. Sauvant (ed), *The Yearbook on International Investment Law and Policy 2008-2009* (OUP 2009) ch 10, 379.

ICJ maintained that:

Considering the important developments of the last half-century, the growth of foreign investments and the expansion of international activities of corporations, in particular of holding companies, which are often multinational, and considering the way in which the economic interests of states have proliferated, it may at first sight appear surprising that the evolution of the law has not gone further and that no generally accepted rules in the matter have crystallized on the international plane.⁵

*Barcelona Traction*⁶ case demonstrated the ICJ awarding opinion that only the state in which the corporation is incorporated has the authority to sue, which also indicates the importance of protection of such corporate nationality over the ownership nationality, which is shareholders and which does not hold the same right by stating that:

Notwithstanding the separate corporate personality, a wrong done to the company frequently causes prejudice to its shareholders. But the mere fact that damage is sustained by both company and shareholders does not imply that both are entitled to claim compensation...whenever a shareholder's interests are harmed by an act done to the company, it is to the latter that he must look to institute appropriate action, for although two separate entities may have suffered from the same wrong, it is only one entity whose rights have been infringed.⁷

Foreign investment law is the oldest and the least developed area of international law.⁸ International Centre for Settlement of Investor Disputes (ICSID) that was set up in 1965 under the auspices of the World Bank with the primary role to resolve disputes between host states and private foreign investors. It has since been dealing with disputes arising from violation of investment treaties, starting with *AAPL v Sri Lanka* in 1987, which was based on the investor-state dispute settlement provision in the investment treaty.

⁵ *Barcelona Traction, Light and Power Co* (Belgium v Spain), ICJ Reports 1970, 3 46-47.

⁶ *Barcelona Traction Company* was established under Canadian Law, doing business in Spain and having the majority of shareholders were Belgian nationals. Which is why Belgium brought a suit on the shareholders behalf against Spain. Spain objected by claiming that the alleged injury was caused to the company and not the shareholders, hence Belgium lacked the *locus standi* to bring the claim.

⁷ *Barcelona Traction. Light and Power Co* (Belgium v Spain), ICJ Reports, 1970, 3 para. 44.

⁸ Surya P Subedi, *International Investment Law* (3rd edn, Hart Publishing 2016).

Number of signed BITs proliferated and according to UNCTAD has reached 3,236, out of which 44 BITs have been terminated.⁹ The Article 42(1) of the ICSID Convention suggests the use of both domestic and international law in case the parties cannot agree otherwise¹⁰ however UNCTAD stated that 58 arbitrations were initiated in 2012 and 56 in 2013.¹¹

Foreign investment law has triggered much controversy together with the outcomes of investment treaties and arbitration awards. Especially after the Second World War and the end of colonialism the issue of nationalisation became very relevant.¹² Independent states had the right to choose their economic policies, which was recognised by the Declaration on Principles of International Law concerning Friendly Relationship and Co-operation among States in accordance with the Charter of the United Nations 1970 stated that ‘each state has the right freely to choose and develop its political, social, economic and cultural systems’ and that ‘the sovereign and inalienable right to choose its economic system’.¹³

BITs that were initially based on the objective of protecting and attracting foreign investments will have to be reviewed as states concerns over the undue protection of foreign investor’s increases. As a result, starting with Latin American states, many of which are following the example of reviewing the existing BITs and even terminating them and withdrawing from ICSID.¹⁴

⁹ UNCTAD, World Investment Report (Geneva 2014) 124.

¹⁰ One of the first cases that included Article 42(1) of the ICSID Convention was *Klöckner Industrie-Anlagen GmbH and others v United Republic of Cameroon and Société Comerounaise des Engrais*, ICSID Case No. ARB/81/2, decision on Annulment of 3 May, 1985, 1 ICSID Reports 1990, 90.

¹¹ UNCTAD, World Investment Report (Geneva 2014) 124.

¹² For historical overview see Andreas F. Lowenfeld, *International Economic Law* (OUP 2002)

¹³ UNGA Res 2625 (XXV) of 1970; Ch 3, Article 1 of the Charter of Economic Rights and Duties of States 1974.

¹⁴ Bolivia, stated that there is a lack of balance between public and private interests, Venezuela, Ecuador, India, Indonesia and South Africa, who are looking in re-negotiating the existing BITs. All states however reject to include the clause in investment treaty that would allow foreign investors to sue a host state. Among developed states Australia is changing policy to subject the foreign investors under national courts; see Leon Trakman, ‘Investor-State Arbitration: Evaluating Australia’s Evolving Position’ (2014) 15(1) *Journal of World Trade Law* 152. The US and EU are also working on Transatlantic Trade and Investment Partnership Agreement (TTIP) since September 2015 when it was first proposed by the European Commission.

The Abs-Shawcross Convention 1959¹⁵ was the first attempt at creating a multilateral treaty that would be protecting foreign investments. As it turned out it was another failed attempt at creating codes of conduct on foreign investment, as was the multilateral agreements on investment (MAI). The failure could be due to the fact that they were both favouring the foreign investors and developed states in terms of their provisions. As it seems the ICSID Convention was the only one that gained success.

Protection of investment is protection of foreign investment from the host developing state's interference as well as protecting host state's interests. Role of international investment law is to find a balance between interests of host states and foreign investors in order to prevent potential conflicts. It has now become clear that balance has to be struck between protecting foreign investors and host state sovereignty.

Over time the importance of TNCs was increasing and it has become apparent that States are not capable of generating sufficient capital through economic activities to support their economy and contribute to their socio-economic development towards socio-economic independence. On the other hand, TNCs are making enormous profits by means of their economic activities. While developing states are struggling to achieve socio-economic development. As a consequence, developing states have realised the potential that foreign investments could have on their socio-economic development.

Developing states were developing different strategies to attract private foreign investments.¹⁶ Investors, on the other hand, looked for investment opportunities. Therefore, the developing states had to ensure secure and stable investment environment in order to attract the foreign investors. Existing international standards such as National Treatment or Non-Discrimination standard were not sufficient for offering required guarantees and protection of the foreign investments in host developing states. As a result, the agreements among states were made to set some basic standards for investment protection. The reason standards were not sufficient and that international law could not

¹⁵ See Abs-Shawcross Draft Convention (1959); Georg Schwarzenberger, *Foreign Investment and International Law* (Praeger 1969); Lord Shawcross, 'The Problems of Foreign Investment in International Law' (1961) 102 Hague Recueil 334.

¹⁶ However that was not the reason for developing states to sign BITs; see Deborah L. Swenson, 'Why do developing countries sign BITs?' (2005) 12(1) Davis Journal of International Law and Policy 131-155.

enforce them is because of the fact that states could exercise their sovereignty and have the right to nationalise foreign property under international law against compensation.¹⁷

Since the 1960s private foreign investors and host developing states started signing bilateral investment treaties (BITs), which for the first time enabled foreign investors' access to international investment tribunals, such as ICSID for investor-state dispute resolution. The main objective of BITs was to attract foreign investment and offer additional protection for investments to the foreign investors inside the host developing states. Consequently, states were also responsible for providing protection for foreign investments. With Convention for the Settlement of Disputes between States and Nationals of Other States the International Centre for Settlement of Investment Disputes Tribunal was created in 1965.¹⁸ Provisions in the investment agreements, such as fair and equitable treatment, most-favoured nation and national treatment are open to interpretation and hence the need for further clarification.¹⁹

States, being developed or developing have started taking actions, over increasing concerns that disproportionate protection is given to the foreign investors, by looking for alternative investor-state arbitration mechanism, reviewing existing BITs and in some cases even terminating some existing BITs and withdrawing from the ICSID, following Bolivia and Brazil. Therefore, ever evolving international investment law is faced with a new challenge to cater opposing aspirations of host developing states and foreign investors.

¹⁷ See Resolutions on the Permanent Sovereign of each State over its Natural Resources of 14 December 1962 (Resolution No. 1803-XVII), 25 November 1966 (Resolution No. 2158) and 17 December 1973 (Resolution No. 3201-XXVIII), New International Economic Order of 1 May 1974 (Resolution No. 3201 and 3202-SVI) and the Economic Rights and Duties of the States (Resolution No. 3281-XXIX of 12 December 1974).

¹⁸ Antonio R. Parra, *The History of ICSID* (OUP 2012); On 31 December 2000, 133 States were parties to the ICSID Convention.

¹⁹ See Antonio R. Parra, 'Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Investments on Investment' (1997) 12 ICSID Rev. – Fly 287, 294.

4.2 The meaning of protection of private foreign investment by means of International Investment Law and International minimum standards

International minimum standards of treatment²⁰ derive from the doctrine of denial of justice. The OECD defined international minimum standards as:

[A] norm of customary international law which governs the treatment of aliens, by providing for a minimum set of principles which States, regardless of their domestic legislation and practices, must respect when dealing with foreign nationals and their property.²¹

International minimum standards were used in 1962 in the *LFH Neer v United Mexican States*²² and *Harry Roberts (USA) v United Mexican States case*²³. In the former case Paul Neer was a murdered US national and the widow filled for lack of due diligence and investigating the murder, but the Commission concluded that international minimum standards on the treatment of aliens were not violated, but stated that it recognises insufficiency questioning ‘Whether this insufficiency proceeds from deficient of an intelligent law or from the fact that the laws of the country do not empower the authorities to measure up to international standards is immaterial’.²⁴ The former case was about a US national who was imprisoned in a cell for nineteen months without sanitary facilities or furniture. The Commission concluded that the treatment was cruel and inhumane.

Schwarzenberger recognised the ambiguity and fluidity of the traditional international minimum standards and its dependence on conditions that are no longer in existence and added that an investor’s legitimate expectations should not include strict application of traditional rules of property protection.²⁵

²⁰ See Adriana Sánchez Mussi, ‘International Minimum Standard of Treatment’ <<https://asadip.files.wordpress.com/2008/09/mst.pdf>> accessed on 15 December 2015.

²¹ OECD Directorate for Financial and Enterprise Affairs. Working Papers on International Investment. Number 2004/3. Fair and Equitable Treatment Standard in International Investment Law. September 2004, 8.

²² *LFH Neer and Pauline Neer (US) v United Mexican States* (1926), 4 RIAA iv. 60.

²³ *Harry Roberts (USA) v United Mexican States, General Claims Commission, Convention of 8 September 1923, of 2 November 1926*, 4 RIAA 77 at 80: ‘that test is, broadly speaking, whether aliens are treated in accordance with ordinary standards of civilization. We do not hesitate to say that the treatment of Roberts was such as to warrant an indemnity on the ground of cruel and inhumane imprisonment’.

²⁴ *LFH Neer and Pauline Neer (US) v United Mexican States* (1926), 4 RIAA iv. 60, 61-62.

²⁵ Georg Schwarzenberger, *Foreign Investments and International Law* (Stevens & Sons 1969)

In the case of NAFTA 'Free Trade Commission issued an interpretation equating the standard to the minimum standard of customary international law'.²⁶ Other standards are Fair and Equitable Treatment, National Treatment, Most-Favored Nation treatment, Compensation payment that applies in the expropriation cases and full protection and security standard of treatment. Payment of compensation is also required in cases of violation of the investment contract.

The standards of treatment that states grant to aliens have evolved over the years in the form of international investment law, property rights²⁷ and human rights. In Article 5 – Minimum Standard of Treatment treaty provision for Canada's investment protection treaty states:

1. Each Party shall accord to covered investments treatment in accordance with the customary international law minimum standard of treatment of aliens, including fair and equitable treatment and full protection and security.
2. The concepts of "fair and equitable treatment" and "full protection and security" in paragraph 1 do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.
3. A determination that there has been a breach of another provision of this Agreement, or of a separate international agreement, does not establish that there has been a breach of this Article.²⁸

The principle of good faith, recognized in *Tecnicas Medioambientales Tecmed SA v Mexico*,²⁹ falls under the minimum standard of fair and equitable treatment. Dozler maintained that 'the substance of the standard of fair and equitable treatment will in large part overlap with the meaning of a good faith clause in its broader setting'.³⁰ 'Together with other standards which have grown increasingly important in recent years, the fair and equitable treatment standard provides a useful yardstick by which relations between

²⁶ Marcela Klein Bronfman, 'Fair and Equitable Treatment: An Evolving Standard' (2005) 10 Max Planck Y.B. U.N.L. 609.

²⁷ Uti posseditis principle.

²⁸ Canada's 2003 Model Foreign Investment Promotion and Protection Agreement (FIPA) <http://www.naftaclaims.com/files/Canada_Model_BIT.pdf> accessed 15 March 2016.

²⁹ *Tecnicas Medioambientales Tecmed SA v United Mexican States*, ICSID Case No ARB (AF)/00/2), award of 29 May 2003, 43 ILM 133 (2004).

³⁰ Rudolf Dolzer, 'Fair and Equitable Treatment: A Key Standard in Investment Treaties' (2005) 39 Int'l Law 87, 91.

private foreign investors and governments of capital-importing countries may be assessed'.³¹ The Fair and Equitable Treatment standards are based on the treaty law, for which the main source of information is taken from bilateral investment treaties (BITs).³²

Sornarajah maintained that:

Many investment treaties provide that a fair and equitable standard of treatment is to be provided to investors and their investments, in addition to the international minimum standard and full protection and security.³³

Vasciannie maintained that fair and equitable treatment only enforces the international minimum standards.³⁴

The failed Multilateral Agreement on Investment (MAI) that were being negotiated between OECD members put forward the element of fairness and Most-Favored Nation treatment. MFN prevent discrimination of foreign investors, which is the principal idea of international minimum standards.

The UNCTAD view from the investors' perspective is that:

[T]he fair and equitable component provides a fixed reference point, a definite standard that will not vary according to external considerations, because its content turns on what is fair and reasonable in the circumstances. The fair and equitable standard will also prevent discrimination against the beneficiary of the standard, where discrimination would amount to unfairness or inequity in the circumstances.³⁵

At the same time:

³¹ Stephen Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice' (1999) 70(1) BYIL 99.

³² See Rudolf Dolzer and Margrete Stevens, *Bilateral Investment Treaties* (Martinus Nijhoff 1995); C.C. Kirkman, 'Fair and Equitable Treatment: Methanex vs. United States and the Narrowing Scope of Nafta article 1105' (2002) 34 Law and Policy in International Business Review 343, 390.

³³ Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (2dn edn, CUP 2004) 349.

³⁴ Stephen Vasciannie, 'The Fair and Equitable Standard in International Investment Law and Practice' (1999) 70(1) BYIL 99, 104.

³⁵ UNCTAD, 'Fair and Equitable Treatment' (UN 1999) UNCTAD/ITE/IIT/11 Vol. III) 16.

[N]ational and MFN treatment, as contingent standards, protect each beneficiary of these standards by ensuring equality or nondiscrimination for that beneficiary vis-a-vis other investments.³⁶

The Energy Charter Treaty (ECT) 1994 includes the provision on investment that calls for fair and equitable treatment at all times. As such it is known to protect the interests of foreign investors' and their expectations. Wilde maintained that principle of protection 'is often combined with the principle of transparency: that government administration has to make clear what it wants from the investor and cannot hide behind ambiguity and contradiction'.³⁷ The origins came from the North American Free Trade Association (NAFTA), World Trade Organisation (WTO) and some of the bilateral investment treaties (BITs).

An international convention admittedly establishes rules binding the contracting states only, and based on reciprocity; but it must be remembered that these rules become generalized through the conclusion of other similar conventions containing identical or similar provisions.³⁸

Clarity of customary international law is needed in addition to the international minimum standards as they are currently open to interpretation. Mann³⁹ examined the difference between international minimum standards in comparison with the fair and equitable standard as to which standards are higher. However according to NAFTA in customary international law fair and equitable standards are not higher than international minimum standards.

Host states have to develop laws to regulate activities of TNCs in their sovereign territory. TNCs will have to sacrifice a portion of their profits, which is why negotiation process should establish the terms and conditions of private foreign investment. The only way to put pressure on TNCs is by legislation and investment agreements that would include capacity building, profit distribution, performance review, succession clause and re-negotiation clause that would be contractually binding for TNCs. Hence the practice of

³⁶ UNCTAD, 'Fair and Equitable Treatment' (UN 1999) UNCTAD/ITE/IIT/11 Vol. III) 16.

³⁷ Thomas W. Wälde, 'Energy Charter Treaty-Based Investment Arbitration. Controversial Issues' (2004) 5 *The Journal of World Investment & Trade* 373, 376.

³⁸ Report of the International Law Commission covering the work of its twelfth Session, Doc. A/4425, in: (1960) 2 *ILCYB* 145.

³⁹ F. A. Mann, *Further Studies in International Law* (Clarendon Press 1990) 234–251.

foreign investment needs to be reviewed. A good example to follow is Bolivia, Brazil, Ecuador, Indonesia, South Africa and Venezuela which are attracting private foreign investments despite not recognizing ICSID and terminating some of the existing BITs.

Mahmood maintained that:

[O]wing to the weaker bargaining power of the then newly independent capital importing states, no comparable internationally recognized standards of minimum protection of national interests from foreign firms could be formulated, even though such firms today are known to have a profound impact on local economies because of the extensive protection and power they yield through lopsided BITs and other general customary standards of treatment of foreign investment.⁴⁰

The question which system of law applies to the issues of investment, international or domestic still awaits clarification.⁴¹ However violation of international minimum standards of treatment in customary international law falls with the principle of State responsibility.⁴² Article 42 of the ICSID leaves space for interpretation to the question of applicable law, depending namely on the type of the investment agreement, which can be contract or treaty based. Article 42(1) favours the principle of party autonomy⁴³ and maintains that there is no clear distinction between the respective scope of international and domestic law.⁴⁴ In practice ‘the circumstances of each case may justify one or another solution’.⁴⁵ *LG&E, Siemens and Enron Tribunal* however maintained the complementarity of international and domestic law.⁴⁶ LG&E Tribunal stated that:

⁴⁰ Nida Mahmood, ‘Democratizing Investment Laws: Ensuring Minimum Standards for Host States’ (2013) 14(1) *The Journal of World Investment & Trade* 79–113.

⁴¹ See Ole Spiermann, ‘Applicable Law’ in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of Investment Law* (OUP 2008) ch.3.

⁴² See A. O. Adede, ‘The Minimum Standards in a World of Disputes’, in R. St J. MacDonald and Douglas M. Johnston (eds), *The Structure and Process of International Law: Essays in Legal Philosophy Doctrine, and Theory* (Martinus Nijhoff 1986) 1001.

⁴³ See cases *Amco v Republic of Indonesia*, ICSID Case No. ARB/81/1, decision of ad hoc Committee of 16 May 1986, 25 ILM 1439 (1986), 1 ICSID (1990) 509; *Wena Hotels Ltd v Arab Republic of Egypt*, ICSID Case No ARB/98/4, Decision of the ad hoc Committee, 28 January 2002, 41 ILM 933 (2002).

⁴⁴ *Wena Hotels Ltd v Arab Republic of Egypt*, ICSID Case No ARB/98/4, Decision of the ad hoc Committee, 28 January 2002, 41 ILM 933 (2002) 941 para. 39.

⁴⁵ *Wena Hotels Ltd v Arab Republic of Egypt*, ICSID Case No ARB/98/4, Decision of the ad hoc Committee, 28 January 2002, 41 ILM 933 (2002) 941 para. 39.

⁴⁶ *LG & E Energy Corporation v Argentine Republic*, ICSID Case No ARB/02/1 of 30 April 2004 para 88; *Siemens AG v Argentine Republic*, ICSID Case No ARB/02/8, DECISION OF 3 August 2004, para. 77; *Enron Corporation and Ponderosa Assets, LP v Argentine Republic*, ICSID Case No ARB/01/3, decision

Initially, scholarly authorities and some ICSID Tribunals admitted that the conjunction “and” means “and in the case of lacunae, or should the law of the Contracting State be inconsistent with international law”.⁴⁷ However, any limitation to the role of international law under these terms would imply accepting that international law may be subordinate to domestic law and would obviate the fact that there are a growing number of arbitrations initiated on the basis of bilateral or multilateral investment treaties.⁴⁸

The Tribunal maintained that:

It is this Tribunal’s opinion that “and” means “and,” so that the rules of international law, especially those included in the ICSID Convention and in the Bilateral Treaty as well as those of domestic law are to be applied.⁴⁹

The Tribunals citations above demonstrate the complimentary nature of international and domestic law. Despite Klöckner-Amco doctrine that is favouring the supremacy of international law over the domestic law in case of investment conflict.

International law overrides domestic law when there is a contradiction since a State cannot justify non-compliance of its international obligations by asserting the provisions of its domestic law.⁵⁰

According to the Vienna Convention on the Law of Treaties 1969 international law cannot be used as a substitute following the failure to respect treaty agreement.⁵¹ Principles that emerged over the course of investment disputes is the *pacta sunt servanda*.⁵² In the case of a treaty the investor agrees to the provision of applicable law, defined in the treaty.

on jurisprudence of 14 January 2004; award of 22 May 2007, para. 207; CMS Gas Transmission Company v Argentine Republic, ICSID Case No ARB/01/8, 17 July 2003, para. 116.

⁴⁷ Gaillard, Emmanuel and Banifetami, Yas, The Meaning of “and” in Article 42(1), second sentence, of the Washington Convention: The Role of International Law in the ICSID choice of the law process, ICSID Review, (2003) 12(2) Foreign Investment Law Journal 375, 381-382.

⁴⁸ LG&E v Argentina, Article 95.

⁴⁹ LG&E v Argentina, Article 96.

⁵⁰ LG&E v. Argentina, Article 94.

⁵¹ See Vienna Convention on the Law of Treaties, especially Article 27.

⁵² An example of *pacta sunt servanda* was in Saudi Arabia v Aramco 27 ILR 117 (1963); Lena Goldfields Ltd v USSR (1930) for historical context see V.V. Veeder, ‘The Lena Goldfields arbitration: The historical roots of three ideas’ (1998) 47 International & Comparative Law Quarterly 755; Arthur Nussbaum ‘The arbitration between the Lena Goldfields Ltd. And the Soviet Government’ (1950-51) 36 Cornell Law Quarterly 31; Klöckner v Cameroon, ICSID Case No Arbi74/3, Award, 21 October 1983, 2

There is a need for a clear global standard of treatment that should be based on non-discrimination, transparency and due process in the course of foreign investment.⁵³ International foreign investment law allows private entities to make claims against host states⁵⁴ in front of international tribunal.⁵⁵ It also indicates that the state has waived the immunity⁵⁶ to their sovereignty,⁵⁷ because an act of state undermining the rights under customary international law or a treaty, guaranteed to aliens, gives rise to state responsibility under ILC Articles on Responsibility of States for Internationally Wrongful Acts 2001.⁵⁸ In case of breach of investment treaty damages have to be paid⁵⁹ under fundamental principles of foreign investment protection.

MFN treatment is a treaty clause that carries legal obligation, which assumes principle *ejusdem generis* that has not been considered by arbitral investment tribunals.⁶⁰ MFN clause was denied by the ICSID Tribunal in *Plama Consortium Limited v Bulgaria case*,⁶¹ which encouraged the UK model BITs to add Article 3(3) that was clear on including MFN principle in dispute settlement procedures. It is equally important that the investments are carried out ‘in accordance with Host State Law’ as in recent cases

ICSID Reports 9; Decision of ad hoc Committee, 3 May 1985, I ICSID Rev-FILU 89 (1986); CME BV v Czech Republic; CME (Netherlands) v Czech Republic, Final Award, 14 March 2003 <http://www.italaw.com/documents/CME-2003-Final_001.pdf> accessed 10 December 2015.

⁵³ Todd J. Grierson-Weiler and Ian A Laid ‘Standards of Treatment’ in Peter T. Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (OUP 2008) ch 8.

⁵⁴ See Federico Ortino, ‘The Investment Treaty System as Judicial Review’ (2013) 24 *American Review of International Arbitration* 437.

⁵⁵ See Gus Van Harten and Martin Loughlin, ‘Investment Treaty Arbitration as a Species of Global Administrative Law’ (2006) 17 *European Journal of International Law* 121-150 <<https://www.international-arbitration-attorney.com/wp-content/uploads/arbitrationlaw65.pdf>> accessed 4 January 2016; Gus Van Harten, *Investment Treaty Arbitration and Public Law* (OUP 2007) 96.

⁵⁶ Freeman Snow, *International Law* (6th edn, CUP 2008) 697.

⁵⁷ Gus Van Harten and Martin Loughlin, ‘Investment Treaty Arbitration as a Species of Global Administrative Law’ (2006) 17 *European Journal of International Law* 121; Gus Van Harten, *Investment Treaty Arbitration and Public Law* (OUP 2007) 133.

⁵⁸ UN Doc A/56/10.

⁵⁹ Gus Van Harten and Martin Loughlin, ‘Investment Treaty Arbitration as a Species of Global Administrative Law’ (2006) 17 *European Journal of International Law* 131; Van Harten, *Investment Treaty Arbitration and Public Law* (OUP 2007) 101.

⁶⁰ *Maffezini v Spain*, ICSID Case No ARB/97/7; *Suez, Sociedad General de Aguas de Barcelona, SA and Vivendi Universal SA v Argentina Republic*, ICSID Case No.ARB/03/19 <<http://www.worldbank.org/icsid>> accessed 10 December 2015, Pia Acconci, ‘Most Favoured Nation Treatment’ in Peter T. Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (OUP 2008) ch 10.

⁶¹ *Plama Consortium v Bulgaria*, ICSID Case No Arb/03/24, decision on Jurisdiction of 8 February 2005, 44 ILM 721 (2005), ICSID Tribunal in para 203 stated that ‘one cannot reason *a contrario* that the dispute resolution provisions must be deemed to be incorporated’ and in para 204 that ‘Rather, the intention to incorporate dispute settlement provisions must be clearly and unambiguously expressed’.

jurisdiction was denied by the tribunal due to non-compliance with the host state law based on the provision on protection of investment in the BITs.⁶²

Due process is without a doubt another requirement that should deserve attention. The International Court of Justice in the *ELSI Case*, the Court made a reference to due process by maintaining that ‘a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety’ will amount to a denial of justice.⁶³ Reference to due process was also made in *Amco v Indonesia* case.⁶⁴ The view was that due process is a general principle of international law. The provision in most of BITs also include due process under expropriation and compensation. On the other side, the view was that due process was not properly drafted in the awards.⁶⁵ There are also cases of non-physical taking of property, but taking over ownership, management and as a result there is depreciation of the value. Issues such as illegal taking is a reason to terminate the BITs.⁶⁶ Due process was also referred to in Article IV of the draft MAI⁶⁷ and NAFTA Article 1110(1) and 1105(1).⁶⁸

⁶² Inceysa Vallisoletana SL v El Salvador ICSID Case No Arb/03/26 Decision on Jurisdiction 2 August 2006 <http://www.italaw.com/sites/default/files/case-documents/ita0424_0.pdf> accessed 13 December 2015> accessed 2 March 2016; See for analysis Christina Knahr, ‘Investments in accordance with host state law’ *Transnational Dispute Management* (TDM 5, September 2007) <<https://www.transnational-dispute-management.com/article.asp?key=1070>> accessed 13 December 2015; Fraport AG Frankfurt Airport Services Worldwide v The Philippines ICSID Case No Arb/03/25, Award, 16 August 2007 <<http://www.italaw.com/documents/FraportAward.pdf>> accessed 13 December 2015.

⁶³ International Court of Justice in the *ELSI Case*, in 1989 in para 128.

⁶⁴ *Amco v Republic of Indonesia*, ICSID Case No. ARB/81/1, decision of ad hoc Committee of 16 May 1986, 25 ILM 1439 (1986); 1 ICSID (1990) 509.

⁶⁵ See Muthucumaraswamy Sornarajah, ‘ICSID involvement in Asian foreign investment disputes’ (1995) 4 *Asian Yearbook of International Law* 69-98.

⁶⁶ BITs are in general long-term investment agreements for various durations as negotiated in the BITs for ten, fifteen, forty years. Some of the BITs can also remain in force after the termination in terms of protection of the investment. Most of the treaty termination provisions contain a continuing effects clause, which means it will respect all agreements made prior to the termination. For example Bolivia denounced the ICSID Convention effective 3 November 2007, Ecuador denunciation took effect 7 January 2010. In 2008, Ecuador terminated nine BITs - with Cuba, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Paraguay, Romania and Uruguay. Denounced BITs El Salvador and Nicaragua, and the Netherlands and the Bolivarian Republic of Venezuela. In 2010, Ecuador’s Constitutional Court declared arbitration provisions of six more BITs (China, Finland, Germany, the UK, Venezuela and United States) to be inconsistent with the country’s Constitution. It is possible that Ecuador will take action to terminate these (and possibly other) BITs. January 2012 Bolivarian Republic of Venezuela denounced the ICSID Convention. See *British Petroleum v Libya*, award 10 October 1973; (1979) 53 ILR 296.

⁶⁷ Draft MAI, Article IV 2.1(c).

⁶⁸ Art 1110(1) and Art 1105(1) of NAFTA.

Protection of investment was not needed in colonial period because colonies fell under the protection and jurisdiction of their colonial masters.⁶⁹ The need for international investment law first came about after the number of independent states started growing.⁷⁰ Treaties such as the North American Free Trade Agreement (NAFTA) 1994 and Energy Charter Treaty 1994 were adopted, together with the World Trade Organisation (WTO) 1995. Further aspirations to establish instruments on investments within WTO did not see the light of day due to concerns and disagreements expressed by both developing and developed states.

The increasing number of bilateral investment treaties (BITs), which were interpreted based on the Vienna Convention on the Law of Treaties 1969⁷¹, revealed weak links in the area of dispute settlement and awards. One of first such examples was the *AAPL v Sri Lanka*.⁷² *AAPL v Sri Lanka* was the first case that involved BIT as a primary source of law under ICSID. *Santa Elena v Costa Rica case*,⁷³ further revealed vulnerability of awards by questioning the non-compensable regulatory takings stated that international law was “controlling”.⁷⁴ The prevailing doctrine was the Klöckner-Amco that also represented the interpretation of Article 42 of the ICSID.⁷⁵ However in 2002 Wena doctrine came about, following the Argentina financial crisis of 2001/2002 in *Wena Hotels Ltd. v Arab Republic of Egypt*,⁷⁶ questioning entitlement of foreign investors to the full protection and security in which the position of the tribunal was based on requirement for due diligence.

At the beginning of 21st century there was a shift of private foreign investment that started for the first time coming from developing states, namely emerging economies of Brazil, Russia, India, China and South Africa (BRICS) in Europe and North America. ‘It is indeed ironic that the United States – long the Leading opponent of the Calvo Doctrine –

⁶⁹ See Antony G. Hopkins, ‘Property Rights and Empire Building’ (1980) 40(4) Journal of Economic History 787.

⁷⁰ See Eduardo Galeano, *Open Veins of Latin America: Five Centuries of Pillage of a Continent* (first published 1971, Cedric Belfrage tr, Monthly Review Press 1973).

⁷¹ Vienna Convention on the Law of Treaties 1969.

⁷² *Asian Agricultural Products Ltd (AAPL) v Sri Lanka* (1990) 4 ICSID Reports 245.

⁷³ *Santa Elena v Costa Rica* (2000) 39 ILM 317; (2002) 5 ICSID Reports 153.

⁷⁴ *Santa Elena v Costa Rica*, 191, para. 65.

⁷⁵ *Klöckner industrie–Anlagen GmbH and others v United Republic of Cameroon and Societe Comerounaise des Engrais*, ICSID Case No. ARB/81/2, decision on Annulment, 3 May 1985, 1 ICSID Reports (1990) 90; *Amco v Republic of Indonesia*, decision of ad hoc Committee of 16 May 1986, 25 ILM 1439 (1986), 1 ICSID (1990) 509.

⁷⁶ *Wena Hotels Ltd. v Arab Republic of Egypt*, ICSID Case No ARB/98/4, para 84.

may now be considered its proponent, at least in regard to national treatment and indirect expropriation'.⁷⁷ Relationship between TNCs and states helped shape the international investment law over the years of practice of foreign investments and international trade. Topics such as protection of foreign investment, liability, activities of states, and activities of TNCs have open the way to further formulating investment law.⁷⁸

Higgins maintained that 'the notion of "property" is not restricted to chattels. Sometimes rights that might seem more naturally to fall under the category of contract rights are treated as property'.⁷⁹ Sacerdoti maintained that 'All rights and interest having an economic content come into play, including immaterial and contractual rights'.⁸⁰

Domestic law continues to be the main source of protecting the foreign investments. Widespread of BITs especially in the recent years has contributed to increasing the standards of foreign investment protection. Proliferation of investment treaties encouraged the developments in international law namely on the protection of foreign investment as it was still undergoing development. The International Court of Justice stated that:

Considering the important developments of the last half-century, the growth of foreign investment and the expansion of international activities of corporations, in particular of holding companies, which are often multinational, and considering the way in which the economic interests of states have proliferated, it may at first sight appear surprising that the evolution of the law has not gone further and that no generally accepted rules in the matter have crystallised on the international plane.⁸¹

⁷⁷ Christopher Duggan, Don Wallace, Noah Rubins and Borzu Sabahi, *Investor-State Arbitration* (OUP 2008) 488.

⁷⁸ See Campbell McLachlan, Laurence Shore and Mathew Weiniger, *International Investment Arbitration: Substantive Principles* (OUP 2007); Christopher Duggan, Don Wallace, Noah Rubin and Borzu Sabahi, *Investor – State Arbitration* (OUP 2008); Christoph Schreuer, *The ICSID Convention: A Commentary* (2nd edn, CUP 2009); Andrew Newcombe and Lluís Pradell, *Law and Practice of Investment Treaties, Standard of Treatment* (Kluwer Law International 2009); Jennifer A. Zerk, *Multinationals and Corporate Social Responsibility, Limitations and Opportunities in International Law* (CUP 2006); Janet Dine, *Companies, International Trade and Human Rights* (CUP 2005).

⁷⁹ Rosalyn Higgins, 'The taking of Property by the State: Recent Developments in International Law' (1982-1983) 176 *Recueil des Cours* 263, 271.

⁸⁰ Giorgio Sacerdoti, 'Bilateral Treaties and Multilateral Instruments on Investment Protection' (1997) 269 *Recueil des Cours* 251, 381.

⁸¹ *Barcelona Traction, Light and Power Co (Belgium v Spain)*, ICJ Reports 1970, 3, 46-7.

Amendments to rules and regulations were done in the spirit of attracting the foreign investments as a source of financing, namely developing states and in the hope to contribute to their socio-economic development.⁸² The UNCTAD considers BITs essential for the protection of foreign investment on international level.⁸³ As the treaties and investment protection law developed over the years so did the investor-state dispute resolution increase in number of presented cases before the ICSID.⁸⁴ Vattel maintained that states have the right to control foreigners entering their borders and once the border is crossed foreigners become subject of domestic laws and host developing states are required to offer them protection.⁸⁵

Asante recognised the disagreement between developing and developed states regarding the relationship among international minimum standards, international and domestic law in regard to which should take control over foreign investments stating that:

The industrialised Western countries insist that the code must unequivocally stipulate the applicability of international law in the relations between the governments and transnational corporations. The developing countries, while recognising that states may have multinational obligations in this area, are reluctant to accept the term 'international law' because of its traditional connotations, and have instead proposed a formula calling for states to fulfil, in good faith, their international obligations in this area.⁸⁶

Developing states argued against 'vague' and 'imprecise' principles of customary international law concerning private foreign investments and have advocated for precise definitions that would not leave any room for interpretation.⁸⁷ Without a doubt the biggest concern for foreign investors are the numerous cases of expropriations in the host

⁸² See Ibrahim F.I. Shihata, 'Promotion of Foreign Direct Investment - A General Account, with Particular Reference to the Role of the World Bank Group' (1991) 6(2) ICSID Review - Foreign Investment Law Journal 484-509.

⁸³ UNCTAD, 'Bilateral Investment Treaties 1959-1999', (New York, Geneva: United Nations 2000).

⁸⁴ After 1995 the number of investor-state dispute cases proliferated at ICSID, see UNCTAD, 'Bilateral Investment Treaties 1995- 2006: Trends in Investment Rulemaking', (United Nations 2007) 1.

⁸⁵ Emer de Vattel, *The Law of Nations* (Liberty Fund 2008) 266-268.

⁸⁶ Samuel K.B. Asante, 'International Codes of Conduct and NIEO' in Proceedings of the First Yugoslav International Seminar on Legal Aspects of the New International Economic Order (1986) 245, 247.

⁸⁷ B. Stern, 'The Future of International Investment Law: A Balance between the Protection of Investors and the States Capacity to Regulate' in José Enrique Alvarez and Karl P. Sauvant (eds), *The Evolving International Investment Regime: Expectations, Realities, Options* (OUP 2011); José E. Alvares and Kathryn Khamsi, 'The Argentine Crisis and Foreign Investors – A Glimpse into the Heart of the Investment Regime' in Karl P. Sauvant (ed), *The Yearbook on International Investment Law and Policy 2008 – 2009* (OUP 2009) 379, 470.

developing states, which have to be followed by an appropriate compensation⁸⁸ payment.⁸⁹

Cheng maintained that:

The rationale of compensation for expropriation consists in the fact that certain individuals in a community, or certain categories of individuals, without their being in any way at fault, are being asked to make a sacrifice of their private property for the general welfare of the community, when other members of the community are not making corresponding sacrifices.⁹⁰

Cheng maintained that sacrifices are made on the expense of host developing states and the local people of the community, which entails giving away their private property that might not be necessarily used for public good. Cheng added that:

The compensation paid to the owners of the property taken represents precisely the corresponding contributions made by the rest of the community in order to equalise the financial incidence of this taking of private property.⁹¹

The US and the UK took measures by enforcing legislation in order to protect their nationals by ensuring “fair treatment” for their assets and rights:

- (a) Suspension of bilateral foreign aid programmes in the taking States;
- (b) denial of trade preferential treatment;
- (c) blocking or freezing of the assets and bank accounts of the taking States and their nationals in the investor States; and
- (d) voting against loan applications by the taking States in multilateral financial institutions or State-owned financial institution.⁹²

The measures taken did not prove to be effective. In fact, some might argue they had the opposite effect. Ellingsen and Wärneryd argued that different industries require different levels of protection as most authors believed and stated that ‘Any industry wants as much

⁸⁸ UN Charter of Economic Rights and Duties of States 1974 supports appropriate compensation payment.

⁸⁹ See Adeoye A. Akinsanya, *Expropriation of Multinational Property in the Third World* (Praeger 1980) 25–46.

⁹⁰ Bin Cheng, ‘The Rationale of Compensation for Expropriation’ (1958–1959) 44 *Problems of Public and Private International Law* 257, 297.

⁹¹ Bin Cheng, ‘The Rationale of Compensation for Expropriation’ (1958–1959) 44 *Problems of Public and Private International Law* 257, 297.

⁹² Adeoye A. Akinsanya, *Expropriation of Multinational Property in the Third World* (Praeger 1980) 284–300.

protection as it can get, and thus the level of protection should be positively correlated with the political influence of the industry. Implicitly, this assumption underlies most of the empirical work in the area'.⁹³

Expropriation⁹⁴ cases can be divided into two categories. First is appropriation of property by the state, such as *Sedelmayer v Russian Federation*⁹⁵ and *Wena v Egypt*.⁹⁶ Second category is initial state approval of investment followed by state intervention. Such cases are *Metalclad*,⁹⁷ *CME v Czech Republic*⁹⁸ and *Tecmed SA*⁹⁹ There are also such cases where both criteria is applicable such examples are seen in *Biloune and Marine Drive Complex Ltd v Ghana Investments Centre and the Government of Ghana*.¹⁰⁰

4.3 Customary International Law on protection of Private foreign investment and State responsibility

In 1949 the Commission named State responsibility at its first session as one of the topics for codification on principles of international law governing State responsibility that was not identified as priority until 1953 on request of the United Nations General Assembly.¹⁰¹

⁹³ Tore Ellingsen and Karl Wärneryd, 'Foreign Direct Investment and the political economy of protection' (1999) 40(2) *International economic review* 357–379, 357. Author is referring to J.J. Pincus, 'Pressure Groups and the Pattern of Tariffs' (1975) 83(4) *Journal of Political Economy* 757-778; Lester M. Salomon and John J. Siegfried, 'Economic Power and Political Influence' (1977) 71 *American Political Science Review* 1026-1043; Edward J. Ray, 'The Determinants of Tariffs and Nontariff Trade Restrictions in the U.S.," *Journal of Political Economy* 89 (1981), 105-121; H. P. Marvel and E. J. Ray, 'The Kennedy Round: Evidence on the Regulation of International Trade in the U.S.' (1983) 73(1) *American Economic Review* 190-197; Robert E. Baldwin, 'The Political Economy of U.S. Import Policy (MIT Press 1985).

⁹⁴ J.H. Herz, 'Expropriation of Foreign Property' (1941) 35 *A.J.I.L.* 243, 250.

⁹⁵ *Sedelmayer v The Russian Federation*, award dated 7 July 1998 <<http://www.italaw.com/sites/default/files/case-documents/ita0757.pdf>> accessed 20 December 2015.

⁹⁶ *Wena Hotels Ltd v Arab Republic of Egypt*, ICSID Case No ARB/98/4, 41 *ILM* 933.

⁹⁷ *Metalclad Corporation v United Mexican States*, ICSID Case No ARB (AF)/97/1, award of 30 August 2000, 40 *ILM* 36.

⁹⁸ *CME Czech Republic BV v Czech Republic*, Ad Hoc UNCITRAL Arbitration Rules, partial award 13 September 2001; IIC 62 (2003), final award 14 March 2003 <http://www.italaw.com/documents/CME-2003-Final_001.pdf> accessed 10 December 2015.

⁹⁹ *SD Myers v Canada* (2000) 40 *ILM* 1408 para. 283, 1st partial award of 13 November 2000.

¹⁰⁰ Award on Jurisdiction and Liability of 27 October 1989, 95 *ILR* 183. After Biloune has been deported government allegedly reacquired the assets with the lease for the resort premises, which is the reason the case involves government appropriation.

¹⁰¹ The International Law Commission held its first session at Lake Success, New York, from 12 April to 9 June 1949 in accordance with General Assembly resolution 174 (II) of 21 November 1947.

In 1955, the seventh session took place and initiated the study of State responsibility for which F.V. García Amador was appointed to produce the reports on topic of responsibility for injuries to the persons or property of aliens. The title was amended in 2001 to ‘Responsibility of States for internationally wrongful acts’.¹⁰² International relations are governed by customary international law, which in case of the law of state responsibility remains effectively under auspice of custom.¹⁰³

When TNCs come in host developing states they are supposed to generate employment, but developing states should develop their own capacity inside their domestic sectors and create more employment rather than rely on the external employment generators. State responsibility should be protection and should also enforce that their system of law takes precedence over international law and include obligatory provision on capacity building in their investment agreements. It seems as if host developing states have failed to negotiate the state contracts that would help them to achieve capacity building.

Private foreign investors believe that the level of protection for their investments should be much higher and should protect them from political instability that might change laws or policies that have an effect on their investment. However, state responsibility does not include intent to expropriate.¹⁰⁴ Since investment was identified as being beneficial to the socio-economic development, developing states were trying to promote and encourage foreign investment. However, ‘as far as developing states are concerned, FDI has not accounted for accelerated economic growth’.¹⁰⁵

States responsibility should primarily be to protect their citizens, but states have extended the protection to foreign investors by signing BITs. Bronfman argued that ‘states realized that they must grant the foreign investor the same, and even greater protection, than that which is granted to their own citizens’.¹⁰⁶ Subedi maintained ‘that much of international

¹⁰² The International Law Commission adopted in 2001 the Draft Articles on Responsibility of States for Internationally Wrongful Acts, UN Doc. A/56/10 (Nov. 2001)

¹⁰³ See International Law Commission <<http://legal.un.org/ilc/guide/annex3.shtml>> accessed 20 November 2015.

¹⁰⁴ See Phillips Petroleum Company Iran v The Islamic Republic of Iran, 21 Iran-U.S. Cl. Trib. Rep. 79, 115; Michael W. Reisman and Robert D. Sloane, ‘Indirect Expropriation and Its Valuation in the BIT Generation’ (2004) 74 Faculty Scholarship Series 115 (namely the discussion on intent).

¹⁰⁵ Leon E. Trakman, ‘Foreign direct investment: Hazard or opportunity?’ (2009-2010) 41 Geo. Wash. Int’l L. Rev. 1, 5.

¹⁰⁶ Marcela Klein Bronfman, ‘Fair and Equitable Treatment: An Evolving Standard’ (2006) 10 Max Planck Y.B. U.N.L. 609.

investment law had been written by Western countries', which 'favour maximising the protection of foreign investors'¹⁰⁷ over host developing states.

Customary international law governing the treatment of foreign investment has been reshaped to embody the principles of law found in more than two thousand concordant bilateral investment treaties. With the conclusion of such a cascade of parallel treaties, the international community has vaulted over the traditional divide between capital-exporting and capital-importing states and fashioned an essentially unified law of foreign investment.¹⁰⁸

The Doctrine of state responsibility include protection against injury to aliens and alien property.¹⁰⁹ Asante maintained that:

[H]ost states are enjoined by international law to observe an international minimum standard in the treatment of aliens and alien property. The duty to observe this standard-objective international standard-is not necessary discharged by according to aliens and alien property the same treatment available to nationals.¹¹⁰

Asante added that:

Where international standards fall below the international minimum standard, the latter prevails. Breach of the minimum standard engages the responsibility of the host State, and provides a legitimate basis for the exercise by the home State of the right of diplomatic protection of the aliens, a right predicated on the inherent right to protect nationals abroad.¹¹¹

The role of International investment law should be addressing disputes arising from the relationship between state sovereignty and investment liberalisation.¹¹² States should take

¹⁰⁷ Surya P Subedi, *International Investment Law* (3rd edn, Hart Publishing 2016) 10.

¹⁰⁸ Stephen M. Schwebel, 'The Influence of Bilateral Investment Treaties on Customary International Law' TDM 5 2005.

¹⁰⁹ See E. M. Borchard, 'The Minimum International Standard in the Protection of Aliens' (1940) 38 MICH. L. REV. 445; Arghyrios A. Fatours, 'Transnational Enterprises and in the Law of State Responsibility' in Richard B. Lillich (ed), *International Law of State Responsibility for Injuries to Aliens* (University of Virginia Press 1983).

¹¹⁰ Samuel K.B. Asante, 'International Law and Foreign Investment: A Reappraisal' (1988) 37 *International and Comparative Law Quarterly* 588-628, 590.

¹¹¹ Samuel K.B. Asante, 'International Law and Foreign Investment: A Reappraisal' (1988) 37 *International and Comparative Law Quarterly* 588-628, 590.

¹¹² See Wenhua Shan, Penelope Simons and Davinger Singh, *Redefining Sovereignty in International Economic Law* (Hart Publishing 2008).

the responsibility for securing their natural resources and socio-economic development by balancing the interests of the investors accordingly.¹¹³ Host developing states on one hand are trying to protect their interests by regulating the foreign investors, while the foreign investors are trying to protect their interests and establish sustainable investment relationship.

Sornarajah maintained that ‘It is undeniable, however, that treaties on foreign investment could limit the state’s sovereignty to treat the foreign investor in violation of the treaty standards which protect him’.¹¹⁴ Trakman maintained that ‘it is important to note that FDI does not ensure economic growth’.¹¹⁵ Two contradicting theories regarding the foreign investment impact on socio-economic development of host developing states are still present¹¹⁶ and include theories from neo-liberal, classical to the theory of dependency.¹¹⁷ Stiglitz for example is among the economists, which contradicts the neo-liberal economic theory.¹¹⁸ Brower and Schill believed that foreign investment is beneficial to socio-economic development and as such requires protection. They also believed that ‘both capital-importing and capital exporting countries derive benefits from increased flows of foreign investment’ because ‘investment treaties create a legal infrastructure for the functioning of a global market economy by protecting property rights, offering contract protection, establishing nondiscrimination as a prerequisite for competition through national and most-favored-nation treatment, and making effective dispute-settlement mechanisms’. As such it creates ‘Perfect market conditions presupposed, this leads to the efficient allocation of capital, economic growth, and development’ which is consequently beneficial for both parties.¹¹⁹

¹¹³ See Louis B. Sohn and R.R. ‘Baxter, Responsibility of States for Injuries to the Economic Interests of Aliens’ (1961) 55 AM. J. INT’L L. 545.

¹¹⁴ Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (3rd edn, CUP 2010) 120.

¹¹⁵ Leon E. Trakman, ‘Foreign direct investment: Hazard or opportunity?’ (2009-2010) 41 Geo. Wash. Int’l L. Rev. 1, 5.

¹¹⁶ See Muthucumaraswamy Sornarajah, ‘The Clash of Globalisations: Its Impact on the International Law on Foreign Investment’ (2003)10 Canadian Foreign Policy 1.

¹¹⁷ See Peter B. Evans, *Dependent Development: The Alliance of Multinational, State and Local Capital in Brazil* (Princeton University Press 1979); Björn Hettne, *Development Theory and the Three Worlds* (Longman 1988).

¹¹⁸ See Ha-Joon Chang, *Bad Samaritans: The Guilty Secrets of Rich Nations and the Treat to Global Prosperity* (Random House Business 2008); Joseph Stiglitz, *Making Globalisation Work* (Penguin 2006); see also Amartya Sen, *The Idea of Justice* (Penguin 2009).

¹¹⁹ Charles N. Brower and Stephen W. Schill, ‘Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?’ (2009) 9 Chicago Journal of International Law 471, 496.

Sornarajah maintained that ‘The right of a state to control the entry of foreign investment is unlimited, as it is a right that arises from sovereignty... a sovereign entity can surrender its rights even over a purely internal matter by treaty’.¹²⁰ While the draft Codes of Conduct on Transnational Corporations stated that ‘States have the right to regulate the entry and establishment of transnational corporations including determining the role that such corporations may play in economic and social development and prohibiting or limiting the extent of their presence in specific sectors’.¹²¹ Based on the lack of clarity on the state responsibility as a result the Draft Codes on ‘General provisions relating to the treatment of transnational corporations stated that ‘In all matters relating to the Codes, States shall fulfil, in good faith, their international obligations, including generally recognised and accepted legal rules and principles’.¹²²

Host developing states have concluded bilateral investment treaties (BITs) and committed themselves to offer a set of standards, which included fair and equitable treatments, MFN and national treatment, investor-state arbitration, protection and security for the foreign investment, due process and appropriate compensation payment¹²³ in cases of expropriation.

A number of international law scholars maintained that:

States are more likely to violate customary international law as the costs of compliance increase, they insist that the sense of legal obligation puts some drag on such deviations. Our theory, by contrast, insists that the payoffs from cooperation or deviation are the sole determinants of whether States engage in the cooperative behaviors that are labelled as customary international law. This is why we deny the claim that customary international law is an exogenous influence on States' behaviour.¹²⁴

¹²⁰ Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (3rd edn, CUP 2010) 88.

¹²¹ UNCTC, ‘Proposed Text of the Draft Code on Transnational Corporations’, E/1988/39/Add.1 (1988).

¹²² Principles of the law on state responsibilities are written in the *Draft Articles on Responsibility of States for Internationally Wrongful Acts 2001*. Principles were adopted by International Law Commission in 2001. UN Doc A/56/10.

¹²³ In *Texaco v Libya* (1977) 53 ILR 389, para 87; *Topco/Calasiatic* (1978) 17 ILM 3; *Aminoil case Kuwait v American Independent Oil Co* (1976) 21 ILM 143, (1982) 21 ILM 976 case tribunal was in favour of appropriate compensation payment.

¹²⁴ Jack L. Goldsmith and Eric A. Posner, ‘A Theory of Customary International Law’ (1999) 66 CHI. L. REV. 1113, 1120-31.

Behaviour of states became particularly challenging after BITs were conducted. The main problem regarding foreign investment was the open interpretation of the principles. ‘Violation of the fair and equitable treatment principle by the host state concerned is the most common allegation made by foreign investors before international investment tribunals’.¹²⁵ Violation of customary international law can only damage state reputation in relationship with the other states.¹²⁶ However states have to care for their reputation¹²⁷ and ‘all things equal, nations will strive to have a reputation for compliance will not always be of paramount concern because all things are not equal’.¹²⁸

The UN Charter¹²⁹ states that under international law no single state or small group of states is able to create or change customary international law, ‘despite the difference in power and influence of States, no individual or small group of States is now dominant’ because ‘Decisions tend to reflect the power relationship and the right of all States to participate in reaching them’.¹³⁰ Wolfke argued that ‘The possibility of the big powers openly imposing rules on minor nations no longer exist’ and added that ‘practice being the nucleus of custom, those states are the most important which have the greatest share and interests in such practice – that is, in most cases the great powers’ because ‘Such acceptance on the part of the great powers frequently has a decisive effect...’.¹³¹

The general belief has been that new states are bound by customary international law by virtue of the fact that they are a state, as a result of *opinio juris*¹³² and not by power.¹³³

¹²⁵ Surya P. Subedi, *International Investment Law* (Hart 2016) 86.

¹²⁶ Robert O. Keohane, ‘International Relations and International Law: Two Optics’ (1997) 38 HARV. INT’L L.J. 487, 496-499.

¹²⁷ See George W. Downs and Michael A. Jones, ‘Reputation, Compliance, and International Law’ (2002) 31 J. LEG. STUD. 95.

¹²⁸ Jack L. Goldsmith and Eric A. Posner, ‘A Theory of Customary International Law’ (1999) 66 CHI. L. REV. 1113, 1136.

¹²⁹ U.N. Charter art.2, para. I.

¹³⁰ Jonathan I. Charney, ‘Universal International Law’ (1993) 87 AM. J. INT’L L. 529, 533.

¹³¹ Karol Wolfke, *Custom in Present International Law* (2nd edn, Springer 1993) 78.

¹³² Thomas M. Franck, *Fairness in International Law and Institutions* (OUP 1995) 32; see also Thomas M. Franck, *The power of legitimacy among nations* (OUP 1990).

¹³³ Edwin M. Borchard, *The Diplomatic Protection of Citizens Abroad* (Nabu Press 2010); Frederick S. Dunn, *The Protection of Foreign Nationals* (The Johns Hopkins Press 1932); C. F. Amerasinghe, *State Responsibility for Injuries to Aliens* (OUP 1967); and Muthucumaraswamy Sornarajah, *The Pursuit of Nationalized Property* (Martinus Nijhoff 1986).

When aliens enter states, the role of international law is to ensure certain standards for their treatment as in the opposite case the states can be held liable for mistreatment.¹³⁴ There is however no unified system of sanctions in existence in international law.¹³⁵ Sornarajah maintained that ‘The theory of state responsibility for injuries to aliens rests on the idea that an injury to an alien is an injury to his home state’,¹³⁶ which is the basic principle of international diplomacy ‘Whoever ill treats a citizen injures the state which must protect the citizen’.¹³⁷ The *Panevezys–Saldutiskis Railway Case*¹³⁸ changed this view to ‘Whoever ill treats the citizen indirectly injures the state, which must protect its citizens’.¹³⁹ ‘While generally adhering to the standard of national treatment, these states also claim that in exceptional instances they could discriminate in favour of their own citizens’,¹⁴⁰ however very few cases actually exercised this.¹⁴¹ ‘[O]nce the alien voluntarily takes the risk of investing in a host state, he must bear the risk of potential injury to his investment and must be satisfied with then same standard of compensation as is given to the nationals of the state who suffer the same fate as he does. It is a potentially sound principle of risk allocation’.¹⁴²

¹³⁴ See Chittharanjan Felix Amerasinghe, *State Responsibility for Injuries to Aliens* (OUP 1967); Frederick S. Dunn, *The Diplomatic Protection of Americans in Mexico* (Columbia University Press 1932); Alwyn V. Freeman, *International Responsibility of States for Denial of Justice* (Longmans 1970); Frank Griffith Dawson, *International Law, National Tribunals and the Rights of Aliens* (Syracuse University Press 1971); F. V. Garcia-Amador, L. B. Sohn and R. R. Baxter, *Recent Codification of the Law of State Responsibility for Injuries to Aliens* (Springer 1974); E. Jimenez de Arechaga, ‘International Responsibility’, in Max Sorensen (ed), *Manual of Public International Law* (Macmillan 1968) 362; Richard B. Lillich (ed), *International Law of State Responsibility for Injuries to Aliens* (University of Virginia Press 1983); Muthucumaraswamy Sornarajah, *The Pursuit of Nationalized Property* (Martinus Nijhoff 1986); James Crawford, *The International Law Commission’s Articles on State Responsibility* (CUP 2002).

¹³⁵ See William M. Reisman, ‘Sanctions and Enforcement’ in Richard A. Falk and Cyril E. Black (eds), *The Future of the International Legal Order* (Princeton University Press 1971) 273; James L. Brierly, ‘Sanctions’ (1932) 17 *Transactions of the Grotius Society* 1932, 67; HLA Hart, *The Concept of Law* (2nd edn, Clarendon Press 1997) 211-221; Anthony D’Amato, ‘The Neo-Positivist Concept of International Law’ (1965) 59 *AJIL* 321; G. Fitzmaurice, ‘The Foundations of the Authority of International Law and the Problem of Enforcement’ (1956) 19 *MLR* 1.

¹³⁶ Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (3rd edn, CUP 2010) 121.

¹³⁷ Emer de Vattel, *The Law of Nations* (Liberty Fund 2008); See also Peter P. Remec, *The Position of the Individual in International Law According to Grotius and Vattel* (Springer 1960).

¹³⁸ *Panevezys–Saldutiskis Railway Case* (Estonia v Lithuania) 1939 *PCIJ Series A/B No. 76*, 16.

¹³⁹ See Peter Remec, *The Position of the Individual in International Law According to Grotius and Vattel* (Springer 1960).

¹⁴⁰ Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (3rd edn, CUP 2010) 123.

¹⁴¹ Only some Latin American states have not adhere to the rule of international minimum standards of treatment for aliens.

¹⁴² Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (3rd edn, CUP 2010) 124.

Connell¹⁴³ argued that states are born in the existing international law. However, there is no agreement on international law in terms of foreign investment protection that all states would agree upon. There is only the rule regarding payment of compensation in case of taking of alien property by the host state, which was primarily formed on the cases of compensation payment in the post-colonial period.

International law on state responsibility instructs to protect their nationals abroad.¹⁴⁴ Furthermore the failure of the state to provide compensation to those whose human rights were violated¹⁴⁵ results in a law suit against the state, as seen in the *Neer v United Mexican States*¹⁴⁶ case example.

Customary international law is clear on the payment of appropriate compensation in case of nationalisation.¹⁴⁷ Lillich and Weston¹⁴⁸ contradict the payment of full compensation, but do agree to a partial compensation payment. The overwhelming majority of writers support the view that partial compensation was the basis of these agreements.¹⁴⁹ This request is in contradiction to the customary international law, which is in favour of full compensation payment in case of nationalisation or taking of alien property and expropriation.

It is state responsibility to compensate for taking as a consequence for damages caused. No state can change the customary rule even if a state was not born at the time.¹⁵⁰ The main objective of customary international law is the intention to be bound and it also

¹⁴³ D. P. O'Connell, 'Independence and Problems of State Succession' in William V. O'Brien (ed), *The New Nations in International Law and Diplomacy* (The Yearbook of world polity, vol. 3 1965) 7-12.

¹⁴⁴ Chittharanjan Felix Amerasinghe, *State Responsibility for Injuries to Aliens* (OUP 1967); and Richard B. Lillich (ed), *International Law of State Responsibility* (University of Virginia Press 1983). The earlier drafts on state responsibility prepared by Garcia-Amador concentrated on alien protection, which was and is a divisive subject in international law. See F. V. Garcia-Amador, *Changing Law of International Claims* (Oceana Publications 1984).

¹⁴⁵ See R. Pisillo-Mazzeschi, 'International Obligations to Provide for Reparation Claims?' in A. Randelzhofer and C. Tomuschat (eds), *State Responsibility and the Individual* (1999) 149.

¹⁴⁶ The USA (L.F. Neer) v United Mexican States 1926.

¹⁴⁷ G. Gantz, 'The Marcona Settlement: New Forms of Negotiation Compensation for Nationalized Property' (1977) 71 AJIL 474;

¹⁴⁸ Richard B. Lillich and Burns H. Weston and David J. Bederman, *International Claims: Their Settlement by Lump Sum Agreements* (Brill Nijhoff 1975) 35.

¹⁴⁹ Vratislav Pechota, 'The 1981 United States-Czechoslovakia Claims Settlement Agreement: An Epilogue to Post War Nationalisation and Expropriation Disputes' (1982) 76 AJIL 639; Chittharanjan Felix Amerasinghe, 'Issues of Compensation in the Taking of Alien Property in the Light of Recent Cases and Practice' (1992) 41 ICLQ 22, 28; Rudolf Dolzer, 'New Foundations of the Law of Expropriation of Alien Property' (1981) 75 AJIL 553, 560.

¹⁵⁰ Uruguay tried to change customary rule, see Filipe Michelini, 'Reflections on Uruguayan Law No. 18831 a Year After Its Enactment' (2013) 20(3) Human Rights Brief 2-17.

demands payment of full compensation. Partly is based on the theory of unjust enrichment.¹⁵¹ The foundation for compensation payment were laid in case concerning the *Certain German Interests in Polish Upper Silesia* in 1925.¹⁵² The Permanent Court maintained that expropriation must be for ‘reasons of public utility, judicial liquidation and similar measures’.¹⁵³ The quote of the Permanent Court of International Justice stated that ‘the principle of respect for vested rights...forms part of generally accepted international law’¹⁵⁴ that was used for case examples of acquired rights.

The Statute of the International Court of Justice in Article 38 (b) states that one of the provisions of international law is ‘international custom, as evidence of a general practice accepted as law’.¹⁵⁵ Customary international law is fundamental to understanding international law.¹⁵⁶ Reuter maintained that ‘customs enjoys privileged status in the international order: “custom” is even more central than the treaty’.¹⁵⁷

New actors such as intergovernmental, non-governmental organisations and transnational companies have been given international legal personality ‘even if only granted by treaties concluded between states’.¹⁵⁸ International law has expanded in its scope and it:

[C]onsists of rules and principles of general application dealing with the conduct of states and of international organizations and with their relations inter se, as well as with some of their relations with persons, whether natural or juridical.¹⁵⁹

¹⁵¹ Dagan Hanoch, *Unjust Enrichment: A Study of Private Law and Public Values* (CUP 1997); Heidi M. Hurd ‘Nonreciprocal Risk Imposition, Unjust Enrichment, and the Foundations of Tort Law: A Critical Celebration of George Fletcher’s Theory of Tort Law’ (2003) 78 *Notre Dame Law Review* 711; Stephen A. Smith, ‘The Structure of Unjust Enrichment Law: Is Restitution a Right of a Remedy’ (2003) 36 *Loyola of Los Angeles Law Review* 1037.

¹⁵² *Certain German Interests in Polish Upper Silesia* (Germany v Poland), PCIJ Rep (1926) Series A, No 7 <http://www.icj-cij.org/pcij/serie_A/A_06/16_Interets_allemands_en_Haute_Silesie_polonaise_Compentence_Arret.pdf> accessed 15 December 2015.

¹⁵³ PCIJ, Series A, No. 7, 1926, 22.

¹⁵⁴ Permanent Court of International Justice, Series A, No.7, 1926, 42.

¹⁵⁵ Statute of the International Court of Justice, art. 38 sec. 1 ch 2; Ian Brownlie, *Principles of Public International Law* (6th edn, 2003).

¹⁵⁶ See Brigitte Stem, ‘Custom at the Heart of International Law’ (2001) 11 *DUKE J. COMP. & INT’L L.* 89.

¹⁵⁷ Paul Reuter, *Introduction au droit des traits* (Graduate Institute Publications 1972) 38.

¹⁵⁸ Peter Malanczuk, *Akehurst’s Modern Introduction to International Law* (7th edn, Routledge 1997) 1.

¹⁵⁹ Definition in the *Restatement (Third)* by the American Law Institute of the *Foreign Relations Law of the United States*, 1987 para 101, 22-24.

States are conscious of their sovereignty and perhaps are therefore failing the UN not due to the 'lack of sanctions in cases of violations of international norms' but due to its execution, which raises the question of the role of international law.¹⁶⁰ However, the areas of international law cover the position of states, state succession, state responsibility, peace and security, the laws of war, the law of treaties, the law of the sea, the law of international waters-courses, the conduct of diplomatic relations, international organisations, economy and development, nuclear energy, air law and outer space activities, the use of resources of the deep sea, the environment, communications and the international protection of human rights.¹⁶¹ The Vienna Convention defines the treaty as 'an international agreement concluded between States in written form and governed by international law'.¹⁶² Byers maintained that treaty rules are based on the general customary rules.¹⁶³ While D'Amato expressed his concern for effectiveness and enforceability of treaties and their binding elements to the signatories.¹⁶⁴ Fidler was exploring the challenges that customary international law is facing.¹⁶⁵ Kelly maintained that 'there is neither a common understanding of how customary international legal norms are formed, nor agreement on the content of those norms' and added that:

Controversy is inevitable because the elements of CIL legal theory are empty vessels in which to pour one's own normative theory of international law Rather than undergoing a revitalization, CIL is disintegrating into a useless, incoherent source of law that is of little guidance in determining norms.¹⁶⁶

Swaine stated that 'Even custom's most ardent supporters, however, have difficulty explaining how it arises, and more particularly, why customary practices should be considered binding on states'.¹⁶⁷ Wolfke maintained that 'the intangibility of custom, in the numerous factors which come into play, in the great number of various views, spread

¹⁶⁰ Peter Malanczuk, Akehurst's Modern Introduction to International Law (7th edn, Routledge 1997) 5.

¹⁶¹ Peter Malanczuk, Akehurst's Modern Introduction to International Law (7th edn, Routledge 1997) 7.

¹⁶² See also Vienna Convention on the Law of Treaties, art. 2(1) 1969.

¹⁶³ Michael Byers, Custom, Power and the Power of Rules, International Relations and Customary International Law (CUP 1999) 107.

¹⁶⁴ Antony A. D'Amato, *The Concept of Custom in International Law* (Cornell University Press 1971) 130.

¹⁶⁵ See David P. Fidler, 'Challenging the Classical Concept of Custom: Perspectives on the Future of Customary International Law' (1996) 39 GERMAN Y.B. INT'L L. 198; Jack L. Goldsmith and Eric A. Posner, 'A Theory of Customary International Law' (2005) 43 University of Chicago.

¹⁶⁶ J. Patrick Kelly, 'The Twilight of Customary International Law' (2000) 40 Va. J. Int'l L. 449, 450-500.

¹⁶⁷ Edward T. Swaine, 'Rational Custom' (2002) 52 Duke Law Journal 559, 563.

over centuries, and in the resulting ambiguity of the terms involved¹⁶⁸ presents the problem for understanding the customs. For that reason, Roberts called for ‘articulation of a coherent theory...’¹⁶⁹ Lack of clarity on customary international law can endanger its importance. D’Amato maintained that ‘if custom creates law, how can a component of custom require that the creative acts be in accordance with some prior right or obligation in international law?’ and asked ‘How can custom create law if its psychological component requires action in conscious accordance with law pre-existing the action?’¹⁷⁰

States are trying to exercise their control over private foreign investment beyond customary international law.¹⁷¹ Sornarajah maintained that state sovereignty is subject to the principles of customary and treaty-based international law.¹⁷² While developed states recognise the importance of customary international law in protecting the foreign investments the developing states are becoming sceptical.

Hackworth stated the US position is the following:

[T]he Department of State does not intervene in cases involving breaches of contract between a foreign state and a national of the United States in the absence of showing a denial of justice ... The practice of declining to intervene formally prior to a showing of denial of justice is based on the proposition that the Government of the United States is not a collection agency and cannot assume the role of endeavouring to enforce contractual undertakings freely entered into by nationals with foreign states.¹⁷³

The main concern of the foreign investors is the fear for security of their assets in the host developing states. Foreign investors are also the subject of host states jurisdiction.¹⁷⁴ The nature of investments is long-term, which means that the circumstances can significantly

¹⁶⁸ Karol Wolfke, *Custom in Present International Law* (2nd edn, 1993).

¹⁶⁹ Anthea Elizabeth Roberts, ‘Traditional and Modern Approaches to Customary International Law: A Reconciliation’ (2001) 95 AM. J. INT’L L. 757, 757.

¹⁷⁰ Anthony A. D’Amato, *The Concept of Custom in International Law* (Cornell University Press 1971) 53, 66.

¹⁷¹ Christine Tietje (ed), *International Investment Protection and Arbitration* (Bwv Berliner-Wissenschaft 2008).

¹⁷² Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (3rd edn, CUP 2010) 119.

¹⁷³ Green Haywood Hackworth, *Digest of International Law* (U.S. Government Printing Office 1943), Vol. 5, 611.

¹⁷⁴ See Noah Rubins and Stephan Kinsella, *International Investment, Political Risk and Dispute Resolution: A Practitioner’s Guide* (Oceana 2005).

change over time. Some of these circumstances can be significant, such as coup d'état, wars, economic crisis, revolutions that could lead to a change of regime. Such actions can potentially jeopardise the relationships between the host states and foreign investors. In extreme cases governments can seize assets and property of foreign investors. It was mainly on the initiative of the foreign investors that insisted on host states to adopt and respect the international minimum treatment standards. As a result, the investment treaties were primarily aimed at securing and protecting the investor property rights from acts of expropriation, and nationalisation from host governments.

The provision on expropriation and nationalisation is also written in the NAFTA Article 1110, which states that 'no Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory'.¹⁷⁵ Unfortunately NAFTA did not include the provision, which would define the two terms and was therefore left to interpretation.¹⁷⁶

However, state sovereignty gives a state the right to expropriate on their territory, which is not considered illegal under international law, as long as compensation is paid.¹⁷⁷

According to the NAFTA Article 1110:

1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ('expropriation'), except:

- (a) For a public purpose;
- (b) On a non-discriminatory basis;
- (c) In accordance with due process of law and Article 1105(1); and
- (d) On payment of compensation in accordance with paragraph 2 through 6.¹⁷⁸

¹⁷⁵ NAFTA Article 1110.

¹⁷⁶ See Muthucumaraswamy Sarnarajah, *The International Law on Foreign Investment* (2nd edn, CUP 2004); UNCTAD, *Bilateral Investment Treaties in the Mid-1990s* (1998) 65.

¹⁷⁷ See Rudolf Dolzer and Christoph Schreuer, *Principle of International Investment Law* (OUP 2007); Ingrid D. DeLupis, *Finance and Protection of Investment in Developing Countries* (Gower 1975).

¹⁷⁸ NAFTA (17 December 1992), (1994) 32 ILM 612.

The primary role of a state is to protect its citizens and its economic interests in order to do that they are allowed to take appropriate measures as per ICL Article 25 of the Draft articles on Responsibility of States for Wrongful Acts 2001.¹⁷⁹

In the Energy Charter Treaty 1994, Article 13(1) states:

(1) Investments of Investor of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation (hereinafter referred to as 'Expropriation') except where such Expropriation is:

- (a) For a purpose which is in the public interest;
- (b) Not discriminatory
- (c) Carried out under due process of law; and
- (d) Accompanied by the payment of prompt, adequate and effective compensation.¹⁸⁰

There is a slight variation of the conditions of expropriation that can be seen in the investment treaties. Under NAFTA Article 1110 identifies key elements for expropriation or taking:

- a. Expropriation requires a taking (which may include destruction) by government-type authority of an investment by an investor covered by the NAFTA.
- b. The covered investment may include intangible as well as tangible property.
- c. The taking must be a substantially complete deprivation of the economic use and enjoyment of the rights to the property, or of identifiable distinct parts thereof (i.e., it approaches total impairment).
- d. The taking must be permanent, and not ephemeral or temporary.
- e. The taking usually involves a transfer of ownership to another person (frequently the government authority concerned), but that need not necessarily be so in certain cases (e.g., total destruction of an investment due to measures by a government authority without transfer of rights).
- f. The effects of the host state's measures are dispositive, not the underlying intent, for determining whether there is expropriation.
- g. The taking may be de jure or de facto.
- h. The taking may be 'direct' or 'indirect'.

¹⁷⁹ A/56/10.

¹⁸⁰ The Energy Charter Treaty (17 December 1994), 2080 UNTS 100.

- i. The taking may have the form of a single measure or a series of related or unrelated measures over a period of time (the so-called ‘creeping’ expropriation).¹⁸¹

The above criteria is applicable to the most of the investment treaties. States are in conflicting position while trying to attract the foreign investment they would also like to retain freedom to control their territory by means of legislation and regulation. These challenges create a great deal of tension, which is a part of the negotiation process and it depends mainly on the bargaining position of the host states on how successful they are in negotiating the investment treaties. In order to protect host state’s interests some investment treaties include exceptions. Such example can be seen in US – Kazakhstan BIT, which states:

Each Party reserves the right to deny to any company the advantage of this Treaty if nationals of any third country control such company and, in the case of a company of the other Party, that company had no substantial business activities in the territory of the other Party or is controlled by nationals of a third country with which the denying Party does not maintain normal economic relations.¹⁸²

In most cases customary international law plays a crucial role as the Tribunal often refers to it in order to find an applicable standard when making decisions. One of such examples was the *ADC Affiliate Limited and ADC & ADMC Management Limited v Republic of Hungary*¹⁸³ where the tribunal was trying to find appropriate standard that would help define the value of compensation. The Cyprus – Hungary BIT stated that ‘the amount of compensation must correspond to the market value of the expropriated investment at the moment of the expropriation’¹⁸⁴ to which Hungary claimed that the appropriate standard should be ‘market value’. However, the tribunal concluded that the provision in BIT only

¹⁸¹ Feldman’s Fund Insurance Company v United Mexican States, ICSID Case No ARB/(AF)/02/1, award 17 July 2006) NAFTA 176.

¹⁸² Treaty between the United States of America and the Republic of Kazakhstan Concerning the Encouragement and Reciprocal Protection of Investment (signed 19 May 1992, entered into force 12 January 1994) Art I(2) <http://tcc.export.gov/Trade_Agreements/All_Trade_Agreements/exp_005571.asp> accessed 25 February 2016.

¹⁸³ See *ADC Affiliate Limited and ADC & ADMC Management Limited v Republic of Hungary Award*, ICSID Case No ARB/03/16, award of the Tribunal of 2 October 2006 <<http://www.italaw.com/sites/default/files/case-documents/ita0006.pdf>> accessed 20 March 2016.

¹⁸⁴ Cyprus – Hungary BIT (signed 24 May 1989, entered into force 25 May 1990) Art 4 <<http://investmentpolicyhub.unctad.org/Download/TreatyFile/922>> accessed 20 March 2016.

applies in the cases of legal expropriations and not in cases of the illegal expropriations. Consequently the Tribunal took the *Chorzów Factory* ruling into account and stated that ‘Reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed’.¹⁸⁵ The BIT also states that ‘neither Contracting Party shall take any measures depriving, directly or indirectly, investors of the other Contracting Party of their investment unless...the measures are accompanied by provision for the payment of just compensation’.¹⁸⁶ Just compensation in this case would be the market value. The BIT does not make the distinction between the legal and illegal expropriation, which only the Tribunal has made. That clearly indicates that the compensation was not awarded based on the standards of treatment provided in the BIT, but based on the principle of customary international law and *Chorzów Factory* principle.

4.4 Protection under BITs and Cases of taking of private foreign assets

Bilateral investment treaties (BITs) were commonly concluded to attract foreign investments and to protect property rights of foreign investors, however there is no evidence that BITs increase foreign investments.¹⁸⁷ Mann and von Moltke maintained that there is ‘no recognizable relationship between IIAs and investment flows...’.¹⁸⁸ The question is if the rules included in BITs have consequently also become rules of customary international law considering that BITs offer greater standard of protection than those of customary international law. Gunawardana stated that BITs affect the customary international law, which are governing the investments.¹⁸⁹ Kishoiyan

¹⁸⁵ Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (OUP 2007) 484.

¹⁸⁶ Cyprus – Hungary BIT (signed 24 May 1989, entered into force 25 May 1990) Art 4
<<http://investmentpolicyhub.unctad.org/Download/TreatyFile/922>> accessed 20 March 2016.

¹⁸⁷ Developing countries that signed BITs in hope to attract FDI have now started to regret this decision concretely South Africa and Indonesia, who for example terminated BIT with the Netherlands in 2015. Bolivia withdraw from ICSID. Despite the actions taken, these countries are still attracting FDI.

¹⁸⁸ Howard Mann and Konrad von Moltke, *A Southern Agenda on Investment? Promoting Development with Balanced Rights and Obligations for Investors, Host States and Home States* (Winnipeg, International Institute for Sustainable Development 2005) 4,
<http://www.iisd.org/pdf/2005/investment_southern_agenda.pdf> accessed 5 March 2016.

¹⁸⁹ Asoka de Z. Gunawardana, ‘The Inception and Growth of Bilateral Investment Promotion and Protection Treaties’ (1992) 86 PROc. AM. Soc’Y INT’L L. 544, 550.

maintained that ‘each BIT is nothing but *lex specialis* between parties’.¹⁹⁰ Subedi maintained that an example of *lex specialis* can be seen in the ‘recent attempts by states such as Bolivia, Venezuela, and Ecuador to re-negotiate concessions and other contracts with foreign companies’.¹⁹¹ Schwebel on the other hand maintained that ‘the very purpose of treaties is to constrain the freedom of States’.¹⁹² This research however maintains that it is not the investment treaties that constrain developing states but the lack of initiatives to include re-negotiations clause and oppose to the most-favour-nation treatment and full compensation payment, both of which are in favour of foreign investors. Concluding investment treaties should be accorded greater drafting attention to the provisions that should be better negotiated to adequately represent interests of both parties.

Foreign investments are controlled by signed BITs, however notwithstanding the need for their protection.¹⁹³ Host states are keen on enabling socio-economic development, technology transfer, and acquisition of skills without endangering their sovereignty, while the investors are interested in the return on their investment. The objective of foreign investors is to get the highest returns on their investment, while the objective of host developing states was to regain sovereignty, which namely applied to those newly formed independent states.

In quest to accommodate the interests of both parties’ investment agreements were formed, which became dominant form of formal investment relationships. In the case of dispute reconciliation and protection, under the auspices of the World Bank (WB) the convention on Settlement of Investment Disputes between States and Nationals of Other States (ICSID) 1965¹⁹⁴ and the Multilateral Investment Guarantee Agency (MIGA) 1985¹⁹⁵ Conventions were formed. BITs enabled foreign investors to access the ICSID for resolving investment disputes with host states, which can be conducted in the absence of

¹⁹⁰ Bernard Kishoiyian, ‘The Utility of Bilateral Investment Treaties in the Formulation of Customary International Law’ (1994) 14 Nw. J. INT’L L. & Bus. 327, 329.

¹⁹¹ Surya P. Subedi, *International Investment Law* (3rd edn, Hart Publishing 2016) 116. In 1997 UN Convention on the Use of International Watercourses maintains that if there are *lex specialis* between states regarding sharing, management and development of an international water course they would apply before the principles of the UN Convention, see Surya P. Subedi (ed), *International Watercourses Law for the 21st Century: The Case of the River Ganges Basin* (Ashgate Publishing 2005).

¹⁹² Stephen M. Schwebel, ‘In Defense of Bilateral Investment Treaties’ (2015) 31 Arbitration International 181, 189.

¹⁹³ See Rudolf Dolzer and Margrete Stevens, *Bilateral Investment Treaties* (Martinus Nijhoff 1995) 26.

¹⁹⁴ ICSID Convention 1965.

¹⁹⁵ MIGA Convention 1985.

the host states by appointed arbitrary. These conventions have formulated the scheme to insure foreign investments against risks. The main concern of foreign investors was the political instability of host developing states as well as their underdeveloped legal system and judiciary in which they had little trust and effectively taking.

The question ‘whether, for an “investment” to qualify as a foreign investment, a transfer of capital is required’ has been raised, however ‘An investment is a foreign investment if it is owned or controlled by a foreign investor’¹⁹⁶ is one view; the other view is that the origin of funds is not relevant. Investment could come from various sources, such as imported capital, profits made, payments received or loans raised locally, makes no difference to the degree of awarded protection. In *Tokios Tokelès v Ukraine*¹⁹⁷ case for example ICSID ruled that due to the signed BIT, the parties have the right to determine what classifies the investment and the right to review the existing requirements set in the BIT. Terms and conditions in BITs should therefore be clearly defined and agreed. Lack of clarity was the case in *Tradex v Albania*,¹⁹⁸ where the former claimed their financial source was irrelevant to which the tribunal agreed as there was no clear definition of investment. Schlemmer maintained that the ‘nature of an investment is determined exclusively by the nationality of the investor that exercises ownership and control’.¹⁹⁹ BITs left the definition of an investment open to interpretation and therefore ICSID reached different conclusions. Such argument can be noted in *AMT v Zaire*²⁰⁰ and *Fedax v Venezuela*.²⁰¹ However in spite of referring to the latter case the tribunal in *Joy Mining v Egypt*²⁰² came to a different conclusion regardless of the fact that the investment was

¹⁹⁶ Engela C. Schlemmer, ‘Investment, Investor, Nationality, and Shareholders’ in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds), *Oxford Handbook of International Investment Law* (OUP 2008) ch 2, 58.

¹⁹⁷ *Tokios Tokelès v Ukraine*, ICSID Case No. Arb/02/18, 29 April 2004 <www.ita.law.uvic.ac.ca> accessed 20 January 2016.

¹⁹⁸ *Tradex Hellas SA v Republic of Albania*, ICSID Case No. Arb/94/2 24 December 1996, 14 ICSID Review – FILJ 197 (1999); 5 ICSID Rep 47 (2002) at para. 103-131, award of 29 April 1999.

¹⁹⁹ Engela C. Schlemmer, ‘Investment, Investor, Nationality, and Shareholders’ in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds), *Oxford Handbook of International Investment Law* (OUP 2008) ch 2, 60. The stated can be seen in numerous cases, such as *SGS Société Générale de Surveillance SA v Pakistan*, ICSID Case No. Arb/01/13, 6 August 2003 <www.worldbank.org/icsid accessed 20 January 2016> accessed 20 January 2016; *SGS Société Générale de Surveillance SA v Republic of the Philippines*, ICSID Case No. Arb/02/6, 29 January 2004 <www.worldbank.org/icsid> accessed 20 January 2016.

²⁰⁰ *AMT v Zaire* (1997) 36 ILM 1531.

²⁰¹ *Fedax v Venezuela*, 37 ILM 1378, 1998.

²⁰² *Joy Mining Machinery Ltd v Egypt*, ICSID Case No ARB/03/11, award on jurisdiction of 6 August 2004.

aimed at economic development, which the tribunal in *LESI v Algeria*²⁰³ found to be irrelevant but not in *Patrick Mitchell v Democratic Republic of the Congo*²⁰⁴ and *Malaysian Historical Salvors, SDN, BHD v Malaysia*.²⁰⁵ The lack of clarity is the reason that ICSID came to different conclusions in their arbitral ruling.

Relationship between states are at the forefront of the investment agreements, namely between developed and developing states, which contain provision on the settlement of investment disputes by international tribunal. There is no such provision in the rare BIT between two developed states.²⁰⁶ Newly independent states expressed their aspirations in a number of UN resolutions²⁰⁷ as well as the right of developing states to fully regulate foreign investments on their territory in accordance with the domestic laws as recommended in the Calvo doctrine.²⁰⁸

Private foreign investors wanted to protect their investments from the potential government intervention resulting in taking. Bernardini maintained that contractual guarantee is ‘a matter of negotiations with the State, based on the parties’ respective bargaining power, to agree in the investment contract on the most suitable provisions’.²⁰⁹ As mentioned in the first chapter the importance of bargaining position plays a crucial role in negotiating terms and conditions of an investment agreement.

In the definition of foreign investment, the provision on the protection of foreign investment is included. More recent developments have added to the concerns expressed

²⁰³ *LESI v Argentina*, ICSID Case No. Arb/05/03 <www.ita.law.uvic.ca/documents/LESIAlgeria.pdf> accessed 20 January 2016.

²⁰⁴ *Patrick Mitchell v Democratic Republic of the Congo*, ICSID No. Arb/99/7, Annulment Decision of 1 November 2006 <<http://ita.law.uvic.ca/documents/mitchellannulment.pdf>> accessed on 20 January 2016.

²⁰⁵ *Malaysian Historical Salvors, SDN, BHD v Malaysia*, ICSID Case No. Arb/05/10, Decision on Jurisdiction of 17 May 2007 <<http://ita.law.uvic.ca/documents/MHS-jurisdiction.pdf>> accessed 20 January 2016.

²⁰⁶ An example is US-Australia BIT 2004.

²⁰⁷ The most significant of such resolutions are those affirming the Permanent Sovereignty of each State over its Natural Resources of 14 December 1962 (Resolution No. 1803-XVII), 25 November 1966 (Resolution No. 2158) and 17 December 1973 (Resolution No. 3171-XXVIII); those concerning the establishment of a New International Economic Order of 1 May 1974 (Resolutions Nos. 3201 and 3202-SVI); and those defining the Economic Rights and Duties of the States in the so-called Charter of Algiers approved by Resolution No. 328 1- XXIX of 12 December 1974.

²⁰⁸ The main notion in the Calvo doctrine requires aliens to submit investment disputes to the host state court. In other words foreign investors have to exhaust local remedies before resorting to international arbitration.

²⁰⁹ Piero Bernardini, ‘Investment Protection under Bilateral Investment Treaties and Investment Contracts’ (2001) 2(2) *Journal of World Investment* 235, 240.

in the *Aminoil*²¹⁰ and the *Sedco*²¹¹ cases. In addition to ‘Expropriation in the sense of an outright taking of private property by the state, usually involving a transfer of ownership rights to the state or to a third person’²¹² and compensation, physical property also the provisions in property right, copyright, intellectual property rights, share of the company that represent either ownership or management and contractual and regulatory rights²¹³ were expressed.

‘The foreign corporation stood at a disadvantage in any agreement it made with the host state’ because ‘the host state had the legislative power to alter the impact on the contract’ in their territory, including contractual or property rights based on its sovereignty.²¹⁴ Foreign investors therefore wanted to protect themselves and for that reason the stabilisation clause was introduced.²¹⁵ Notwithstanding that stabilisation clause has caused much controversy, examples of which can be seen in *Texaco v Libya*²¹⁶, *Aminoil v Kuwait*²¹⁷, *Chad-Cameroon Pipeline Project*²¹⁸, *Consortium-Chad Convention for the Development of Oil Fields and the Host Government Agreement between Turkey and the Consortium of British Petroleum*.²¹⁹

Re-negotiation clause has unfortunately not been utilised in the investment treaties in order to re-negotiate on the new terms of the contract, when circumstances change or a need for modification arises.²²⁰ The main question is over the governing law for which foreign investors are not keen to leave in the hands of the host developing states’ domestic

²¹⁰ *Aminoil* (1982) 21 ILM 976.

²¹¹ *Sedco Inc v National Iranian Oil Co* (1985) Iran-US CTR 248, secondary interlocutory award, (1986) 1- Iran-US CTR 180.

²¹² August Reinisch, ‘Expropriation’ in Peter T. Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (OUP 2008) ch 11, 408.

²¹³ Such example can be seen in Australia – Indonesia BIT of 1992, ICSID, 1992, 2.

²¹⁴ M. Sornarajah, *The International Law on Foreign Investment* () 281.

²¹⁵ Stabilisation clause is a kind of guarantee to the investors that the legal and administrative system in the host state will not change to the point that will endanger the return on investment by disrupting their operations set in the investment agreement.

²¹⁶ *Texaco v Libya* (1977) 53 ILR 389.

²¹⁷ *Aminoil v Kuwait* (1982) 21 ILM 976.

²¹⁸ *Chad-Cameroon Pipeline Project* < http://www.ifc.org/wps/wcm/connect/region_ext_content/regions/sub-saharan+africa/investments/chadcameroon > accessed 20 March 2016 (see COTCO-Cameroon Convention 1997)

²¹⁹ *Consortium-Chad Convention for Development of Oil Fields Article 34.4 and the Host Government Agreement between Turkey and the Consortium led by the British Petroleum 2000* as cited in S Leader, ‘Human Rights, Risks, and New Strategies for Global Investment’ (2006) 9 *Journal of International Economic Law* 657, 667, 672-73.

²²⁰ See Piero Bernardini, ‘The Renegotiation of the Investment Contract’ (1998) 13(2) *Foreign Investment Law Journal* 411.

legal system and judiciary and would therefore prefer to be given to international tribunals.²²¹ The problem of treaties is their vagueness of provisions and bias in favour of foreign investors. The biggest problem of investment treaties is however the lack of balance of interests between both contracting parties translated in the clear provisions.

Umbrella clause is another provision of BITs, which is regarded as alternative but creates more problems because it is bias against developing states by protecting only foreign investors. Example can be seen in *Switzerland-Pakistan* BIT, however the ICSID in *SGS v Pakistan* maintained that the umbrella clause alone does not consequently make the breach of contract equal to breach of international treaty law.²²²

ICSID Convention in Article 42(1) states that:

The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.²²³

BITs include similar provisions on protection such as fair and equitable treatment, full protection and security, MFN and national treatment, prohibited arbitrary or discriminatory measures, payment of appropriate compensation,²²⁴ which should equally protect host states and investors against violating BITs provisions, but are significantly lacking the needed balance.

²²¹ See Piero Bernardini, 'The Law Applied by International Arbitrators to State Contracts' in Liber Amicorum and Karl-Heinz Böckstiegel, *Law of International Business and Dispute Settlement in the 21st Century* in Robert Briner, L.Yves Fortier, Klaus Peter Berger and Jens Bredow (eds) (Carl Heymanns Verlag 2001) 51.

²²² *SGS Société Générale de Surveillance SA v Islamic Republic of Pakistan*, ICSID Case No ARB/01/13, award of 8 September 2003, 361-63.

²²³ ICSID Convention in Article 42(1).

²²⁴ The term "prompt, adequate and effective compensation" was used by Secretary of State Cordell Hull in the course of Mexican expropriations, which was not seen as illegal and Mexican government was required to pay compensation to American citizens for the land taken during the land reforms; see Marjorie M. Whiteman, *Digest of International Law*, 8 Volumes covering 1940 – 1969, Vol. 8 (1965) 1020 and Haywood Hackworth, *Digest of International Law*, 15 Volumes covering 1906-1940, Vol. 3 (1965) 657. However Hull formula is not universally accepted as for example in the UK-India BIT in Article 5 provides for fair and equitable compensation against expropriation (1995) 34 ILM 935, therefore appropriate will be used as in UNGA 1803 para 4.

Foreign investment is promoted with BITs, which strive towards reciprocity and mutual benefits to the parties concerned towards socio-economic development.²²⁵ Bernardini maintained that ‘where the host country has enacted legislation governing private business activity and providing for some measures of protection of foreign investment’ because there is a risk that ‘the country may be subject to political instability’.²²⁶ Political stability unfortunately cannot be controlled with the provisions of BITs.

Reisman and Sloane maintained that ‘failure to create or maintain the normative “favourable” conditions in the host state’²²⁷ requires to ‘establish and maintain an appropriate legal, administrative, and regulatory framework’.²²⁸ While political stability cannot be controlled with BIT provision the legal system and judiciary can develop to the required international standard, which can be specified in the BIT provision.

Foreign investment has been controversial, especially in the host developing states. Despite the UN Resolution on Permanent Sovereignty over Natural Resources 1962 doubts have been expressed over the obligation of States to pay compensation due to taking.²²⁹ The most common cases of taking were the *Norwegian Shipowners’ Claims*²³⁰ in which the US ‘took over the legal rights and duties of the shipowners toward the shipbuilders’²³¹ and case concerning *Certain German interests in Polish Upper Silesia*²³² where the Permanent Court of International Justice maintained that Poland expropriated contractual rights, patents and licenses by seizing a machinery and the factory and has therefore appropriated foreign-held property. On the ground of extensive damages that the investor suffered *Starret Housing Corporation v Islamic Republic of Iran* the Tribunal maintained that ‘measures taken by a state can interfere with property rights to such an

²²⁵ See ICSID, *Investment Promotion and Protection Treaties* (1983); see also M Sornarajah, *The International Law on Foreign Investment* (CUP 1994) 225-276;

²²⁶ Developed states are mainly stable democracies where the property right is protected by law and political risk is low. Piero Bernardini, ‘Investment Protection under Bilateral Investment Treaties and Investment Contracts’ (2001) 2(2) *The Journal of World Investment* 235, 240.

²²⁷ Michael W. Reisman and Robert D. Sloane, ‘Indirect Expropriation and Its Valuation in the BIT Generation’ (2003) 74 *B.Y.I.L.* 117.

²²⁸ Michael W. Reisman and Robert D. Sloane, ‘Indirect Expropriation and Its Valuation in the BIT Generation’ (2003) 74 *B.Y.I.L.* 117.

²²⁹ See A. Akinsanya, ‘Permanent Sovereignty Over Natural Resources and the Future of Foreign Investment’ (1979) 7(2) *Millennium: Journal of International Studies* 124; A. Akinsanya, ‘The United Nations Charter of Economic Rights and Duties of States’ (1980) 30 *Eg.R.I.L.* 51-99.

²³⁰ *Norwegian Shipowners’ Claims* (Norway v US) (1922) 1 *RIAA.* 307, 332.

²³¹ *Norwegian Shipowners’ Claims* (Norway v US) (1922) 1 *RIAA.* 307, 323.

²³² *Certain German Interests in Polish Upper Silesia* (Germany v Poland), *PCIJ Rep* (1926) Series A, No 7, 42.

extent that these rights are rendered so useless that they must be deemed to have been expropriated'.²³³ However, compensation payments are no longer an issue for international law.²³⁴

There were many other cases such as *SD Myers Inc. v Canada* which maintained that:

An expropriation usually amounts to a lasting removal of the ability of an owner to make use of its economic rights although it may be that, in some contexts and circumstances, it would be appropriate to view a deprivation as amounting to an expropriation, even if it were partial or temporary.²³⁵

SD Myers the tribunal maintained that expropriation includes “taking” of property by a government authority.²³⁶ Schwartz maintained that:

Expropriations tend to deprive the owner and to enrich - by a corresponding amount - the public authority that the property, or the third party to whom the property is given. There is both unfair deprivation and unjust enrichment when an expropriation is carried out [without] compensation. By contrast, regulatory action tends to prevent an owner from using property in a way that unjustly enriches the owner.²³⁷

Compañía del Desarrollo de Santa Elena, S.A. v The Republic of Costa Rica: ‘property has been expropriated when the effect of the measures taken by the state has been to deprive the owner of title, possession or access to the benefit and economic use of his property’.²³⁸

²³³ *Starrett Housing Corporation v Iran* (Interlocutory Order (1984) 23 ILM 1090, (1983) 4 Iran-US CTR 122, 154. For a discussion of the expropriation jurisprudence of the Iran-US Claims Tribunal see Allahyar Mouri, *The International Law of Expropriation as Reflected in the Work of the Iran-U.S. Claims Tribunal* (Springer 1994); George H. Aldrich, *The Jurisprudence of the Iran-United States Claims Tribunal* (Clarendon Press 1996); Charles N. Brower, Lee M. Caplan, Jeremy K. Sharpe and Jarrod Wong, *The Iran-United States Claims Tribunal* (Brill 1998).

²³⁴ Rudolf Dolzer, ‘Indirect Expropriations: New Developments’ (2002) 11 N.Y.U. Envtl. L. J. 64; Rudolf Dolzer and Felix Bloch, ‘Indirect Expropriation: Conceptual Realignment?’ (2003) 5(3) International Law Forum 155.

²³⁵ *SD Myers Inc. v Canada* (2000) 40 I.L.M. 1408 at para 283, 1st partial award of 13 November 2000.

²³⁶ *SD Myers Inc. v Canada* (2000) 40 ILM 1408 at para 280, 1st partial award of 13 November 2000.

²³⁷ *SD Myers Inc v Canada*, arbitration under UNCITRAL Rules, Separate Concurring Opinion of Dr. Bryan Schwartz to the Partial Award of 13 November 2000, para 212.

²³⁸ *Compañía Del Desarrollo de Santa Elena SA v The Republic of Costa Rica* (2001) 39 ILM 1317, ICSID Case No ARB/96/1, (2000) 15:1 ICSID Review-FILJ at para. 77.

Expropriation includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.²³⁹

Technicas Medioambientales Tecmed SA v Mexico:

The issue is whether the investor was radically deprived of the economical use and enjoyment of its investments, as if the rights related thereto—such as the income or benefits related to the [property] or to its exploitation—had ceased to exist. In other words, if due to the actions of the Respondent, the assets involved have lost their value or economic use for their holder and the extent of the loss.²⁴⁰

It further maintains that:

This determination is important because it is one of the main elements to distinguish, from the point of view of an international tribunal, between a regulatory measure, which is an ordinary expression of the exercise of the state's police power that entails a decrease in assets or rights, and a de facto expropriation that deprives those assets and rights of any real substance.²⁴¹

In case of *GAMI Investment, Inc. v Mexico* ‘the affected property must be impaired to such an extent that it must be seen as “taken”’.²⁴²

First case under the Energy Charter Treaty 1994 in investor-state arbitration award was *Nykomb Synergetics Technology Holding AB v Latvia*²⁴³ where tribunal concluded that:

The decisive factor for drawing the border line towards expropriation must primarily be the degree of possession taking or control over the enterprise the disputed measures entail. In the present case, there is no possession taking of Windau or its assets, no interference with the shareholder's rights or with the

²³⁹ *Metalclad Corporation v United Mexican States*, ICSID Case No ARB (AF)/97/1, award of 30 August 2000 para. 103.

²⁴⁰ *Technicas Medioambientales Tecmed S.A. v. Mexico* (2003) (ICSID Case No. ARB (AF)/00/2) at para. 115.

²⁴¹ *Technicas Medioambientales Tecmed S.A. v. Mexico* (2003) (ICSID Case No. ARB (AF)/00/2) at para. 115.

²⁴² *GAMI Investment, Inc. v Mexico*, NAFTA Award, 15 November 2004 at para. 126.

²⁴³ Award dated 16 December 2003 <<http://www.italaw.com/sites/default/files/case-documents/ita0570.pdf>> accessed 20 December 2015.

management's control over and running of the enterprise – apart from ordinary regulatory provisions laid down in the production licence, the off-take agreement.²⁴⁴

The risk of foreign investment is without a doubt the possibility of taking in addition to being subjected to the domestic legal system and judiciary, which can be challenged by sudden change in government, ideology, economic crisis, revolution, civil war and other scenarios that have direct impact on the foreign investments, if domestic courts are not independent and reliable. Therefore balance is called for between host developing states exercising its sovereign right to take actions in the interest of their socio-economic development and foreign investors profit maximisation. International institutions have been appointed to control host states behaviour under accordance with the international law, however there is no reciprocal system in place to control the activities of foreign investors in host developing states.

It is challenging to formulate the right provision that would properly tackle the protection of foreign investments balanced with the interests of host developing states.²⁴⁵ There is a need to balance the investment protection against measures that should be imposed on foreign investors by the host developing states in terms of codes of conduct that should become a part of international customary law and as such legally binding. Codes of conduct should also be included in BITs and be contractually binding. However, the best way to offer protection is by means of state's responsibility and international minimum standards.

Wortley for example opposed to the payment of compensation even in cases of nationalisation.²⁴⁶ In any case the taking of private assets by public authorities is no longer an open issue of international law because host state has the right to taking as long as appropriate compensation is paid.

²⁴⁴ Award dated 16 December 2003 *Nykomb Synergetics Technology Holding AB v Latvia* section 4.3.1. <<http://www.italaw.com/sites/default/files/case-documents/ita0570.pdf>> accessed 20 January 2016.

²⁴⁵ See G.C. Christie, 'What constitutes a taking of property under international law?' (1962) 38 *The British Yearbook of International Law* 307-316; B. Weston, 'Constructive takings under international law: a modest foray into the problem of creeping expropriation' (1975) 16 *Virginia Journal of International Law* 103-175; Rudolf Dolzer, 'Indirect expropriation of alien property' (1986) 1 *ICSID Review: Foreign Investment Law Journal* 41-65.

²⁴⁶ Ben A. Wortley, *Expropriation in Public International Law* (University Press 1959).

Kuwait v Aminoil case²⁴⁷ is an example of fair compensation payment. The 60 – year oil concession granted by Kuwait to Aminoil in 1948 included stabilisation clause and was re-negotiated in 1961. Kuwait nationalised assets and agreed to pay fair compensation. The Tribunal concluded that stabilisation clause was not violated due to changing circumstances in which Kuwait became an independent state, but was due to pay “appropriate compensation” for which the replacement cost was used on a reasonable rate of return, including inflation.

The question of legitimacy of taking arose and examples of when such activity is lawful remains to be reviewed. To date there is no universal agreement relating to the manner of assessment of due compensation payment. The UK-India BIT for example does not recognise Hull formula for expropriation or nationalisation.²⁴⁸

On the topic of expropriation authors were divided in their views.²⁴⁹ International law however provides international minimum standards of protection against expropriation. The extent of expropriation in international law was studied in depth by a number of scholars.²⁵⁰ The biggest critic however still remains that none of the authors made clear distinction between regulation and expropriation or addressed newer types of expropriation on policy issues and factors that the tribunals should take into consideration while making decisions on compensation payment.²⁵¹ García-Amador maintained that

²⁴⁷ *Kuwait v American Independent Oil Co (Aminoil case)* (1982) 21 ILM 976, (1976) 21 ILM 143 <http://www.biicl.org/files/3938_1982_kuwait_v_aminoil.pdf> accessed 15 December 2015.

²⁴⁸ The UK-India BIT (1995) 34 ILM 935, Article 11(1) provides that ‘all investments shall be governed by the laws in force in the territory of the Contracting Party in which such investments are made’.

²⁴⁹ Gillian White, *Nationalisation of Foreign Property* (Stevens 1961) 150; S. Friedman, *Expropriation in International Law* (1977) 142; Chittharanjan F. Amerasinghe, *State Responsibility for Injuries to Aliens* (Clarendon Press 1967) 138; oppose the need for the requirement. However, the older authors favoured it. Ben A. Wortley, *Expropriation in Public International Law* (University Press 1959) 24–5; Lord McNair, ‘The Seizure of Property and Enterprises in Indonesia’ (1959) 6 *Netherlands International Law Review* 218, 243; J. L. Kunz, ‘The Mexican Appropriations’ (1940) 34 *AJIL* 48, 54.

²⁵⁰ J.H. Herz, ‘Expropriation of Foreign Property’ (1941) 35 *A.J.I.L.* 243; S. Friedman, *Expropriation in International Law* (Stevens & Sons Ltd 1953); Ben A. Wortley, *Expropriation in Public International Law* (CUP 1959); G.C. Christie, ‘What Constitutes a Taking of Property under International Law’ (1962) 33 *B.Y.I.L.* 307; B.H. Weston, ‘Constructive Takings under International Law: A Modest Foray into the Problem of Creeping Expropriation’ (1975) 16 *Va. J. Int’l L.* 103; Detlev F. Vagts, ‘Coercion and Foreign Investment Rearrangements’ (1978) 72 *A.J.I.L.* 17; Rosalyn Higgins, ‘The Taking of Property by the State: Recent Developments in International Law’ (1982-1983) 176 *Rec. des Cours* 259.

²⁵¹ See Vicki Been and Joel C. Beauvais, ‘The Global Fifth Amendment: NAFTA’s Investment Protections and the Misguided Quest for an International “Regulatory Takings” Doctrine’ (2003) 78 *N.Y.U. L. Rev.* 30; Maurizio Brunetti, ‘Iran-United States Claims Tribunal, NAFTA Chapter 11, and the Doctrine of Indirect Expropriation’ (2000) 2 *Chi. J. Int’l L.* 203; Rudolf Dolzer, ‘Indirect Expropriation of Alien Property’ (1988) 1 *ISCID Rev.* 41; Rudolf Dolzer, ‘New Foundations of the Law of Expropriation of Alien Property’ (1981) 75 *A.J.I.L.* 553; Rudolf Dolzer, ‘Indirect Expropriations: New Developments?’ (2003) 11 *N.Y.U. Envtl. L. J.* 64; Rudolf Dolzer and Felix Bloch, ‘Indirect

‘the very raison d’être of compensation for expropriation ordered in the public interest is the idea that the State, i.e. the community, must not benefit unduly at the expense of private individuals’.²⁵²

Foreign investors operate in host developing states and therefore as such should be the subject to their domestic laws. Taking has hence been one of the biggest risks of foreign investment. Also due to the ever changing political situation in host developing states, where the circumstances at the entry can significantly change over time. The same applies to the legislation regarding foreign investments.²⁵³ At the same time the host developing states were questioning the rationale behind the compensation payment.²⁵⁴

British Government issued a statement when Libya nationalised assets of British Petroleum stating that:

An act of nationalisation is not legitimate in international law unless it satisfies the following requirements:

- (i) It must be for a public purpose related to the needs of the taking state, and
- (ii) It must be followed by the payment of prompt, adequate, and effective compensation.

Expropriation: Conceptual Realignments?’ (2003) 5(3) Int’l L. Forum 155; Edward M. Graham, ‘Regulatory Takings, Supranational Treatment, and the Multilateral Agreement on Investment: Issues Raised by Nongovernmental Organizations’ (1998) 31 Cornell Int’l L. J. 599; Vaughan Lowe, ‘Regulation or Expropriation?’ (2002) 55 Current Legal Problems 447; Ignacio Madalena, ‘Foreign Direct Investment and the Protection of the Environment: the Border between National Environmental Regulation and Expropriation’ (2003) 12(3) European Env’tl. L. R. 70; Jan Paulsson and Z. Douglas, ‘Indirect Expropriation in Investment Treaty Arbitrations’ in Norbert Horn and Stefan M. Kröll (eds), *Arbitrating Foreign Investment Disputes: Procedural and Substantive Legal Aspects* (Kluwer Law International 2004) 145; G.H. Sampliner, ‘Arbitration of Expropriation Cases Under US Investment Treaties—A Threat to Democracy or the Dog that Didn’t Bark?’ (2003) 18(1) ICSID Review–FILJ 1; Hassan Sedigh, ‘What Level of Host State Interference Amounts to a Taking under Contemporary International Law’ (2002) 2 J. World Investment 631; Thomas W. Wälde and Abba Kolo, ‘Environmental Regulation, Investment Protection and “Regulatory Taking” in International Law’ (2001) 50(4) I.C.L.Q. 811; J. Martin Wagner, ‘International Investment, Expropriation and Environmental Protection’ (1999) 29(3) Golden Gate U. L. Rev. 465.

²⁵² F.V. García-Amador, ‘Fourth Report of the Special Rapporteur - Responsibility of the State for Injuries Caused in its Territory to the Persons or Property of Aliens - Measures Affecting Acquired Rights’ (1959) 2 Y.B. Int’l Law Comm. 1, 5.

²⁵³ See P. Georgia Bullitt and Laura I. Lagomarsino, ‘Protecting Intellectual Property Rights Abroad: New Uses for Political Risk Insurance and Standby Letters of Credit’ (1987) 5(2) International Tax and Business Law 283.

²⁵⁴ See Muhamad A. Mughraby, *Permanent Sovereignty Over Oil Resources, a Study of Middle East Oil Concessions and Legal Change* (The Middle East Research and Publishing Center 1966); Henry Catton, *The Law of Oil Concessions in the Middle East and North Africa* (Oceana 1967); Henry Catton, *The Evolution of Oil Concession in the Middle East and Africa* (Oceana 1968).

Nationalization measures which are arbitrary, discriminatory or which are motivated by considerations of a political nature unrelated to the internal well-being of the taking State are, by a reference to those principles, illegal and invalid.²⁵⁵

Libyan Oil Ministry replied that:

[N]o dispute has arisen over the application of the provisions of the concession agreement.... The revolution has merely exercised a sovereign right which is not open to challenge or debate in any form whatever. Nationalization is a legitimate course of action sanctioned by international law and society.²⁵⁶

The *restitutio in integrum* was ordered by Jean-René Dupuy as sole arbitrator in the *Texaco Overseas Petroleum Company and California Asiatic Oil Company v The Libyan Republic* case. This order followed a declaration that the nationalisation of the foreign company's assets was invalid by reason of its non-compliance with public international law standards.²⁵⁷

More common is the interference of governments in signed investment agreements that resulted in termination of the contract due to the breach, namely by the foreign investor.²⁵⁸

²⁵⁵ *British Petroleum v Libya*, award 10 October 1973 (1974) 53 ILR 317.

²⁵⁶ *Middle East Econ. Survey*, Dec. 24, 1971, 3.

²⁵⁷ *Texaco v Libya* (1977) 53 ILR 389, award of 19 January 1977, *International Council for Commercial Arbitration*, *Yearbook Commercial Arbitration*, Vol. IV, 1979, 177.

²⁵⁸ Such examples can be seen in *CME Czech Republic BV v Czech Republic*, Ad Hoc UNCITRAL Arbitration Rules, partial award 13 September 2001; IIC 62 (2003), final award 14 March 2003 <http://www.italaw.com/documents/CME-2003-Final_001.pdf> accessed 13 December 2015; *Eureko BV v Poland*, Partial Award of 19 August 2005, IIC 98 (2005), Ad Hoc Tribunal (UNCITRAL) <http://www.italaw.com/sites/default/files/case-documents/ita0308_0.pdf> accessed 13 December 2015; *Biloune and Marine Drive Complex Ltd. v Ghana Investments Centre and the Government of Ghana*, award on Jurisdiction and Liability of 27 October 1989, (1989,1990) 95 ILR 184, 203 in this case the main investors were banished; *Benvenuti & Bonfant v People's Republic of the Congo* (1982) 21 ILM 740 in this case the government interfered with the management and removed the key investment persons. In the Iran-US Claims Tribunal cases such as *Starrett Housing Corporation v Iran* (Interlocutory Order (1984) 23 ILM 1090, (1983) 4 Iran-US CTR 122, 154; *ippetts, Abbett, McCarthy, Stratton v TAMS-AFFA Consulting Engineers of Iran*. 6 Iran-US C.T.R. 219, 225 (June 29, 1984) in which the government has replaced the management composed by investors, who were also the owners with the managers selected by the government. In case *Middle East Cement v Egypt*, *Tecnicas Medioambientales Tecmed SA v United Mexican States*, ICSID Case No ARB (AF)/00/2, award of 29 May 2003, 43 ILM 133 (2004) or *Metalclad Corporation v United Mexican States*, ICSID Case No ARB (AF)/97/1, award of 30 August 2000, *Antoine Goetz and others v Republic of Burundi*, ICSID Case No ARB/95/3, award of 10 February 1999, 15 ICSID Rev-FILJ 457 (2000); *Middle East Cement Shipping and Handling Co. SA v Arab Republic of Egypt*, ICSID Case No. ARB/99/6 Award, 12 April 2002 <<http://www.italaw.com/sites/default/files/case-documents/ita0531.pdf>> accessed 13 December 2015; *Tecmed v Mexico* ICSID Case No Arb (AF)/00/2, Award, 29 May 2003, 43 ILM 133 (2004) the licences

Therefore the arbitral tribunals were struggling to balance the rights of investors on one hand to the rights of sovereign states to control the investors and their investments on the territory of host states on the other. Under Canadian law for example in expropriation case²⁵⁹ the Court ruled that compensation payment was due in *Manitoba Fisheries Ltd. v R*²⁶⁰ and *British Columbia v Tener*.²⁶¹

Expropriation is described as the act of a state taking private property, and consequently taking the ownership.²⁶² Dolzer maintains that ‘the single most important development in state practice has become the issue of indirect expropriation’.²⁶³ The UNCTAD dealt with the issue of tangible and intangible property and definition of property and investment, to determine what expropriation might include.²⁶⁴ BITs include the provision on investment protection in cases of expropriation that will normally resolve in compensation payment and would also include definition of investment.²⁶⁵

NAFTA in Articles 1110(1) and 1105(1) add the concept of ‘due process of law’, ‘fair and equitable treatment’ and ‘full protection and security’.²⁶⁶ Customary international law also protects foreign property from expropriation, which includes intangible rights. The most important distinction to be made is between the breach of contract that carries legal consequences and expropriation of contract rights, which carries consequences as per the international law. Indirect expropriation includes effective loss of management, use or control, or a significant depreciation of the value of the assets of a foreign investor’.²⁶⁷

were not granted by the government; *Metalclad v Mexico* ICSID Case No Arb (AF)/97/I, 40 ILM 36 (2001) where government did not grant permits.

²⁵⁹ *Mariner Real Estate Ltd. v Nova Scotia* (1999) 177 DLR (4th) 696 (NS CA).

²⁶⁰ *Manitoba Fisheries Ltd. v R*, (1979) 1 S.C.R. 101, (1978) 6 WWR 498 (SCC).

²⁶¹ *British Columbia v Tener*, [1985] 1 S.C.R. 533.

²⁶² See Andreas F. Lowenfeld, *International Economic Law* (OUP 2002) 392.

²⁶³ Rudolf Dolzer, ‘Indirect Expropriations: New Developments?’ (2002) 11 NYU Envl J 64, 65.

²⁶⁴ UNCTAD, *Taking of Property*, Series on issues in international investment agreements (New York and Geneva, United Nations 2000) 36.

²⁶⁵ Rudolf Dozler and Margaret Stevens, *Bilateral Investment Treaties* (Martinus Nijhoff 1995) 27 on the Germany-Guyana BIT 1989.

²⁶⁶ North America Free Trade Agreement between the Government of Canada, the Government of the United Mexican States, and the Government of the United States of America (NAFTA) 17 December 1992, 32 ILM 289 (1993) Article 1139.

²⁶⁷ UNCTAD, *Taking of Property*, series on issues in international investment agreements (New York and Geneva, United Nations 2000) 2.

Burton and Inoue maintained that “nationalisation” started with the socialist revolution in Russia and Mexico for which no compensation was paid.²⁶⁸ During the years 1960 and 1977 the authors reported 1,857 cases of such takings. The issue was not in the nationalisation process, but in the fact that appropriate compensation was not paid. Hence numerous concerns were expressed, especially in the large-scale takings, where developing states might not be in the position to afford paying required compensation in money and in-kind. Taking was also common in the decolonisation period. McNair,²⁶⁹ Domke²⁷⁰ and Sornarajah²⁷¹ have discussed one of the most interesting cases of nationalisation, which occurred in Indonesia, when it took over Dutch property. Developing states are in favour of “appropriate” in oppose to the “prompt, adequate and effective” compensation payment. However, since there are no unified standards of compensation it all depends on the bargaining position and successful negotiation process. Model Agreements on Promotion and Protection of Investments of the Asian-African Legal Consultative Committee (AALCC) provides in its first alternative formulation of article 7(i) that:

A Contracting Party may exercise its sovereign rights in the matter of nationalization or expropriation in respect of investments made... upon payment of appropriate compensation...²⁷²

And in its first alternative part (ii) states that ‘compensation calculated on the basis of recognised principles of valuation’.²⁷³ Model of BIT of the United Kingdom in article 5 (1) states that:

The national or company affected shall have a right, under the law of the Contracting Party making the expropriation, to prompt review, by a judicial or other independent authority of that Party, of his or its case and of the

²⁶⁸ F. N. Burton and H. Inoue, ‘Expropriations of foreign-owned firms in developing countries: a cross-national analysis’ (1984) 18(5) *Journal of World Trade Law* 396-414.

²⁶⁹ A. McNair, ‘The seizure of property and enterprises in Indonesia’ (1959) 6(3) *Netherlands International Law Review* 218-256.

²⁷⁰ M. Domke, ‘Indonesian nationalization measures before foreign courts’ (1960) 54 *American Journal of International Law* 305-326.

²⁷¹ Muthucumaraswamy Sornarajah, *The Pursuit of Nationalized Property* (Martinus Nijhoff 1986).

²⁷² UNCTAD, 1998, 231.

²⁷³ UNCTAD, 1998, 232.

valuation of his or its investment in accordance with the principles set out in this paragraph.²⁷⁴

While Chile in their BIT model in Article 6 (3) states that:

The investor affected shall have a right to access, under the law of the Contracting Party making the expropriation, to the judicial authority of that Party, in order to review the amount of compensation and the legality of any such expropriation or comparable measure.²⁷⁵

The issue of legality²⁷⁶ of taking²⁷⁷ and appropriate payment of compensation is no longer a challenge for international law. Compensation payment does not apply to the situation where state takes a property for the purposes of socio-economic development or public good.

4.5 Compensation payments and The Issue of the breach of Bilateral Investment Treaties (BITs)

The issue of taking of private assets of foreign investors by public authorities has been a challenge for international law for a few decades now. Some ‘governmental measures may not involve an actual physical taking of property, but may still result in the effective loss of management, use or control, or a significant depreciation of the value, of the assets of a foreign investor’.²⁷⁸

Fear of taking still represents a big risk to the foreign investors, which could be resolved if ‘the takings clause could be drafted to reflect the formulation of a certain relationship

²⁷⁴ UNCTAD, 1996, vol. III, 188.

²⁷⁵ UNCTAD, 1996, vol. III, 146.

²⁷⁶ British Claim in the Spanish Zone of Morocco (1925) 2 RIAA ii. 617, 620; in *Funnekotter v Zimbabwe*, ICSID Case No. ARB/05/6, award of 22 April 2009.

²⁷⁷ *Siderman de Blake v Argentina*, 965 F 2d 699 (9th Cir. 1992) court ruling was in favour of the illegal taking of the property, because it was based on ethnicity.

²⁷⁸ UNCTAD, *International Investment Agreements, Key Issues, Volume I* (Ney York, Geneva 2004) 235.

that can accommodate both the concerns of foreign investors and national policy makers'.²⁷⁹

Latin word "Tortus" provides the basis for the commonly used Tort, which refers to the civil wrongs in opposed to the criminal wrongs. As such the claims from tort origin arise from negligence, nuisance, trespass, defamation and others. Winfield and Jolowicz maintained that 'Tortious liability arises from a breach of a duty primarily fixed by law; this duty is towards persons generally and its breach is redressible by an action for unliquidated damages'.²⁸⁰ According to Winfield 'all injuries done to another person are torts, unless there is some justification recognised by law'.²⁸¹

Absolute liability applies in any case even when there is no fault by the responsible party. In absolute liability the party responsible is also not given any exceptions such are those given in rule of strict liability. Absolute liability is also more precise than strict liability and refers to "no fault liability". The rule was laid by *Rylands v Fletcher*.²⁸² Strict liability applies to the defendant even if it is not present nor being responsible for negligence. One may ask how it is possible to apply liability without negligence. There must be proof of accumulation on the defendant's land, which has not been there before or is not of natural cause and has been brought on the land. In other case no liability will arise.²⁸³ Strict liability lies in between negligence and absolute liability. What strict liability does is hold defendant accountable but gives the possibility of defence limited to "abnormally dangerous activities". The *Chorzów Factory Case* maintained that 'it is a general conception of law that every violation of an engagement involves an obligation to make a reparation'.²⁸⁴ Therefore the general principle of law states that compensation must be paid in case of any taking. Strict liability should also apply in cases of environmental pollution.²⁸⁵

²⁷⁹ UNCTAD, *International Investment Agreements, Key Issues, Volume I* (Ney York, Geneva 2004) 235.

²⁸⁰ W. V. H. Rogers, *Winfield and Jolowicz on Tort* (Sweet & Maxwell 2010).

²⁸¹ W. V. H. Rogers, *Winfield and Jolowicz on Tort* (Sweet & Maxwell 2010) 15.

²⁸² *Rylands v Fletcher* 1868 (LR 3 HL 330).

²⁸³ Such cases are: *Giles v Walker* (1890) 24 QBD 656; *Pontardawe RDC v Moore-Gwyn* (1929) 1 Ch 656; *Carstairs v Taylor* (1871) LR 6 Ex 217; *Ellison v Ministry of Defence* (1997) 81 BLR 101; *Dunne v North West Gas Board* (1964) 2 QB 806; *Pearson v North Western Gas Board* (1968) 2 All ER 669.

²⁸⁴ *Factory at Chorzów (Germany v Poland) (Indemnity)* (Mertis), PCIJ (1928), Series A No 17, 29.

²⁸⁵ J. Martin Wagner, 'International Investment, Expropriation and Environmental Protection' (1999) 29(3) *Golden Gate University Law Review* 465; Thomas W. Walde and Abba Kolko, 'Environmental Regulation, Investment Protection and Regulatory Taking in International Law' (2001) 50(4) *ICLQ* 811;

Foreign investors might, in the process of investment, commit acts such as environmental pollution, human rights, child labour violation or other kind of harmful activities. The issues of environmental protection have been addressed in a number of declarations, namely Stockholm Declaration of the United Nations Conference on the Human Environment 1972, World Charter for Nature 1982,²⁸⁶ Rio Declaration on Environment and Development 1992 and Kyoto Declaration on Sustainable Development 1993. The legal principle that has emerged, namely from Article 16 of the Rio Declaration is ‘the polluter-pays principle’ and is based on the strict liability. Under customary international law states are obliged to take the necessary measures to protect the environment and corporate entities are equally obliged to abide by them. A proper conduct from TNCs is expected during the course of their investments in host developing states, which was also included in the UN Draft Code of Conduct on TNCs. Similar did the OECD 2011 Guidelines include provision advising TNCs to abide by the environmental standards of host developing states in which they are conducting business activities.

One of the concerns in the *Barcelona Traction Case*²⁸⁷ was the diplomatic protection of TNCs shareholders. The *ELSI Case*²⁸⁸ involved the compensation amount for taking and questioned the liquidation of a foreign corporation by a court and examined the states involvement in potential violation by denying justice. The *Diallo v Congo* case deals with the issue of corporate nationality by recognising the place of incorporation.²⁸⁹ Investment treaties also include the provision that the foreign investment are given “full protection and security”.²⁹⁰

AMCO v Republic of Indonesia the Arbitration Tribunal stated that:

[T]he full compensation of prejudice, by awarding to the injured party the *damnum emergens* and *lucrum cessans* is a principle common to the main

for a general survey see Gaetan Verhoosel, ‘Foreign Direct Investment and Legal Constraints on Domestic Environmental Policies: Striking a Reasonable Balance Between Stability and Change’ (1998) 29 *Law and Policy in International Business* 451; Michael Anderson, ‘Transnational Corporations and Environmental Damage: Is Tort Law the Answer?’ (2002) 41 *Washburn L.J.* 399.

²⁸⁶ UNGA Res 37/7; (1983) 22 *ILN* 455, adopted on 28 October 1982.

²⁸⁷ *Barcelona Traction, Light and Power Co Case (Belgium v Spain)*, ICJ Reports 1, 1970, 3, 46-47.

²⁸⁸ *Elettronica Sicula SpA (ELSI) (United States v Italy)*, judgment of 20 July 1989, ICJ Reports (1989) 15, (1989) 28 *ILM* 1109.

²⁸⁹ *Ahmadou Sadio Diallo (Guinea) v Congo* (2008) ICJ Reports.

²⁹⁰ Giuditta Cordero Mos, ‘Full Protection and Security’ in August Reinisch (ed), *Standards of Investment Protection* (2008) ch 7, 131.

systems of municipal law, and therefore, a general principle of law which may be considered as a source of international law.²⁹¹

The Asian Agricultural Products Ltd. (AAPL) Corporation from Hong Kong invested in equity capital in Sri Lanka in Serendib Seafoods Ltd. Company that was in the business of shrimp culture. The investment suffered a total loss in disagreement between “Tigers” the Tamil rebels and Sri Lanka’s security forces (STF). AAPL claimed compensation from Sri Lanka based on Article 8(1) of the BIT agreement between the UK (extended to Hong Kong) and the government of Sri Lanka and ICSID Convention.²⁹² The legal issue was regarding Sri Lanka’s responsibility for damages caused to AAPL and adequate compensation under customary international law. AAPL stated that the destruction of their property and assets were caused in cold-blooded killing and was not a consequence of a “combat action”.²⁹³ Sri Lanka was also accused of not performing “due diligence”. From a legal point of view, the international minimum standards do require a State to provide full protection of the foreign investment under customary international law. In addition to the investment treaty that includes provisions on other standards that the host states are due to fulfil and in case of violation “strict liability” may apply. Article 2(2) stated that foreign investor enjoys full protection and security in the territory of the host state. The question is whether the responsibility was in fact “*force majeure*”. The Tribunal concluded that “full protection and security” does not give rise to “strict liability” for the host State.²⁹⁴ Tribunal maintained that ‘The State into which an alien has entered...is not an insurer or a guarantor of his security....It does not, and could hardly be asked to, accept an absolute responsibility for all injuries to foreigner’...the nature of both the obligation and ensuring responsibility remain unchanged, since the added words “consent” or “full” are by themselves not sufficient to establish that the Parties intended to transform their mutual obligation into a “strict liability”.²⁹⁵ BIT Sri Lanka v UK the Tribunal stated that:

²⁹¹ Amco v Republic of Indonesia, 89 ILR, 366, 504.

²⁹² Article 8(1) of the BIT agreement between the UK (extended to Hong Kong) and the government of Sri Lanka and ICSID Convention 14 January 1981.

²⁹³ Asian Agricultural Products Ltd (AAPL) v Sri Lanka, (1990) Claimant’s Memorial 8.

²⁹⁴ Referring to the Sambiaggio case in 1903 (Italy v. Venezuela) 1903 10 RIAA 499, Treaty of 1861 between Italy and Venezuela, see UN Rep. of Int. Arb. Awards, vol. X, 512; see also Elettronica Siculo SpA (ELSI) between the US and Italy.

²⁹⁵ Alwyn v Freeman. Responsibility of States for Unlawful Acts of Their Armed Forces, Leiden (Sijthoff 1957) 14.

[N]one among the authors referred to by the Parties claimed in his commentary that the Sri Lanka/U.K. Treaty or similar Bilateral Investment Treaties had the effect of increasing the customary international law standards of protection to the extent of imposing “strict liability” on the host State in cases where the investment suffers losses due to property destruction.²⁹⁶

However, the Tribunal stated that:

[N]either Party was able to provide reliable evidence explaining with precision the conditions under which the destruction and other losses, mainly of the shrimps crop, took place. Under these circumstances it would be extremely difficult to determine whether the destructions and losses were caused as an inevitable result of the “necessity of the situation” or on the contrary, were avoidable if the governmental security forces would have been keen to act with due diligence.²⁹⁷

Decisions of the Tribunals was made following the rule of strict liability. However, if the standards of treatments and proper of codes of conduct would have been practiced there would be no need for the law as the actor for settling the investor-state disputes.

Foreign investment is covered by BITs²⁹⁸ that ‘focus mainly on the rights of the foreign investor and on the duties of the host state *vis-à-vis* the investor and their investment’.²⁹⁹ Disputes are namely caused by government interferences with foreign investment. A state’s objective is to ensure capital flow, new technologies and management skills in order to contribute to the socio-economic development that is not on the expense of their sovereignty.³⁰⁰ In that quest states agreed to enter in contractual agreements with the

²⁹⁶ ICSID, Arbitration between AAPL v Sri Lanka, June 27, 1990, Case No. ARB/87/3 Final Award, 547 <<http://www.italaw.com/sites/default/files/case-documents/ita1034.pdf>> accessed 4 January 2016.

²⁹⁷ ICSID, Arbitration between AAPL v Sri Lanka, June 27, 1990, Case No. ARB/87/3 Final Award, 552 <<http://www.italaw.com/sites/default/files/case-documents/ita1034.pdf>> accessed 4 January 2016.

²⁹⁸ See Juliane Kokott, ‘The exhaustion of local remedies’ Interim Report. International Law Association. Report of the sixty-ninth conference (London 2000); Juliane Kokott, ‘The Role of Diplomatic Protection in the Field of the Protection of Foreign Investment’ in A. Soons and C. Ward, The International Law Association. Report on the Seventieth Conference, New Delhi (ILA, 2002) 259-277.

²⁹⁹ Stefan D. Amarasinha and Juliane Kokott, ‘Multilateral Investment Rules Revisited’ in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds), *Oxford Handbook of International Investment Law* (OUP 2008) ch.4, 122.

³⁰⁰ Permanent Sovereignty of each State over its Natural Resources of 14 December 1962 (Resolution No. 1803-XVII), 25 November 1966 (Resolution No. 2158) and 17 December 1973 (Resolution No. 3171-XXVIII); establishment of a New International Economic Order of 1 May 1974 (Resolutions Nos. 3201 and 3202-SVI); Economic Rights and Duties of the States in the so-called Charter of Algiers approved by Resolution No. 328 1-XXIX of 12 December 1974.

investors that became known as the investment agreements and have been widely spread in the form of bilateral investment treaties (BITs).³⁰¹

The rule of law should be the only element guiding contracts, and as such neutral. Bonell argued that:

Even when drafted by sophisticated lawyers, investment contracts are inevitably incomplete as it is impossible to foresee all the events which might occur in the course of performance. Hence the necessity to have external sources to which to refer whenever a question arises that has not been expressly dealt with in the contract.³⁰²

Obligations of TNCs to the host developing states have not been given much attention. Protecting the assets of TNCs via means of investment treaties or customary international law gained momentum, while the topic of obligations of TNCs to host developing states are in need of further development. Sornarajah maintained that ‘the notion of corporate liability for human rights violation have also been slow in evolving’.³⁰³ The pressure to hold TNCs accountable for human rights violation is gaining momentum. Therefore, human rights should be fundamental rights and as such be included as part of the constitutions, which would make them legally binding and compulsory.³⁰⁴ As discussed more in depth in chapter 3 many attempts were made towards forming codes of conduct for TNCs, however almost just as many have failed and the ones that did succeed were non-binding in nature.³⁰⁵

OECD was keen on developing binding multilateral agreements on investments namely for the TNCs. Developing states were also in favour of such binding obligations for the TNCs. The United Nations Commission on Transnational Corporations (UNCTC) responded to their request by creating the draft Codes of Conduct for TNCs, however it

³⁰¹ See Piero Bernardin, ‘State Contracts’ in *New Trends in International Trade Law* (G. Giappichelli 2000) 47.

³⁰² Michael Joachim Bonell, ‘International Investment Contracts and General Contract Law: a Place for the UNIDROIT Principles of International Commercial Contracts?’ (2012) 17 *Unif. L. Rev.* 141, 152.

³⁰³ Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (2nd edn, CUP 2004) 146.

³⁰⁴ A limited number of cases exist in which TNCs have been held accountable for human rights violation during the course of their business activities in the host developing states, such as *The Amco Cadiz* (1984) 2 *Loyds Rep* 304; *Connelly v RTZ Plc* (1998) AC 854; *Lubbe v Cape* (2000) 1 *WLR* 1545.

³⁰⁵ See M. Baker, ‘Promises and Platitudes: Towards a New 21st Century Paradigm for Corporate Codes of Conduct’ (2007) 23 *Connecticut Journal of International Law* 123.

was unfortunately not developed further from the draft version, covering areas of potential harmful activities of TNCs and its effect on the socio-economic development. The main objective was to formulate internationally accepted business practices that would be beneficial and acceptable to both parties without harmful consequences on the environment or human rights.

Many attempts were made to agree on the international law of foreign investment between states, starting with the Havana Charter in 1948.³⁰⁶ The biggest critic was that it was not tailored for the developing states, but on protecting the foreign investment. Trade comes out of investment and yet no direct reference to investment was made in the Havana Charter.

Settlement of investment disputes was entrusted with International Centre for the Settlement of Investment Disputes (ICSID)³⁰⁷ by the World Bank. Arbitration however still remains the main system for settling foreign investment disputes. In addition to the ICSID there are also *ad hoc* arbitration and private arbitral institutions.³⁰⁸ The ICSID Convention in Article 42 (1) states that:

The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such other rules of international law as may be applicable.³⁰⁹

The above article has been subject to controversy because it touches on the choice of law and if such choice should be specified in the host state legislation or investment treaty, but it would be too lengthy to go into details at this stage.³¹⁰

³⁰⁶ See J. E. S. Fawcett, 'The Havana Charter' (1949) 5 Yearbook of World Affairs 320.

³⁰⁷ Muthucumaraswamy Sornarajah, *The Settlement of Foreign Investment Disputes* (Kluwer Law International 2000), 315–333.

³⁰⁸ See Christoph Schreuer, *The ICSID Convention: A Commentary* (2nd edn, CUP 2009).

³⁰⁹ ICSID Convention Article 42(1)

³¹⁰ In the *Klöckner* case for example international law was given subsidiary role to the law of the host state which is contradictory to the ICSID convention.

Some attempts were made in the ICSID jurisprudence, which can be seen in award such as *Benvenuti et Bonfant v Congo*³¹¹ for example. Contract based arbitration³¹² was the most prominent until the *AAPL v Sri Lanka*³¹³, when the treaty-based arbitration became more utilised.³¹⁴

The dispute has to clearly arise from an investment. There are however many international transactions and only foreign investment transactions qualify as an investment. The challenge is to identify criteria for an investment. Salini made an attempt to that end by a test that has been taken into consideration on a number of arbitral tribunals.³¹⁵ In addition to contributions in money, in-kind or in industry, long duration, presence of risk, and promotion of economic development, Schreuer added generation of profits.³¹⁶ Schreuer argued that economic development is ‘the only possible indication of an objective meaning of the term “investment”’.³¹⁷ Economic development is also identified as an objective of investment treaties.

While ICSID³¹⁸ arbitrations are the most common route for settling investment dispute but it is not the only one. BITs also include provisions on the dispute settlements. However, the codes of conduct for investment and other guidelines for arbitration do not have any legally binding force. Therefore, the notion of creating formal sets of rules that would have legally binding force is still to be reviewed.

The question is also if a breach of contract constitutes a violation of international law. In *Consortium RFCC v Morocco* ICSID panel maintained that a breach of contract would constitute a breach of treaty provisions ‘unless it be proved that the state or its emanation

³¹¹ *Benvenuti & Bonfant v People's Republic of the Congo*, ICSID Case No ARB/77/2, 21 ILM 740 (1982).

³¹² See Campbell McLachlan, Laurence Shore and Matthew Weiniger, *International Investment Arbitration* (OUP 2007); Christopher Dugan, Don Wallace, Noah Rubins and Borzu Sabahi, *Investor–State Arbitration* (OUP 2008).

³¹³ *Asian Agricultural Products Ltd. (AAPL) v Republic of Sri Lanka*, ICSID Reports 254, final award of 27 June 1990.

³¹⁴ Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (OUP 2008)

³¹⁵ See *Salini Costruttori SpA v Morocco*, ICSID Case No. ARB/00/4 (Jurisdiction Award, 23 July 2001), (2001) 42 ILM577.

³¹⁶ Christoph Schreuer, *The ICSID Convention: A Commentary* (2nd edn, CUP 2009) 130–134.

³¹⁷ Christoph Schreuer, *The ICSID Convention: A Commentary* (2nd edn, CUP 2009).

³¹⁸ See also ICSID Secretariat Possible Improvements of the Framework for ICSID Arbitration (Discussion Paper, 22 October 2004); ICSID Secretariat Suggested Changes to the ICSID Rules and Regulations (Working Paper, 12 May 2005).

has gone beyond its role as a mere party to the contract, and has exercised the specific functions of a sovereign'.³¹⁹

Hull standards are used by the Energy Charter Treaty 1994, APEC Non-Binding Investment Principles,³²⁰ MAI in Chapter IV (2) also refers to Hull standards while The World Bank specifically states “appropriate compensation” in Article IV (2):

Compensation for a specific investment taken by the State will, according to the details provided below, be deemed “appropriate” if it is adequate, effective and prompt.³²¹

Hull standards have become widely used in arbitration ruling on compensation payment however they are not universally recognised and recent arbitration is leaning toward appropriate compensation payment.

In 1984 the United States signed BIT with the Republic of Zaire.³²² American Manufacturing & Trading Inc. (AMT), a US company from Delaware State, owned 94% of a Zairian company, Société Industrielle Zairoise (SINZA). AMT has invested in production of automotive, dry cell batteries, importation, re-sale of consumer goods through SINZA. Two incidents of looting occurred, first in 1991 and second in 1993, when soldiers from Zairian army destroyed, damaged property and stole belongings of SINZA. After the second incident in 1993 SINZA commercial complex remain closed. AMT claimed Republic of Zaire violated BIT and requested compensation in amount of \$14.3 million without interests and costs and the dispute was brought before the ICSID Tribunal. Zaire did not argue against the damaged caused to SINZA, but it did not agree to the compensation claims on the ground of Article IX of the BIT:

³¹⁹ Consortium RFCC v Kingdom of Morocco, ICSID Case No. ARB/00/6, Award, 22 December 2003 <<http://www.italaw.com/cases/325>> accessed 13 December 2015.

³²⁰ UNCTAD, Taking of Property (UNCTAD Series on issues in international investment agreements) (UN 2000).

³²¹ UNCTAD, International Investment Instruments: A Compendium (UN 1996) vol I, 252.

³²² BIT signed between The United States and the Republic of Zaire came into force on 28 July 1989. American Manufacturing & Trading Inc (AMT) v Zaire, ICSID Case No ARB/93/1, award of 21 February 1997, (1997) 36 ILM 1531. <http://www.biicl.org/files/3933_1997_amt_v_zaire.pdf> accessed 4 January 2016.

This Treaty shall not supersede, prejudice or otherwise derogate from:

- (a) Laws and regulations, administrative practices or procedures, or adjudicatory decisions of either Party;
- (b) International legal obligations; or
- (c) Obligations assumed by either Party, including those contained in an investment agreement or an investment authorization, Whether extant at the time of entry into force of this Treaty or thereafter, that entitled investments, or associated activities, of nationals or companies of the other Party to treatment more favourable than that accorded by this Treaty in like situations.³²³

Zaire also claimed that the treaty deviates from the public policy matters and must as such be inadmissible. The case has several dimensions. In Article 25(2) of the ICSID Convention legal entity is considered to be a “national” of a country in which it is registered.³²⁴ Zaire claimed that while AMT is US national company SINZA is a Zairian company, in spite of the fact that AMT owns 94%, which does not grant AMT the right to act on SINZA’s behalf³²⁵ as it was a case of an “investment” as stated in Article 1 (c) of BIT:

[E]very kind of investment, owned or controlled directly or indirectly, including equity, debt and service and investment, contracts, and includes:

- (ii) a company or shares of stock or other interests in a company or interests in the assets thereof”.³²⁶ AMT claimed Zaire failed to respect AMT’s investment under “protection and security”.

The Tribunal stated that:

It is not called into question whether, as Zaire suggests, AMT can act in the name of SINZA. AMT acts in its own name and in its capacity as an American enterprise having invested in Zaire, that is to say, a national of a State party having a dispute with another State party which has welcomed his investments on its territory.³²⁷

³²³ BIT USA 0 Republic of Zaire, Article IX of the BIT: Preservation of Rights.

³²⁴ See Chittharanjan F. Amerasinghe, ‘Jurisdiction *rationae personae* under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States’ (1974) 47 *The British Yearbook of International Law* 227–267.

³²⁵ AMT v Zaire, para 5.11 of the Award of the Tribunal, note 1.

³²⁶ BIT US v. Republic of Zaire 1989 Article 1(c).

³²⁷ Award of the Tribunal, Paragraph 5.15, note 1.

According to Article 25 of the ICSID Convention in order to qualify it must be “investment dispute” arising directly from an investment and one party has to be private entity, while the other is a host State. The Tribunal stated that ‘The bilateral Treaty does not suffice since it provides that the dispute of the type to be considered by the Tribunal must be justiciable before ICSID’.³²⁸

The Republic of Zaire was under the impression according to their national legislation they are not required to make any kind of reparations for injuries caused on their territory. According to international law however, the host state is obliged to pay compensation to aliens when they suffer injuries. State responsibility is to provide protection to foreign investors and nationals. Due diligence is used to determine whether a state has ensured sufficient protection. Chatterjee maintained that ‘A failure by a host State to afford protection to foreign nationals and foreign investors amounts to a breach of the rule of State responsibility’.³²⁹ In any case under international law ‘exist duty to pay compensation to foreign investor for the injury caused to them’.³³⁰ Article II is clear on the violating the international responsibility.

Republic of Zaire was in breach of BIT.³³¹ In regards to the international minimum standards violation, due to their obligatory nature under the principle of international responsibility, regardless if there was a case of received treatment different from that given to the nationals as it is applicable only to the aliens.

The Tribunal argued that:

[T]he fact remains that Zaire has manifestly failed to respect the minimum standard required of it by international law. It should be added that Zaire has equally failed to perform a similar obligation with regard to a third State or all other third States. In effect, the agreement advanced by Zaire that it has not accorded to nationals and companies of these States any protection or reparation, is not pertinent for the Tribunal. Since the repetition of breaches and failures to perform similar obligations its owes to third States will not in any way exonerate the objective responsibility of the State of Zaire for the

³²⁸ Award of the Tribunal, Paragraph 5.17, note 1.

³²⁹ Charles Chatterjee, ‘The arbitration between American manufacturing & trading Inc. and the Republic of Zaire’ (1999) 16(1) Kluwer Law International 43.

³³⁰ Charles Chatterjee, ‘The arbitration between American manufacturing & trading Inc. and the Republic of Zaire’ (1999) 16(1) Kluwer Law International 44.

³³¹ BIT US - Republic of Zaire, Article II.

breach of its obligation of the treatment of protection and security it owes to AMT by virtue of Article II paragraph 4 of the BIT.³³²

The above only reaffirms that there are no excuses that would justify any host state from its responsibility under the international law. However, it is interesting to note that the Republic of Zaire did not mention in front of the Tribunal that riots caused the damages in which case “*force majeure*”³³³ could be considered for the damages and would consider freeing Zaire of the liability and consequently fulfilling their treaty obligation under the signed contract.

Another case was that of Asian Agricultural Products Ltd. (AAPL) and the Republic of Sri Lanka.³³⁴ Sri Lanka was accused of failure to give full protection to the foreign investor, failed to do due diligence for the catastrophe caused by the Tamil Tigers and of violation of the BIT as well as international responsibility. BITs include the provision on full protection and security that should be provided by the host state to the foreign investors. The ICSID Tribunal stated that “full protection and security” is not the cause for strict liability of the host State based on the *Sambiaggio* case.³³⁵ Sri Lanka did not oppose paying the compensation, but did oppose to admit to have failed in due diligence or treaty commitments to ensure full protection and did not deviate from its international responsibility.

4.6 Conclusions

States have substantial control over the foreign investment on their territory due to their sovereignty. States also have the right to decide on the treatment to be offered to their national investors as well as to their foreign investors. The division between capital-importing and capital-exporting states are becoming wider and at the same time the

³³² Award of the Tribunal, note 1, paragraph 6.10.

³³³ “*Force majeure*” was used in Arbitration between National Oil Corporation (Libya) and the Libyan Sun Oil Company (USA) May 1985.

³³⁴ Asian Agricultural Products Ltd. (AAPL) v Republic of Sri Lanka, ICSID Reports 254, final award of 27 June 1990.

³³⁵ UN Report on International Arbitral Awards, Vol. X, 512.

distinction between developed and developing states is becoming more common and is gaining momentum.

After newly born states became independent in the decolonisation process in the late 1940s, they were competing to attract foreign capital and investments in order to help their socio-economic development and ultimately achieve socio-economic independence.

The World Bank (WB) and the International Monetary Fund (IMF) were the two primary international institutions that were also making funding available under certain restrictions for developing states in the form of financial aid. Bilateral investment treaties (BITs) were significantly growing in numbers especially in 1990s. The biggest challenge was to find the balance between protecting foreign investments and state sovereignty as well as between domestic and international law applicable for settlement of investor-state disputes.

There are a number of rules that can be applied to the international law, Articles 53 and 30 of the Vienna Convention on the Law of treaties as well as Article 103 of the UN Charter and the fundamental human rights³³⁶ known as *jus cogens* rules. Human rights are normally dealt with via *amicus curiae* that were accepted by arbitral tribunals.³³⁷

Taking of property by public authorities has put a big stain on international law, namely when involving private foreign investments. In case of government interference with the assets, which does not directly resolve in compensation payment. However, in order for the taking to be legal some kind of compensation has to be offered.

The main challenge is to separate the breach of contract, which falls under the national law and contains legal consequences and expropriation of contract rights, which falls under international law.³³⁸ As ‘the breach by a State of a contract does not as such entail

³³⁶ See Thomas Donaldson, *The Ethics of International Business* (OUP 1992); Tom Campbell and Seumas Miller (eds), *Human Rights and Moral Responsibilities of Corporate and Public Sector Organisations* (Kluwer Law International 2004).

³³⁷ *Suez, Sociedad General de Aguas de Barcelona S.A., and InterAguas Servicios Integrales del Agua S.A. v The Argentine Republic*, ICSID Case No. ARB/03/17 (formerly *Aguas Provinciales de Santa Fe S.A., Suez, Sociedad General de Aguas de Barcelona, S.A., and InterAguas Servicios Integrales del Agua, S.A.*) <<http://www.italaw.com/cases/1048>> accessed 10 December 2015; see also Andrea Shemberg, ‘Investment Agreements and Human Rights: The Effects of Stabilization Clauses’ Corporate Social Responsibility Initiative Working Paper No. 42 (Harvard University, March 2008).

³³⁸ See Stephen M. Schwebel, ‘On Whether the Breach by a State of a Contract with an Alien is a Breach of International Law’ in Stephen M. Schwebel, *Justice in International Law* (CUP 1994) 425.

a breach of international law. Something further is required before international law becomes relevant, such as a denial of justice by the courts of the State in proceedings brought by the other contracting party'.³³⁹ Some major issues of the role of law have been highlighted through the cases of settlement of international investment disputes between states, which is the objective of international law.

One of the challenges for the evolving international investment laws is finding the right balance between states' sovereignty and protection of foreign investments. The balance is also needed between national domestic law of host developing states and international law. Several different cases of arbitration and awards have shown that there are many provisions open to interpretation.

International treatment standards and namely expropriation are still major issues of public international law. With the increase of foreign investment, the foreign investors wanted higher protection for their investments in the host developing states.

Aspirations of developing states were expressed in the Permanent sovereignty over natural resources 1962 and New International Economic Order 1974 in which they expressed their aspiration to maintain full control over foreign investments in their territory. Many different attempts were made to form multilateral treaty framework, without desired success. However, the objective of the international investment law was to find the balance between host developing states and foreign investors. BITs were formed with the purpose to protect and promote foreign investments. Number of signed BITs proliferated and also revealed the shortcomings of the investor-state dispute settlement mechanism. As indicated in a number of cases further vulnerability was revealed.

The benefits of private foreign investment for the host developing states, namely their contribution to the capacity building and socio-economic development remain to be seen. However, BITs did encourage further development of international investment law. With the number of signed BITs, a number of investor-state disputes also increased. The dispute between the use of domestic and international law in such investor-state disputes

³³⁹ Commentaries to the Draft Articles on Responsibility of States for internationally wrongful acts, adopted by the International Law Commission at its fifty-third, session (2001), Official Records of the General Assembly, Fifty-Sixth session, Supplement No. 10 (A/56/10) ch IV.E.2, 78.

has not yet been resolved. Finding the balance between state sovereignty and aspirations of private foreign investors will have to be achieved in the near future as the aspirational gaps will have to be closed. However, there is also the disagreement between developed and developing states regarding international minimum standards of treatment that will require further attention.

Foreign investors are concerned with their investments in host developing states, based on the fact that state sovereignty allows them to expropriate, which is not illegal as long as compensation is offered. Sovereigns have the inherent right to nationalise and the law cannot take or stop this right. As long as compensation is paid, this right cannot be taken from a sovereign state. States are taking necessary actions to protect their citizens. At the same time, they are trying to attract foreign investments and control them by means of regulations and legislation. These issues are namely discussed during the negotiation process, when the terms and conditions of the investment treaties are made.

While domestic law is important the Tribunal tends to lean on the customary international law, when making decisions on investor-state dispute settlement. BITs are the most common form of foreign investment relationships between developed and developing states with the objective to promote and protect foreign investments. However shortcoming of BITs is that it cannot protect foreign investments from the political risks. Foreign investment in principle should contribute to the socio-economic development of host developing states, but many authors' questions this correlation.

The importance of bargaining position comes to light again as the states have the opportunity to negotiate their contractual obligations as well as the contractual obligations of foreign investors. In order to protect foreign investors "stabilisation clause" can be included.³⁴⁰ In order to protect the host state re-negotiation clause should be included as well as the requirements for capacity building, local management participation and profit distribution.

The main question remains open, and that is who should take the lead in investor-state dispute settlement, be it domestic or international courts. Foreign investment remains

³⁴⁰ See Aminoil arbitration.

controversial from the question of its contribution to the socio-economic development to the law that should be managing such cases in the first instance.

In cases of contract breach absolute or strict liability can apply. The difference is that absolute liability occurs even when there is no fault but intent to harm, while strict liability sits between negligence and absolute liability and does not depend on the intent to harm.

The best way of giving protection is through state responsibility and international minimum standards that should also include codes of conduct for TNCs. At present investment treaties are giving more attention to the MFN treatment, which is not compulsory as it is not a part of customary international law. Protection for foreign investment activities in different treaties is used in different ways. NAFTA 1998 for example offers protection for the ‘establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments’,³⁴¹ while Energy Charter Treaty 1994 covers all investment-related activities ‘including management, maintenance, use, enjoyment, or disposal’.³⁴² Therefore agreeing on clear definitions of investment treaty provisions would be a good start moving forward, towards establishing universally acceptable system of protecting the interests of TNCs and host developing states in a balanced way.

³⁴¹ NAFTA, Article 1103.

³⁴² Energy Charter, Article 10, para 7; see also UNCTAD, Most-Favoured-Nation Treatment, UNCTAD Series on Issues in International Investments Agreements (United Nations 1999) 1.

Chapter 5: Role of Law: Jurisdiction and governing law issues

5.1 Introduction

Investor-state dispute settlement has always provoked controversy, especially in deciding which law should be the governing law. By virtue of choosing and supported by the Article 42 of the ICSID Convention, the foreign investors' preference of governing law was international law and not the legal system and judiciary of the host developing states. Developing states 'agreed to offer additional protection to foreign investors by agreeing to international arbitration in legal disputes with investors'.¹ The ICSID convention does not require the exhaustion of local remedies, unless BIT includes the provision that requires foreign investors to exhaust local remedies prior to resorting to international arbitration.² Developing state that signed BITs can refuse to participate in arbitration, however as two-party consent is not required under BIT arbitrators are appointed 'on behalf of the host state to enable the arbitration to proceed even without the co-operation of the host state'.³ As mentioned earlier, while it is possible to delocalise the dispute, contract on the other hand cannot be delocalised. Therefore, jurisdiction needs to be local and foreign investors should accept the law of the host developing state in which they are investing and operating.

Place of performance should give the jurisdiction the governing law. However, just because this should be the case, it does not mean that it is, which is the case in current foreign investors and host developing states' relationship. TNCs should equally be govern by the domestic law of the host state in which they are operating. The reason this is not the case is due to the lack of confidence in the national law that is legal system and judiciary of the host developing state by foreign investors.

¹ Surya P. Subedi, *International Investment Law* (3rd edn, Hart Publishing 2016) 105.

² Such example can be seen in Spain – Argentina BIT, which requires (1) the foreign investor to exhaust all local remedies and (2) an 18-month period to expire without issuance of a court decision on the merits. However in *Maffezini* case these requirements were not respected.

³ Surya P. Subedi, *International Investment Law* (3rd edn, Hart Publishing 2016) 121.

Therefore, the recommendation is delocalisation of disputes, as there is no need to centralise the dispute. Host developing states should provide for neutral procedural law and neutral governing law. Hence the governing law and contract law should be neutral. Local procedures law has not been applied in the arbitral investor-state disputes settlement. Hence local courts should have appointed judges that understand international law and are independent and reliable, which would be an ideal solution.⁴

5.2 Artificiality in choosing the governing law of investment treaties

When the European businessmen were trading with foreign states, namely Africa, Asia and Latin America ‘it was held that the local law did not apply to them since they were already subject to the law of their home country’.⁵ The foreign businessmen were subject of their own state national laws⁶ mainly because ‘the local law was inferior, it could not apply to the foreigners, who were subject to the superior body of law of their home country’.⁷ This notion changed with newly born independent states, under the law of protection of aliens and alien property⁸ based on the principle of sovereignty and doctrine of state responsibility, which gave sovereign states the right to expropriate, and nationalise against due compensation payment. Developing states ‘wished to have an international instrument regulating foreign investment’ however ‘now these very same states appear reluctant to implement such an instrument because of the fear that they may come under pressure to agree to a higher level of protection for foreign investors’.⁹ The issue of discrimination based on the ownership nationality was already addressed in

⁴ Bin Cheng, *General Principles of Law as Applied by International Courts and Tribunals* (CUP 2008).

⁵ Surya P. Subedi, *International Investment Law* (3rd edn, Hart Publishing 2016) 22.

⁶ See C.H. Alexandrowicz, ‘The Afro-Asian Nations and the Law of Nations’ (1968) 123 *Hague Recueil* 117.

⁷ Surya P. Subedi, *International Investment Law* (3rd edn, Hart Publishing 2016) 22.

⁸ Several scholars were in favour of the doctrine of state responsibility, such as Edwin M. Borchard, ‘The Minimum Standard in the Protection of Aliens’ (1939) 33 *ASIL Proceedings* 51; Arghyrios A. Fatouros, ‘Transnational Enterprises and in the Law of State Responsibility’ in Richard B. Lillich (ed), *International Law of State Responsibility for Injuries to Aliens* (University Press of Virginia 1983) 361.

⁹ Surya P. Subedi, *International Investment Law* (3rd edn, Hart Publishing 2016) 77.

national treatment, which accorded foreign investors the treatment accorded to domestic investors in like circumstances.¹⁰ However, it did allow for the international minimum standards to be applied in cases where local law was underdeveloped or failed to meet the required international minimum standards.¹¹

Root maintained that:

If any country's system of law does not conform to that standard, although the people of the country may be content or compelled to live under it, no other country can be compelled to accept it as furnishing a satisfactory measure of treatment to its citizens.¹²

Schwarzenberger argued that:

[T]he national standard cannot be used as a means of evading international obligations under the minimum standard of international law. Even if the standard of national treatment is laid down in a treaty, the presumption is that it has been the intention of the parties to secure to their nationals in this manner additional advantages, but not to deprive them of such rights as, in any case, they would be entitled to enjoy under international customary law or the general principle of law recognised by civilised nations.¹³

As recognised in the Article 9 of the Convention on the Rights and Duties of States 1933, which was one of the first international instruments to support the principle of national treatment. The idea was based on the state responsibility to protect aliens against injuries and to offer protection for aliens in a host state that would be equal as the protection offered to their own nationals. Whether the national standard or external standard of treatment they both share the idea to facilitate free movement of trade and investment across national borders.¹⁴

¹⁰ Antony Anghie, *Imperialism, Sovereignty and the Making of International Law* (CUP 2005).

¹¹ See Emer de Vattel, *The Law of Nations* (Liberty Fund 2008).

¹² Elihu Root, 'The Basis of Protection to Citizens Residing Abroad' (1910) 4 *American Journal of International Law* 16, 21-22.

¹³ Georg Schwarzenberger, *International Law as Applied by International Courts and Tribunals* (Stevens 1957) 248; see also Georg Schwarzenberger, 'The Standards of Civilization in International Law' (1955) VII *Current Legal Problems* 220.

¹⁴ See Hugo Grotius, *The Free Sea* (Richard Hakluyt tr, Evergreen Review Inc. 2009).

Based on the principle of sovereign immunity¹⁵ states were exempt from lawsuits brought by private foreign entities until the states started entering in BITs, which ‘enable foreign investors to sue host governments but not vice versa’.¹⁶ Breach of BITs gave foreign investors the right to sue the host governments for the first time.¹⁷ While states should have the right to regulate their investment regime and not be subjected to the interests of foreign investors when the regulation is exercised in good faith and on behalf of the public welfare.¹⁸ It seems that the justification for changing the current law relating to private foreign investments is much needed and the future of existing BITs, IIAs, FTAs as well as the ICSID is questionable at best. The former practice has already changed in some states, such as Malaysia, Singapore, South Africa, Switzerland, the UK (Protection of Trading Interest Act 1980) and the US (Federal Sovereign Immunities Act 1976). New system for resolving investor-state arbitration is required together with reformed Investment Court System that would be public and will not favour foreign investors over host developing states, but will represent the interests of both parties in a balanced way.

The questions regarding the law that should be applicable in such cases still remains to be answered and clarified.¹⁹ The negotiated agreement should be that the law of the host state should apply.

The Annulment Committee decision 39 stated that:

Some of these views have in common the fact that they are aimed at restricting the role of international law and highlighting that of the law of the host State. Conversely, the view that calls for a broad application of international law

¹⁵ Hazel Fox and Philippa Webb, *The Law of State Immunity* (3rd edn, OUP 2013). When the dispute between governments is of commercial nature state immunity does not apply. Following the decision of *Trendtex Trading corporations v Central Bank of Nigeria* case 1977, the Protection of Trading Interest Act 1980 was adopted and therefore government department and agencies cannot claim state immunity if the dispute is commercial in nature.

¹⁶ Surya P. Subedi, *International Investment Law* (3rd edn, Hart Publishing 2016) 235.

¹⁷ Carlo de Stefano, ‘Arbitration Agreements as Waivers to Sovereign Immunity’ (2014) 30 *Arbitration International* 59.

¹⁸ See further Thomas Kendra, ‘State Counterclaims in Investment Arbitration – A New Lease of Life?’ (2013) 29 *Arbitration International* 575; Public Statement on the International Investment Regime – 31 August 2010 < <http://www.osgoode.yorku.ca/public-statement-international-investment-regime-31-august-2010/>> accessed 20 August 2016.

¹⁹ *Wena Hotels Ltd v Arab Republic of Egypt*, ICSID Case No ARB/98/4, Decision on Annulment, 28 February, 2002, 41 I.L.M. 933 <<http://www.italaw.com/sites/default/files/case-documents/ita0903.pdf>> accessed 15 March 2016.

aims at restricting the role of the law of the host State. There seems not to be a single answer as to which of these approaches is the correct one.²⁰

Applicability of the appropriate law will therefore depend on the circumstances, which will justify the taken decisions followed by courses of actions. In ICSID Article 42(1) second sentence uses the word ‘may’, which suggests that there is no definitive line to divide the scope of international and domestic law and consequently the grants the tribunal the power of interpretation.²¹

The important thing to note is that:

The law of the host State can indeed be applied in conjunction with international law if this is justified. So too international law can be applied by itself if the appropriate rule is found in this other ambit.²²

In the first instance domestic law should be considered. However, it seems that powerful states ‘attempt to impose standards of investment protection preferred’ by them.²³ Schultz and Dupont argued that ‘investment arbitration appears to have been used as a replacement for dysfunctional domestic courts in countries with a weak rule of law tradition until the mid-to-late 1990s’²⁴ and added that ‘the overall picture of investment arbitration seems to have changed...when the system shifted from...a neo-colonial instrument to an instrument that...promote the international rule of law’.²⁵

ICJ stated in the *Belgium v Spain* case that:

²⁰ Wena Hotels Ltd v Arab Republic of Egypt, ICSID Case No ARB/98/4, Decision on Annulment, 28 February, 2002, 41 I.L.M. 933 para 39 <<http://www.italaw.com/sites/default/files/case-documents/ita0903.pdf>> accessed 15 March 2016.

²¹ Article 42(1) ICSID, second sentence.

²² *Wena Hotels Ltd. v. Arab Republic of Egypt*, ad hoc committee decision of Feb. 5, 2002, 6 ICSID Rep. 129, 138 (2004).

²³ Muthucumaraswamy Sarnarajah, *The International Law on Foreign Investment* (3rd edn, CUP 2004) 19.

²⁴ Thomas Schultz and Cédric Dupont, ‘Investment Arbitration: Promoting the Rule of Law or Over-Empowering Investors? A Quantitative Empirical Study (2014) 25 European Journal of International Law 1147, 1149.

²⁵ Thomas Schultz and Cédric Dupont, ‘Investment Arbitration: Promoting the Rule of Law or Over-Empowering Investors? A Quantitative Empirical Study (2014) 25 European Journal of International Law 1150.

When a State admits into its territory foreign investment of foreign nationals, whether natural or juristic person, it is bound to extend to them the protection of the law and assumes obligations concerning the treatment to be afforded to them.²⁶

Therefore, negotiations of the investment treaties with agreed terms and conditions are important as they can determine the protection foreign investment and responsibility of foreign investor as well as decide on the governing law. Bargaining position plays an important role and was therefore given the needed attention in the first chapter. The terms and conditions should be negotiated in a way to benefit both parties involved in the foreign investments. Since the existing international investment law was predominantly made by the foreign investors it is time that the host developing state contribute their part and re-negotiate the existing practice of foreign investments by re-negotiating the existing investment agreements and making newer investment agreements based on reciprocity accordingly.

A balance must be struck between the investors' aspirations and those of host developing states in the light of international investment law that should be based on the agreed investment treaties between the two parties and backed by the rule of law be it domestic or international. Domestic in terms of governing law by supporting the international minimum standards of treatment.

5.3 The lack of enforcement procedures

States started losing hope in the ICSID as they realise the trade-offs they have made by entering in BITs. The ICSID has also resulted in various interpretations of BITs provisions. Notion of collective property was replaced with the notion of private individual property.²⁷

²⁶ Barcelona Traction, Light and Power Co Case (Belgium v Spain), ICJ Reports 1970, 3 para 33.

²⁷ Antony G. Hopkins, 'Property Rights and Empire Building' (1980) 40(4) Journal of Economic History 787.

During the colonial period there was no such issues regarding the applicable law that should be the governing law and its enforcement as the law of imperial powers suffice for protection of the private foreign investments in the colonies at the time. Protection was secured by means of imperial parliament and their imperial courts under the colonial rule. System of extraterritoriality was imposed by power as the ultimate arbiter for investment disputes. There have been some cases of coercive dispute resolution to help foreign investors even by means of force.²⁸

The situation has since evolved drastically. While the gap between capital-exporting and capital-importing states became wider and the dynamics has changed. The biggest critics of the Calvo doctrine, mainly the developed states are now embracing the ideas supported in the Calvo doctrine. BRICS countries are gaining momentum and many developing states are homes to successful TNCs that are starting to invest in developed states. Their views on international minimum treatment standards, investor-state dispute resolution regarding foreign investments and rights, still vary. The role of law however is becoming more and more instrumental in these cases, notwithstanding that it still significantly lacks clarity on the question which is the governing law.

PCIJ in *Mavrommatis Palestine Concessions* case for example stated that:

It is an elementary principle of international law that a State is entitled to protect its subjects, when injured by acts contrary to international law committed by another State, from when they have been unable to obtain satisfaction through the ordinary channels. By taking up the case of one of its subjects and by resorting to diplomatic action or international judicial proceedings on his behalf, a State is in reality asserting its own rights – the right to ensure, in the person of its subject, respect for the rules of international law.²⁹

Above is an example of the right of a state to resort to diplomatic protection, which has been extended to BITs that enabled foreign investors to sue the host state. The ruling has been adopted by the ICJ as seen in *Belgium v Spain* case. Under BITs the investors got the right to sue the host states' governments before international tribunal. It can also be

²⁸ Such cases are the intervention of overthrowing the government of Mossadegh in Iran and Allende in Chile; Iraq intervention.

²⁹ *Mavrommatis Palestine Concessions* case (Greece v UK), PCIJ Rep (1924) Series A, No 2.

considered to be a form of extended diplomatic protection as stated in *The Republic of Ecuador v Occidental Exploration & Production Co.* that:

States owe duties to other States to protect their citizens. This is known as the “doctrine of diplomatic protection”. Effectively, BITs are treaties that acknowledge this principle of public international law, apply it to particular circumstances between two States and develop the protection of investors by giving them “standing” to pursue a State directly in “investment disputes” between an investor and a State Party in ways that are set out in BIT.³⁰

Notion of diplomatic protection is a part of treatment of aliens. In recent years, investment agreements, mainly BITs are offering the protection of foreign investment. Foreign investors have the option to bring investor-state disputes before international tribunals. For example, investor – state disputes can be resolved before ICJ or ICSID or before other international tribunals or courts. However, states can exercise their sovereign rights, which means that the only obligatory standard is the minimum standard of treatment under international investment law, which can be potentially extended to BITs in addition to state responsibility.

Law is fundamental for development of a state as well as for the development of civil society, which functions through three central organs, the law-making (legislative), law determination (courts and tribunals), and law enforcement (administration, police, army). ‘The United Nations General Assembly is not a world legislature, the International Court of Justice in The Hague can operate only on the basis of the consent of states to its jurisdiction, and the law enforcement capacity of the United Nations Security Council is both legally and politically limited’.³¹ Under the UN Charter the General Assembly ‘powers are limited to making recommendations’.³²

While the investment agreements clearly define the responsibility of the state to protect foreign investors, there is no such written responsibility for the foreign investors to protect the host developing states or its citizens from wrongful or harmful activities. Concerns have been expressed for the current investor-state dispute mechanism facilitated by the

³⁰ *Occidental Exploration and Production Company v Republic of Ecuador*, High Court of Justice, QBD (Commercial Court), Case No 04/656, 2 March 2006, para 8.

³¹ Peter Malanczuk, *Akehurst’s Modern Introduction to International Law* (7th edn, Routledge 1997) 3.

³² Surya P Subedi, *International Investment Law* (3rd edn, Hart Publishing 2016) 42.

ICSID and therefore a recommendation was made to look for an alternative option. An alternative that would facilitate complaints of individuals, public society and governments against foreign investors' wrongful acts. Unlike current investor-state dispute mechanism only enables the foreign investors to sue host developing states. In the events the government would file a claim against foreign investor 'they do not have to pay compensation to the host government or to the victims of violation of environmental or human rights standards'.³³ The challenge is that in spite of state sovereignty 'the complex nature of the operation of MNEs, their institutional structure, and the immense power and influence' national institutions are struggling 'to hold multinationals to account for the violations or non-compliance with their obligations'³⁴ be it under international or national law. Democratic society should be able to facilitate individuals to be able to sue foreign investors for wrongful acts without them enjoying any favourable treatments or privileges that do not apply to their own nationals. Furthermore, there should be an international institution created that would have the authority and independence in facilitating such investor-state arbitration. In any case the integrity of the rule of law has to be protected.

5.4 Conclusions

The notion of regulating private foreign investment and activities of TNCs has been on the international agenda for a long time. There were also a number of treaties concluded to that end, however this far no universal agreement has yet been reached.

While BITs are perceived to protect economic rights, predominantly those of foreign investors the BITs are overdue in revisiting and re-negotiating the terms and conditions of such relationship, that should be equally beneficial to both parties. This is the reason that it should not have been down to the power but to the law to be the supreme authority.

³³ Surya P Subedi, *International Investment Law* (3rd edn, Hart Publishing 2016) 270.

³⁴ Surya P Subedi, *International Investment Law* (3rd edn, Hart Publishing 2016) 270.

For the law to be able to function properly it requires the three fundamental organs that have to be present within the state and can only be achieved by means of capacity building through well informed electorate with high public awareness.

Law is fundamental for development of the stable democratic states. States have clear responsibilities, among which is also the protection of private foreign investors. Private foreign investors invest in host developing states and during the course of their investment host states are responsible to provide protection. Since the emergence of BITs, the states have opened themselves for investor-state lawsuits by means of signing such bilateral investment treaties (BITs). Current investor-state dispute mechanism is under review and recommendations were made for an alternative dispute settlement mechanism to be formed. In democratic societies, no wrongful act should be left without proper review to assign compensation for caused damages. Such a mechanism should work both ways on the principle of reciprocity. Institutions, be it national or international should be able to hold TNCs accountable for any harmful activities, violation of obligations or non-compliance with national laws and regulations. Stable democratic societies should be able to sue private foreign investors for wrongful acts through independent institutions executing arbitration. In any case the decisions rendered by courts or tribunals have to be made in a way that they protect the integrity of the rule of law at all times, without allowing that their decisions are open for interpretation.

Debates over the definition of the rule of law have been ongoing. The lack of its definition does however not limit its use. As such, the rule of law remains an idea awaiting clarification. The role of law is to assist in finding an acceptable definition of the rule of law, which can only exist in democratic societies. There is a disagreement regarding the rule of law and its conflicting role with state sovereignty and the parliament. The question that state sovereignty might be limited due to the obligations to foreign investors' committed by signing the investment agreements is yet to be reviewed. State limitation to the sovereign immunity 'was voluntarily accepted by states when they concluded BITs or IIAs with an ISDS mechanism'.³⁵ Democracy and the rule of law go hand in hand in building stable democratic societies. A state cannot exist without its government and at

³⁵ Surya P Subedi, *International Investment Law* (Hart Publishing 2016) 9.

the same time a change of government does not affect obligations of a state made before the change of government took place.

Newly born independent states were developing their judiciaries and therefore foreign investors were not keen to subject their investments under national courts. However, a new initiatives has called for expanding the Calvo doctrine, which would mean that the investor-state disputes have to first be submitted to the national courts before they can be taken in front of the international courts or international arbitration. Verwey and Schrijev maintained that Calvo doctrine implies the principle of territorial sovereignty of the state.³⁶

New development in international investment law allowed foreign private entities to bring suits against host states that entered in BITs with them. Breach of BITs gave foreign investors the right to sue the governments or host developing states. For a long time, international arbitration arising from private foreign investments was considered to be of commercial nature and it was not until BITs came about that the investor-state disputes thrived. BITs were originally meant to help developing states in their development by attracting private foreign investments. Cases brought before ICSID are mainly due to expropriation and breach of due compensation payments. However, the decision held by the tribunals have been heavily criticised for their creative interpretation of the rules of international investment law, international minimum standards and provisions of BITs. Foreign investors enjoy the right to bring dispute resolutions before ICSID, while host developing states cannot, creates tensions in investor-state dispute resolution mechanism. Developing states have started raising louder concerns over this issue as well as favouring the protection of foreign investors over host developing states. Developed states seem to be imposing standards on the developing states that were preferred by themselves.

Recent sequence of events, starting with developing states reviewing and rejecting signed bilateral investment treaties and withdrawing from ICSID, showed that reforms of BITs, IIAs, FTAs as well as ICSID are much needed. ICSID also does not provide an option for appeal against their decisions. Developing states have lost its trust in ICSID and investor-state dispute resolution mechanism, especially considering the trade-offs made by

³⁶ WD Verwey and NJ Schrijev, 'The Taking of Foreign Property under International Law: A New Legal Perspective?' (1984) XV *Netherlands Yearbook of International Law* 3, 23.

developing states when signing BITs, which ICSID interpreted in its own way. The main role of law is to offer protection, which should be given equally to both parties and not favouring one party over the other. Law is playing a crucial role and it is also fundamental in development of a democratic state that would cater for a balanced investor-state dispute resolution mechanism.

This is also an existing constitutional principle of the rule of law. However, there is no definite definition of the rule of law. It is however recognised as a principle. Bingham maintained that ‘All individuals and organisation within a state whether public or private are bound by and entitled to the benefit to laws prospectively promulgated and publicly administered in the courts’. More precisely Bingham suggested that the rule of law can be explored based on eight principles.³⁷ While governments are producing administrative legal documents it is making it even more difficult to crystallise the definition of the rule of law instead of making it clearer and more applicable in practice. The basic assumption is that there should be an existing “rule of law” to oppose to the rule of power. While the expression “the rule of law” was coined by Dicey³⁸ the idea originates from Aristotle by maintaining that ‘It is better for the law to rule than one of the citizens’, because this way ‘even the guardians of the law are obeying the laws’.³⁹ Dicey presented three explanations for the rule of law. Firstly, ‘no man is punishable or can lawfully be made to suffer in body or goods except for a distinct breach of law established in the ordinary legal manner before the ordinary courts of the land’. Secondly, the rule of law ‘as a characteristic of our country, not only that with us no man is above the law, but (which is a different thing) that here, every man, whatever be his rank or condition, is subject to the ordinary law of the realm and amenable to the jurisdiction of the ordinary tribunals’. Thirdly, ‘the constitution is pervaded by the rule of law on the ground that the general principle of the constitution (as for example the right to personal liberty, or the right of public meeting) are with us the result of judicial decisions’ which are ‘determining the rights of private persons in particular cases brought before the courts’ that fell ‘under many foreign constitutions the security (such as it is) given to the rights of individuals results, or appears

³⁷ Tom Bingham, *The Rule of Law* (Penguin books 2011) 37.

³⁸ A.V. Dicey, *An Introduction to the Study of the Law of the Constitution* (first published 1885, 9th edn, Macmillan 1945) 188.

³⁹ Aristotle’s *Politics and Athenian Constitution* (John Warrington tr, J. M. Dent 1959) book 3, section 1287, 97.

to result, from the general principles of the constitution.⁴⁰ Regardless of the lack of its definition, the rule of law has been consistently referred to in judgments and in court rulings. Even the European Convention of Human Rights 1950 provides *inter alia* that the governments of European states ‘have a common heritage of political traditions, ideals, freedom and the rule of law, to take the first steps for the collective enforcement of certain of the rights stated in the Universal Declaration.’⁴¹ The Consolidated Version of the Treaty on European Union stated that ‘The Union is founded on the principles of liberty, democracy, respect for human rights and fundamental freedoms, and the rule of law, principles which are common to the Member States’.⁴² The rule of law is also present in the British Constitutional Reform Act 2005.⁴³ The Constitutions of the United States represent an important point in the evolution of the rule of law, whereas the first ten amendments are known as the American Bill of Rights.⁴⁴

In the UK, parliamentary sovereignty is what distinguishes it from the other states in which ‘the constitution, interpreted by the courts, has been the supreme law of the land, with the result that legislation inconsistent with the constitution, even if duly enacted, may be held to be unconstitutional and so invalid’.⁴⁵ Bingham concluded that parliament sovereignty and the rule of law are “potential antagonists”⁴⁶ because ‘there was and could be no fundamental or constitutional law which Parliament could not change by the ordinary process of legislation’⁴⁷ but that does not make the Parliament omnipotent.

Council of the International Bar Association stated in resolution *inter alia* that ‘The Rule of Law is the foundation of a civilised society.’⁴⁸ The Rule of Law remains to be an idea without precise definition. However, it does make a difference in terms of the government, which takes the rule of law in consideration and attempts to abide by it at all times. The notion of the rule of law makes a distinction between the bad and the good

⁴⁰ A.V. Dicey, *An Introduction to the Study of the Law of the Constitution* (first published 1885, 9th edn, Macmillan 1945) 195.

⁴¹ European Convention of Human Rights 1950, 5, <http://www.echr.coe.int/Documents/Convention_ENG.pdf> accessed 17 March 2016.

⁴² The Consolidated Version of the Treaty on European Union, Article 6.

⁴³ Constitutional Reform Act 2005, c.4, part 1, section 1.

⁴⁴ The Constitutions of the United States, first ten amendments American Bill of Rights, 15 December 1791.

⁴⁵ Tom Bingham, *The Rule of Law* (Penguin books 2011) 160.

⁴⁶ Tom Bingham, *The Rule of Law* (Penguin books 2011) 161.

⁴⁷ Tom Bingham, *The Rule of Law* (Penguin books 2011) 162.

⁴⁸ The Council of the International Bar Association, September 2005 Resolution.

governments especially in the developing states, which are not yet fully developed liberal democracies and therefore the rule of law is not based on the law but on the merit of the leading authority in power. The role of law should therefore be to become the supreme authority in regulating the conduct of human beings and corporate entities. Developing states should therefore strive towards developing stable democratic societies and their own stable judiciaries that will give them the ability to enforce the law on the citizens as well as on the corporate entities, which will extend to TNCs. The role of law is therefore primarily *inter alia* to offer protection for its citizens and their property, and for corporate entities and their assets, especially in the light of recent trends of state practices and jurisprudence. Schultz and Dupont maintained that ‘the functional effects of investment arbitration is that it serves to make up for deficient rule of law in the host developing states’ and ‘to replace “dysfunctional” courts in “unreliable” countries’.⁴⁹ Schultz and Dupont added that investor-state arbitration is losing momentum because it is ‘accused of harming developing states facing economic hardship for the benefit of a wealthy few’.⁵⁰ Investment arbitration was used as ‘a means to impose the rule of law in non-democratic states with a weak law and order tradition’.⁵¹ Therefore Jacobs maintained that the rule of law ‘cannot coexist with traditional conceptions of sovereignty’⁵² while Bogdanor added that ‘there is a conflict between these two constitutional principles, the sovereignty of Parliament and the rule of law’.⁵³ States in general are not affected by the legitimacy of the rule of law.⁵⁴ However, the question arises about the period needed in order to either accept or change the rule.⁵⁵ States are sovereign and as such Lotus maintained that ‘The rules of law binding upon States therefore emanate from their own free will...’.⁵⁶ Henkin added that ‘state is not subject to any external authority unless it has voluntarily consented

⁴⁹ Thomas Schultz and Cédric Dupont, ‘Investment Arbitration: Promoting the Rule of Law or Over-Empowering Investors? A Quantitative Empirical Study (2014) 25 *European Journal of International Law* 1160.

⁵⁰ Thomas Schultz and Cédric Dupont, ‘Investment Arbitration: Promoting the Rule of Law or Over-Empowering Investors? A Quantitative Empirical Study (2014) 25 *European Journal of International Law* 1147, 1147.

⁵¹ Thomas Schultz and Cédric Dupont, ‘Investment Arbitration: Promoting the Rule of Law or Over-Empowering Investors? A Quantitative Empirical Study (2014) 25 *European Journal of International Law* 1147, 1147.

⁵² Francis Jacobs, *The Sovereignty of Law: The European Way* (CUP 2007) 8.

⁵³ Vernon Bogdanor, ‘The Sovereignty of Parliament or the Rule of Law?’ (Magma Carta Lecture 15 June 2006) 20.

⁵⁴ See also Thomas M. Franck, *Legitimacy in the International System* (1988).82 *AM. J. INT’L L.* 705

⁵⁵ See Gennady M. Danilenko, *Law Making in the International Community* (Martinus Nijhoff 1993) 97.

⁵⁶ *SS Lotus (France v Turkey) 1927*, judgment PCIJ Series A No 9, 18, ICGJ 248 of 7 September 1927 <http://www.icj-cij.org/pcij/serie_A/A_10/30_Lotus_Arret.pdf> accessed 20 March 2016.

to such authority'.⁵⁷ State responsibility in this case is to give consent to abide by the international law, which is the condition for customary international law. Subedi maintained that 'Most developed countries are stable democracies where the right to property is protected by law, the judiciary is by and large independent, and there is little non-commercial or political risk involved in investments made'.⁵⁸ However, to review the role of law in democratic societies, law has to be seen as a tool not as a driving force to which the civil society has to abide. In a stable democratic society people should be able to voice their concerns to the government and not be penalised for taking such actions. At the same time people have to be properly trained by means of educational institutions available to them in which they can receive proper training and acquire the needed skill set. In democracy 'law must be employed to foster and safeguard that equality of opportunity, which is the essence of the democratic way of life'.⁵⁹

The United Nations addressed the rule of law in relation to the democracy and stated that 'a fundamental distinction has to be drawn between "rule by law", whereby law is an instrument of government and government is considered above the law' and the rule of law 'which implies that everyone in society is bound by the law, including the government. Essentially, constitutional limits on power, a key features of democracy, requires adherence to the rule of law'.⁶⁰ In this distinction it is worth noting that democracy and the rule of law go hand in hand when building stable democratic societies. State cannot exist without a government, notwithstanding that a state is not its government, which is why international rights and obligations of a state are not affected by the change of its government. In other words, a state is responsible to pay due compensation for the government wrongdoing. TNCs should be equally responsible and bound by the law to pay such compensations for similar wrongful activities in the host developing states. The principle of accountability should be applicable to both by means of the rule of law.⁶¹ Since 'Democracy is a universal value based on the freely expressed will of people to

⁵⁷ Louis Henkin, *International Law: Politics, Values and Functions* (Nijhoff 1989).

⁵⁸ Surya P. Subedi, *International Investment Law* (3rd edn, Hart Publishing 2016).

⁵⁹ Charles E. Clark, 'The Function of Law in a Democratic society' (1942) 9 *University of Chicago Law Review* 393.

⁶⁰ Massimo Tammasoli, 'Rule of Law and Democracy: Addressing the Gap Between Policies and Practices' *UN Chronicle, The Magazine of the United Nations* (New York, December 2012) <<http://unchronicle.un.org/article/rule-law-and-democracy-addressing-gap-between-policies-and-practices/>> accessed 20 March 2016.

⁶¹ See Chorzon factory case

determine their political, economic, social and cultural systems and their full participation in all aspects of their lives'.⁶² Stable democratic societies require high public awareness as well as peoples' participation in the governance of a state, where 'the will of the people shall be the basis of the authority of government'.⁶³ Public society has to be properly informed as they represent the electorate that has the power to elect members of the parliament whom they entrust decision-making on their behalf for the benefit of the state and wellbeing of its citizens. Equally the public has the power to remove the members of the parliament. Public society can achieve such action in addition to the democratic voting mechanism of general elections or referendum and also by means such as protests, demonstrations and by signing petitions. These actions of civil society can also be targeted at certain decision-making process or decisions made by the government that the civil society opposes. In some cases, it can also be because of the poor working conditions, low wages, insufficient benefits or other dissatisfaction of the public society, all of which then trigger government to take appropriate actions. In some democratic states workers have strong unions that are representing their interest and fighting for worker's rights and wellbeing. In most stable democratic states, the board level employee participation is highly practiced, which allows the workers to be involved in the decision-making process and give recommendations for improving working conditions, which consequently increase workers' productivity and bring visible benefits for both the workers and the company. However, since not all the developed states have the board level employee participation yet fully developed and because government can make decisions that are not in the best interests of its citizens, hence disagreements and dissatisfactions occur, which can result in protests and demonstrations. The bottom line is that this kind of protests and demonstrations can only emerge in stable democratic societies. Therefore, the people of a state have to be able to access the fundamental state institutions that provide citizens with education and healthcare, and most importantly legal institutions and mechanisms, where public society can seek justice for wrongful acts or mistreatment. The main role in this process is without a doubt in educational system that has the role to educate and train the public society, which can then take the roles and responsibilities in providing and improving state services for its citizens. There is no doubt that democracy was one of the more successful political ideas, unfortunately it has

⁶² 2005 World Summit, the UNGA Resolution 60/1 of 18 September 2005.

⁶³ The UNGA, The Universal Declaration of Human Rights 1948.

not reached and evolved in all the states equally to facilitate a viable stable democratic regimes and as it seems, it is going through turmoil even in some of the more established democratic states. It is felt that if the rule of law is observed the aspirational differences could be narrowed. However, the rule of law is an important and a complex topic that would require further research.

Conclusions

A large number of TNCs and their activities, namely through private foreign investment in host developing states have caused heated debates on the impact that private foreign investment has in terms of contributing to the socio-economic development by means of capital, technology transfer, market access, increasing competitive advantage, capacity building, employment generation and effects on the environment. Some of the major issues were caused over the question of foreign ownership and control. With the increasing importance of TNCs during the period of their expansion they have been identified by some as agents of development due to the significant role that they played in the world political economy, however not consensually.

The perception of foreign investment has changed significantly over the years. Starting with acknowledgment of foreign investment as a key to socio-economic development and the suggestion to remove the obstacles that were standing in its way. This was a complete opposite to what Havana Charter 1948 had proposed in its investment provisions. The UNCTAD addressed Governments of capital exporting states to take ‘all appropriate steps to provide favourable conditions for foreign investment’ and against ‘preventing or limiting the flow of capital from such countries to developing countries’ and ‘to encourage the flow of private investments to developing countries’.¹

TNCs have been seen as enormous economic powers and as such were considered to be endangering sovereignty of host developing states, including their environment and engaging in massive exploration of host developing states’ natural resources for the profit-maximisation purposes.

The UNCTAD Assembly resolution 3202 (S-VI) section V stated that:

all efforts should be made to formulate, adopt and implement an international code of conduct for transnational corporations:

- (a) To prevent interference in the internal affairs of the countries where they operate and their collaboration with racists regimes and colonial administrations;
- (b) To regulate their activities in host countries, to eliminate restrictive business practices and to conform to the national development plans, and in this

¹ The United Nations Conference on Trade and Development, 1948.

context facilitate, as necessary, the review and revision of previously concluded agreements;

- (c) To bring about assistance, transfer of technology and management skills to developing countries on equitable and favorable terms;
- (d) To regulate the repatriation of the profits accruing from their operations, taking into account the legitimate interests of all parties concurred;
- (e) To promote reinvestment of their profits in developing countries.²

The Codes of conduct for TNCs unfortunately were not implemented due to a number of factors, such as general restructure of the UNCTC, which came under the UNCTAD and reduced interest in general because there were simply too much disagreements resulting from the differences of the parties at the negotiating table that could not have been overcome. The focus was shifted to bilateral investment treaties (BITs) and the role of foreign investment on the socio-economic development in the lack of public finances and aids available for the developing states and their socio-economic development. TNCs with their investment became the only source of capital injecting assistance. In spite of the new climate the TNCs still could not wash the stain of their bad reputation. Nevertheless, developing states are now launching campaigns to promote foreign investments as was proposed by the UNCTAD to stimulate sustainable development. The challenge was how to measure the impacts of foreign investment without the activities of TNCs on the host developing states.

The World Investment Report (WIR) 1992³ focused on *Transnational Corporations as Engines of Growth* in which it analysed the relationship between foreign investment and development. The World Investment Report 1999 reviewed the *FDI and the challenges of development*.⁴

Importance of the UN role cannot be denied as it formed the first platform for the development concept in the modern form and allowed developing states to take part in decision making process. Its contribution, namely in terms of development aid was instrumental in times after the Second World War, when development became international public concern, especially for the newly born independent states, that used to be colonies.

² The UNCTAD Assembly resolution 3202 (S-VI) section V.

³ World Investment Report 1992.

⁴ World Investment Report 1999.

Over the decades the scholars and researchers have been striving to understand the dynamics of foreign investment and its effects on socio-economic development. It became obvious that balanced approach is needed since strict policies on one side nor “laissez-faire” on the other were not efficient.

The final conclusion is that TNCs ‘can do well, by doing good’⁵ and therefore the UN will have to continue to lead the discussions and negotiations towards achieving international corporate governance and take notes from previously failed attempts for balancing the interests between the parties.

As Sagafi-Nejad recommended that:

[T]he United Nations should rededicate itself to creating a special focal point on TNCs within the United Nations (like the UNCTC in New York) to interface with TNCs about their relations with home and host countries on matters of good corporate citizenship and their impact on the developmental process.⁶

The UN made significant efforts in trying to understand the impact of TNCs and its role in the world economy by exploring concepts, information on their size, locations, distribution channels, ownership structure, and organisation. Notwithstanding the recognition of accountability of TNCs to the wider international community and suggested courses of actions, the report *inter alia* also noted that:

While the conditions in the real world hardly permit an ideal system of international exchange and cooperation, a practical economic solution is required in which the political entities...can co-operate to reconcile the conflicting interests, harmonize their policies for their mutual benefit, and achieve a greater measure of international distributive justice.⁷

The controversy of TNCs activities was on the national sovereignty in the host developing states where they had their operations. There were many different and contradicting views

⁵ Howard V. Permuter in Tagi Sagafi-Nejad and John Dunning, *The UN and Transnational Corporations, From Code of Conduct to Global Compact* (Indiana University Press 2008), 195.

⁶ Howard V. Permuter in Tagi Sagafi-Nejad and John Dunning, *The UN and Transnational Corporations, From Code of Conduct to Global Compact* (Indiana University Press 2008), 215.

⁷ United Nations, *Multinational Corporations in World Development* (New York; United Nations Department of Economic and Social Affairs, 1973) 3.

on the subject of TNCs from ‘engines of growth’ to fear that ‘conflict between rich and poor nations will be converted into a struggle between developing countries and MNCs’⁸ to the ‘agents of capitalism’. One of critics of TNCs Hymer was sceptical of the UN efforts by maintaining that the reports the UN produced were “inadequate” as they failed to address many fundamental issues and asked if ‘a world system based on private multinational capitalism [could] ever achieve the development goals we all desire’.⁹ Hymer was in favour of strict control and regulation over TNCs and their activities. The concerns over ‘undesirable effects that foreign investment by multinational corporations’ and ‘Host countries are concerned about the ownership and control of key economic sectors by foreign enterprises’ due to ‘the extent to which they may encroach upon political sovereignty’.¹⁰ One of the objectives of Economic and Social Council was to strengthen the negotiating skills of host developing states, which will effectively contribute to the capacity-building. Also, because ‘the perception by many developing countries that they lacked bargaining power vis-à-vis TNCs’.¹¹ Objectives of creating the commission and the centre on TNCs was intended:

[T]o serve the cause of economic development and the role of TNCs and FDI in that development and to do so in the context of ideas, philosophies, and economic policies prevalent among developing countries.¹²

Over the years, the relationship between TNCs and host developing states changed. A common agreement is that developing states could do more to help attract needed foreign investment for capacity building and socio-economic development. Improved relationships with TNCs could also be based on better negotiation process and bargaining position.

⁸ UN Department of Economic and Social Affairs, Summary of the Hearings before the Group of Eminent Persons, 445.

⁹ UN Department of Economic and Social Affairs, Summary of the Hearings before the Group of Eminent Persons.

¹⁰ Taji Sagafi-Nejad, *The UN and Transnational Corporations: From Code of Conduct to Global Compact* (Indiana University Press 2008) 79.

¹¹ Taji Sagafi-Nejad and John H. Dunning, *The UN and Transnational Corporations, From Code of Conduct to Global Compact* (Indiana University Press, Bloomington 2008) 94.

¹² Taji Sagafi-Nejad and John H. Dunning, *The UN and Transnational Corporations, From Code of Conduct to Global Compact* (Indiana University Press, Bloomington 2008) 95.

Socio-economic development cannot be achieved without significant financial contribution also because ‘inequality and privilege act as major obstacles to development.’¹³ ‘[R]esources locally available in underdeveloped countries were insufficient to stimulate and sustain economic development’.¹⁴ It was clear that developing states were in need of foreign investment.

As the World Bank’s World Development Report 1990 stated *inter alia* that:

[M]any countries experienced macroeconomic difficulties in the 1980s as the debt crisis and international recession brought structural weakness into the open. But when structural adjustment issues came to the fore, little attention was paid to the effect on the poor. Macroeconomic issues seemed more pressing, and many expected that there would be a rapid transition to new growth paths. As the decade continued, it became clear that the macroeconomic recovery and structural change were slow in coming. Evidence of declines in incomes and cutbacks in social services began to mount.¹⁵

Developing states ‘to put themselves on a path of convergence with the advanced economies, developing countries must align their policies with the forces of globalization’.¹⁶ The International Labour Organisation (ILO) added that ‘rather than eliminating or attenuating differences and inequalities, the integration of national economies into a global system has on the contrary made those differences and inequalities more apparent and, in many ways, more unacceptable’.¹⁷

Objectives of profit maximisation were put in confrontation to the national social-economic development and capacity building objectives.

TNCs were not only a concern for developing states, they were also a concern for the developed states. The international business community also reacted to the activities of

¹³ Peter Bauer, The United Nations Report on the Economic Development of Under-Developed Countries (Economic Journal 63, March 1953) 213.

¹⁴ Louis Emmerji, Richard Jolly, Thomas G. Weiss, Ahead of the curve? UN Ideas and Global Challenges (Indiana University Press 2001) 40 – 41.

¹⁵ World Bank, World Development Report 1990: Poverty (New York: Oxford University Press 1990) 103.

¹⁶ IMF, Forces of Globalization Must Be Embraced (IMF Survey 26, no.10 1997) 154.

¹⁷ ILO, Defending Values, Promoting Change: Social Justice in a Global Economy, an ILO Agenda (Geneva: ILO, 1994) 18.

TNCs by adopting guidelines.¹⁸ Salacuse and Sullivan maintained that ‘foreign investors who sought the protection of international investment law encountered an ephemeral structure consisting largely of scattered treaty provisions, a few questionable customs, and contested general principles of law’.¹⁹ TNCs have ‘been portrayed both as engine of growth capable of eliminating international economic inequality and as a major obstacle to development’.²⁰

Foreign direct investment ‘reflects the objective of obtaining a lasting interest by a resident entity in one economy (“direct investor”) in an entity resident in an economy other than that of the investor (“direct investment enterprise”)’.²¹

However, the states, whether developed or developing have started taking actions over concerns that disproportionate protection is given to the foreign investors also by means of jurisprudence by looking for alternative investor-state arbitration mechanism, reviewing existing BITs and in some cases even terminating existing BITs and withdrawing from ICSID. Ever evolving international investment law has faced a new challenge to accommodate for different aspirations between the parties involved, for which there still exist a big gap that will have to be overcome. A new mechanism for settlement of investor-state investment disputes will have to be introduced and the existing BITs will have to be reviewed to accommodate for changing circumstances. Therefore, the recommendation is that new investment agreements should include succession clause, re-negotiation clause, performance clause and transfer of profits. This goals can only be achieved in stable democratic societies where civil society public

¹⁸ These guidelines were voluntary. See for example International Chamber of Commerce, Guidelines for International Investment (ICC 1972) (updating its ‘International Code of Fair Treatment for Foreign Investments’, which had been drawn up by the ICC’s Committees on Foreign Investments and Foreign Establishments and approved by the ICC’s Quebec Congress in June 1949; contained in UNCTAD, International Investment Instruments: A Compendium (UNCTAD 1996) vol III 273–278). It was updated in May 2012, available online <<http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2012/2012-ICC-Guidelines-for-International-Investment/>> accessed 10 January 2016. See also United States Senate, Committee on Foreign Relations, Subcommittee on Multinational Corporations, 93rd Congress, 1st Session, The International Telephone and Telegraph Company and Chile 1970–1971 (Government Printing Office 1973) (the extensive hearings in the United States on outward FDI and especially the activities of ITT in Chile). In Europe, Jean-Jacques Schreiber’s *Le défi américain* (Éditions Denoël 1968) received wide attention.

¹⁹ Jeswald W Salacuse and Nicholas P Sullivan, ‘Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and Their Grand Bargain’ (2005) 46 *Harvard Intl L J* 68.

²⁰ Rhys Jenkins, *Transnational corporations and uneven development, the internationalization of capital and the Third World* (First published 1987, Routledge 1991) 1.

²¹ OECD definition of FDI.

awareness is high and the rule of law is heavily imbedded in the existing legal order. Such stable democracies should also have well developed judiciaries and state institutions to offer protection for their citizens and continue to govern the state in the spirit of the wellbeing of its citizens as well as aliens.

Based on the ideas researched and developed in this research the hypotheses that were laid at the beginning can now be confirmed.

1. How may it be possible to develop a technique whereby interests of both parties may be balanced?

The only possible way moving forward is through balanced negotiations, where bargaining position would be equal on both sides and benefits would have to be agreed for both of the parties. It has to be a two-way process and the UN should be the platform to facilitate such negotiations with the support of the principle of the rule of law. Any disputes that might arise between the parties in the investor-state dispute settlement should be facilitated by autonomous entity that would not favour any of the parties and would work in a balanced way and would help developing states in their quest of developing reliable judiciaries by offering know-how and training the staff. Therefore, the gap between the aspirational differences between the parties has to be closed by means of negotiations and taking reciprocity into consideration as well as equal distribution of benefits and profits. Hence roles and responsibilities should be equally and clearly distributed during the negotiation process. Domestic courts should take the lead and become the first port of call for any investor-state disagreement which could be solved by re-negotiating the terms and conditions if there is a change of circumstances. However, domestic courts have to engage in capacity building and develop to the point that they are able to provide reliable due process for solving investor-state disagreements.

2. A false notion of bargaining power has hindered the process of implementing the concept of balancing the interests.

Due to the misconception and the use of the word ‘power’ it has been recommended that bargaining position would be more appropriate word to use in future negotiations of international investment agreements. That is due to the fact that power suggest superior position of one party over the other and as such does not facilitate balanced representation of interests. Aspirations have to be met and both parties should work towards mending

fences. Starting by taking the responsibility and assigning clear roles during the negotiation process in which interest of both parties will be equally represented. While TNCs are profit-maximisers and HDS are benefit-maximisers. TNCs are interested in achieving highest return on their investment and HDS are interested in achieving socio-economic independence. The interests of both parties have to find a balance in order for both parties to benefit from signed agreements towards achieving the interests of both the parties in a balanced way.

3. The aspirational differences between the parties are currently unreachable and some progress on this issue can be made if only true bargaining position concept is developed and applied.

As seen from the previous two notions it is of significant importance that aspirational differences of the parties are met. High profits of TNCs are no longer sustainable without the capacity building, re-negotiation clause, distribution of profits, succession and progress review. At the same time host developing states have to do their part in developing stable democratic societies, where civil society is involved in governance of the state and reliable judiciaries are at the forefront of ensuring stability. Such stable democratic states can only operate on developed and reliable judiciaries that can eventually take over investor-state dispute resolutions in cases they arise and offer protection and security for its citizens as well as aliens. The recommended way forward is to apply the concept of bargaining position in the negotiations process and re-negotiate existing investment agreement that would represent aspirations of both the parties in a balanced way and facilitate reciprocity moving forward. In the case when investment disputes between the foreign investor and a host state do arise, domestic courts should be able to facilitate independent dispute arbitration. There are three litigation options. First option is based on the signed BIT and recognition of the domestic court of the developing state that has the capacity to facilitate litigation also by the recognition of the court order, in which the developed state sends their skilled and trained arbitrators to the host developing state in order to conduct litigation. Second option is that the court of the developed state carries litigation for the claims brought by the host developing states. The third option is the revival and implementation of the Calvo doctrine. In the UK for example the English courts have jurisdiction over any company that is domiciled within

their territory.²² In the US on the other hand the courts do not automatically accept jurisdiction over TNCs sued for actions that took place abroad.

This research achieved its purpose to establish the lack of balance of interests between TNCs and host developing states. While this research found inconclusive arguments on the contribution of TNCs it equally found opposing arguments on the benefits of private foreign investors in host developing states on socio-economic development and effectively capacity building. This research concludes that the reasons for this is in history and the lack of capacity in respect of reciprocity between developing and developed states. This research therefore establishes the need for the attitudes of both the parties to be changed. The way towards achieving mutually beneficial cooperation is in closing the gap between aspirational differences. Aspirations between profit-making institutions and maximising benefits for capacity building from the participation of TNCs. There have been many attempts to control the activities of TNCs. One of them was the UN draft codes of conduct on TNCs, OECD codes of conduct and the recommendations on transfer of technology among other codes of conduct developed by intergovernmental or non-governmental institutions, however all attempts have failed and have unfortunately not been successfully implemented so far.

While the host developing states were obliged to follow and to offer the international minimum standards to the foreign investors, the principle of states responsibility included protection of TNCs and their assets. Whenever there was a clash between the two parties, based on their aspirational differences, there have been cases of nationalisation and expropriation of TNCs assets in newly born independent states. This research confirmed the lack of a negotiation system in place that would facilitate mutually beneficial investment agreements, for which both the parties are equally responsible. Therefore, both legislative and normative protective measures, trough codes of conduct particularly of good governance, should be adopted by host developing states as well as by TNCs and implemented with the help of the UN, which should become the platform to facilitate balanced negotiation process. Close examination of a number of existing BITs showed

²² See for example the most recent case of Zambian villagers claims that their water supplies have been heavily polluted by the London based Mining firm Vedanta Resources. The High court has ruled in favour of the Zambian to have their case heard in the British courts. The trial is likely to begin in 2017. Represented by Martyn Day <<https://www.leighday.co.uk/Our-experts/partners-at-ld/Martyn-Day>> accessed 13 December 2016.

that these investment treaties are imbalanced as they tend to protect the interest of TNCs, rather than providing for a climate of mutual participations of both the parties based on reciprocity. It is however believed that challenges associated with this research topic can be resolved by diplomatic negotiations as not everything can be resolved by law due to the limits explored in this research.

This research placed great emphasis upon the need for capacity building of developing host states as it also maintains that state contracts should include certain specific clauses for balancing these interests, namely succession clause, re-negotiation clause, performance clause, transfer of profits clause as agreed and protection of investor's clause. Host developing states should also work on developing stable democratic societies and reliable judiciaries. This is the foundation for the important legislation in regard to private foreign investments, namely legislation on intellectual property rights, equality among investors, human rights legislation and finally they should also promote the rule of law. In the event of disputes arising between investor-state these could be settled by the local courts and the local legislation if the reliable judiciaries and confidence is achieved that will accommodate procedure for enforcement for judicial proceedings and arbitral awards.

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