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## The Origins of Investment Protection and International Investment Law

### CHAPTER OUTLINE

Investment treaty arbitration derives from the consent of the host State, given under a treaty, to submit itself to arbitration in the event of a dispute with a foreign investor. Today, such treaty-based arbitration is the most prominent aspect of international investment arbitration, but it is only one aspect or form of it. Arbitration itself is only one of several means of settling investment disputes between foreign investors and host States. In the past, international investment disputes were resolved diplomatically by the 'home' State of the investor taking up its grievance against a foreign 'host' State, thereby making that grievance the home State's own. Such a claim might be pursued purely through diplomatic means, but throughout the nineteenth century and persisting well into the twentieth century there were several examples of the settlement of investment disputes through 'mixed' claims commissions. These were commissions of an international character which in time were supplemented by national claims commissions. Diplomatic espousal and mixed commissions operated in tandem. Where the commission failed, as it sometimes did, there were diplomatic negotiations leading to 'lump sum' settlements. Section 1 discusses these earlier forms of international investment dispute settlement. Section 2 goes on to discuss the unsettled period following the Second World War from 1945 to the 1970s, during which the standards of protection, particularly the standard of compensation, as well as the means of settlement – whether that ought to be in domestic courts or by way of international arbitration – were controversial. In response to controversy and uncertainty, there was an effort to transform the standards of protection into contractual terms, and to introduce contractual agreements to arbitrate any disputes. The attempt to 'contractualise' international investment protection became an attempt to elevate the contracts themselves onto the international plane, such that the contractual commitments to standards of protection and arbitration would themselves have the force of international law. That is the subject of Section 3. Section 4 deals with the rise, subsequently, of treaty-based protection and treaty-based arbitration in place of the role which contract had played. Thus emerged today's ubiquitous bilateral investment treaties (BITs) and the

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sort of investment treaty arbitration for which they provide. Section 5 discusses related modern institutions; namely, the International Centre for the Settlement of Investment Disputes (ICSID), as well as the inter-State adjudication of investment disputes before the International Court of Justice (ICJ). Section 6 rounds off this opening chapter with a brief introduction to the modern sources of international law usually relied upon by international investment tribunals.

### INTRODUCTION

Many who know nothing of international law are likely to have heard of ‘investor-State dispute settlement’ (‘ISDS’ for short). Some of what has been heard may be discouraging.<sup>1</sup> What is meant by ISDS today is, often, a form of treaty-based arbitration – a late-twentieth-century development. Investment treaty arbitration is the principal focus of this book, although it is not its sole focus. In comparison, contractually based arbitration has had a longer and sturdier history. There are forms of investment arbitration too which are based neither on treaty nor contract, such as arbitrations brought by private claimants on the basis of a host State’s consent to arbitration embodied in a national law, say a national petroleum law, or even in a host State’s investment authorisation or in some other document.<sup>2</sup>

Still, it is important to be reminded of history. The American Supreme Court Justice Oliver Wendell Holmes once wrote that ‘time has upset many fighting faiths’.<sup>3</sup> The converse is true too. Old ideas return. They recur. Seemingly fresh ideas that are emerging, such as the European Union’s proposal today that ‘private’ investment treaty arbitration should be replaced with a multilateral international investment court, cannot be appreciated fully without some acknowledgment of the history of the subject. History may also prove to be the best guide to the future where overbroad international protection for foreign investors is again being challenged, as it once was by the newly decolonised nations of Africa and Asia.

## 1. DIPLOMATIC ESPOUSAL, MIXED AND OTHER SIMILAR COMMISSIONS

### 1.1 Diplomatic Espousal

We should begin, first, with diplomatic protection. Injury to an alien, including injury to a foreign investor, can trigger diplomatic protection by the investor’s home State. The Permanent Court of International Justice, the predecessor to the present-day International Court of Justice, had put it this way:<sup>4</sup>

<sup>1</sup> For which, see, e.g., P. Eberhardt and C. Olivet (with contributions from T. Amos and N. Buxton), *Profiting from Injustice: How Law Firms, Arbitrators and Financiers Are Fuelling an Investment Arbitration Boom* (Brussels/Amsterdam: Corporate Europe Observatory and the Transnational Institute, 2012).

<sup>2</sup> All of this we will come to in Chapter 4 of this book.

<sup>3</sup> *Abrams v. USA*, 250 US 616 (1919) (Holmes J.).

<sup>4</sup> *Mavrommatis Palestine Concessions (Greece v. UK)* [1924] PCIJ Rep. Series A No. 2, 12.

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... it is an elementary principle of international law that a state is entitled to protect its subjects, when injured by acts contrary to international law committed by another state, from whom they have been unable to obtain satisfaction through the ordinary channels.

The term 'diplomatic protection', however, is wide. In the view of the International Law Commission (ILC), that body entrusted with the codification and progressive development of international law, the 'other means of peaceful settlement' include 'negotiation, mediation and conciliation' in addition to 'arbitral and judicial dispute settlement'. In its Draft Articles on Diplomatic Protection, the ILC defines diplomatic protection as:<sup>5</sup>

... the invocation by a State, through diplomatic action or other means of peaceful settlement, of the responsibility of another State for an injury caused by an internationally wrongful act of that State to a natural or legal person that is a national of the former State with a view to the implementation of such responsibility.

The aim is to ensure both protection and reparation for a national wronged by a foreign State.<sup>6</sup> It should be added, for the sake only of completeness, that this definition in the Draft Articles on Diplomatic Protection keeps to the formulation in the ILC's Draft Articles on State Responsibility for Internationally Wrongful Acts.<sup>7</sup>

The legal fiction, said to originate with Vattel's dictum that whosoever injures a national injures the State itself,<sup>8</sup> is this. The claim becomes that of the home State itself, not that of the injured national.<sup>9</sup> It is a fiction which now more than ever is confronted with the reality of investors bringing claims directly before an investment arbitration tribunal. This book is about the new reality, particularly since the late 1990s, of investor-State arbitration. Although not unimaginable, this reality today was once thought to have been unlikely. In the beginning, diplomatic protection meant the espousal of an investor's claim by its own State.

#### Maximilian Koessler, 'Government Espousal of Private Claims before International Tribunals', (1946) 13 *Chicago Law Review* 180, 180–181

International law has not so far developed a generally accepted theory to explain the nature of 'diplomatic protection'. Yet in the postwar era this phrase will be employed to an extent unknown before the war to define the action taken by state against state to secure redress of alleged wrongs done to individuals or corporations. Although many of these claims will be settled by mutual agreement of the respective foreign offices, in many cases the issues will be submitted to an international body of arbitration or adjudication. Such litigation may become

<sup>5</sup> Art. 1, Draft Articles on Diplomatic Protection, text adopted by the ILC at its 58th session, 2006, UN Doc. A/61/10; YrBk of the ILC, 2006, vol. II, Part Two, 24, 27. The page numbers refer to UN Doc. A/61/10.

<sup>6</sup> *Ibid.*, 24.

<sup>7</sup> For '[a]ny system of law must address the responsibility of its subjects for breaches of their obligations'; J. Crawford, *State Responsibility: The General Part* (Cambridge University Press, 2014), 3.

<sup>8</sup> E. de Vattel, *The Law of Nations or the Principles of Natural Law Applied to the Conduct and to the Affairs of Nations and Sovereigns* (Washington, DC: 1758, English translation by C. G. Fenwick, Carnegie Institution, 1916), vol. III, 136.

<sup>9</sup> See further A. Vermeer-Künzli, 'As If: The Legal Fiction in Diplomatic Protection' (2007) 18(1) *EJIL* 37.

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the most important aspect of postwar 'diplomatic protection'. The term itself is not very felicitous since it does not describe an essential or characteristic feature of the institution. The unique character of this international litigation does not lie in the employment of diplomatic measures. Its peculiarity is based on the fact that the claim of a private person, normally without judicial standing as against a foreign state, is espoused by a state and thus converted into a government claim which will be heard by the appropriate international tribunal. An historical analogy may be suggested. It appears that 'interposition', in the sense just referred to, is similar to the representation of the serf by his lord under feudal law. This feudal representation grew out of the fact that the serf, devoid of a standing in the barons' courts, would have been a defenseless victim of aggression by any other lord but for the championship of his own lord. Similarly, the private person today, unrecognized by international courts or arbitration bodies, would be without legal protection against an offending foreign state were not that private person's claim espoused by his government.

...

A streamlined law of nations, granting to private persons a standing before international courts and arbitration commissions, could do away with the roundabout relief through diplomatic protection, just as the emancipation of the serfs eliminated the need for feudal representation.

### 1.2 Diplomatic Espousal and Diplomatic Settlement

We have travelled far since. Diplomatic espousal was viewed as a thing fraught with risk. If only to paraphrase McNair, it arises at the behest of troublesome individuals who are prone to invent claims and were therefore a bit of a nuisance. It was also hardly irrelevant that claimants often enough asked for the right to wage private war through the grant of special reprisals.<sup>10</sup> McNair observed that the famous *Don Pacifico* incident was notable in that regard. A British subject who suffered loss and injury when his house was broken into and plundered by a riotous mob had sought and obtained British espousal of his claim for the loss and injury sustained to him and his family. Lord Palmerston was in that case advised by Sir John Dodson that the Greek authorities had breached 'the duty of every civilized Government to protect Persons and Property within its Jurisdiction'.<sup>11</sup> This led to a claim by the British Government for losses sustained. The same principle had been expressed, as Professors Rudolf Dolzer and Christoph Schreuer have pointed out, by John Adams during the year before he became the President of the United States following the conclusion of a friendship, commerce and navigation (FCN) treaty with France<sup>12</sup> – a precursor to today's bilateral investment treaties.<sup>13</sup>

<sup>10</sup> Lord McNair, *International Law Opinions: Selected and Annotated* (Cambridge University Press, 1956), vol. 11, 197, 198.

<sup>11</sup> J. Dodson to Lord Palmerston, 13 July 1847; reproduced in McNair, *International Law Opinions*, 239.

<sup>12</sup> Cited and quoted in R. Dolzer and C. Schreuer, *Principles of International Investment Law*, 2nd edn (Oxford University Press, 2012), 1.

<sup>13</sup> For the influence of FCN treaties today, see K. J. Vandeveld, *Bilateral Investment Treaties: History, Policy and Interpretation* (Oxford University Press, 2010).

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For our purposes, it would be excessive to explore the various criteria which have been applied by individual governments in deciding upon the exercise of their discretionary power. Suffice to say that the exhaustion of local remedies is typically a requirement,<sup>14</sup> so too the requirement that the injured party should have the protecting State's nationality, which in turn might involve further questions about the continuity of that nationality and its duration.

The chief shortcoming of diplomatic espousal from the viewpoint of the private party who alleges injury is the discretionary nature of that remedy.<sup>15</sup> There is no assurance that protection will be forthcoming. In comparison, the investor may elect, on its own, whether or not to pursue that right directly and when to do so. This may be advantageous not just to the claimant, but also to the State, which is spared from the role of serving as a debt collector for its merchantmen.

The story of how diplomatic espousal, which although it remains, gave way to investor-State claims and arbitration, is a story of adaptation, experimentation and human ingenuity. The roots lie in the mixed international commissions of old.

### 1.3 Mixed International Commissions, National Commissions and Modern Claims Settlement

The idea of a 'mixed' dispute settlement mechanism, where mixed nationality commissioners are chosen by the States, has a long history. Such international claims commissions have existed since the earliest 'investment' disputes. International mixed claims commissions should also be distinguished from 'national' claims commissions, which represent a related, but distinct, device, as the extract by Professor Lillich, below, explains.

So far as mixed claims commissions were concerned, these were an inherently flexible device which had been designed to settle claims between the citizens of different States, between the citizens of one State against another State and also between the States themselves.<sup>16</sup> One should be careful to observe that this does not mean that individuals could simply appear to press their own claims as they can today in investment arbitration.<sup>17</sup> Typically, such commissions were established under treaty by States – i.e. by more than one State, unlike in the case of national commissions – and it is the States which play a key role in choosing the commissioners who would comprise a majority of their own nationals. Mixed commissions were most prominent during the nineteenth century, during which some eighty or so of them replaced the single arbitrator tribunals of an

<sup>14</sup> Flexibly interpreted, see, e.g., 'Letter of US Secretary of State to Minister to Turkey, 5 February 1853' (1906) 6 *Moore's Digest of International Law* 264, also reproduced in C. F. Dugan, D. Wallace, Jr, N. D. Rubins and B. Sabahi, *Investor-State Arbitration* (Oxford University Press, 2008), 28. Dugan *et al.* cite the Canadian Foreign Ministry's position, requiring nationality at the time of loss and presentation of claim and in the case of a company its formation under Canadian law prior to the time of the presentation of the claim, as well as the exhaustion of local remedies again flexibly interpreted (*ibid.*, 29–30).

<sup>15</sup> See the well-known passage in *Barcelona Traction, Light and Power Co., Ltd (Belgium v. Spain)* [1970] ICJ Rep. 3, p. 44.

<sup>16</sup> See R. Dolzer, 'Mixed Claims Commissions' in *Max Planck Encyclopedia of Public International Law*, available at [www.opil.ouplaw.com](http://www.opil.ouplaw.com) (last updated: May 2011). As ideas in the field tend to, this very flexibility now returns in modern form in the Iran–US Claims Tribunal and the UN Compensation Commission, discussed further below.

<sup>17</sup> This only appeared after the First World War (Dolzer, 'Mixed Claims Commissions').

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earlier era. They presaged today's 'mixed' arbitral tribunals. Unlike diplomatic espousal, such commissions would not normally require the exhaustion of local remedies. The mixed claims commissions lasted well into the late 1930s,<sup>18</sup> one of the more prominent being perhaps the commission established by the United States and Mexico just before the Second World War in order to settle the Mexican agrarian expropriations.<sup>19</sup>

As for national commissions, these are explained in the extract below.

**Richard B. Lillich, *International Claims: Their Adjudication by National Commissions* (New York: Syracuse University Press, 1962) (footnotes omitted)**

Many proposals have been made through the years for the establishment of international judicial bodies to facilitate the settlement of claims. All would modify or eliminate the espousal concept and give the individuals more or less direct access to some form of permanent international tribunal. All, unfortunately, have come to naught. Nor have the increasing availability of municipal fora to aliens for the prosecution of direct claims against the sovereign and the concurrent trend toward the restrictive theory of sovereign immunity alleviated the situation for the vast majority of aggrieved individuals, whose only recourse against a foreign state remains via the method of espousal.

The United States at an early date sought to avoid the unwieldy espousal concept whenever a large number of claims arose against a single state by resort to international claims commissions. Beginning with the Jay Treaty of 1794, regarded as the commencement of modern international arbitration, this country [i.e. the United States] pursued a policy of advocating the use of mixed claims commissions. These commissions, composed of nationals of the United States, the foreign country, and a third state, would receive and adjudicate claims brought by the United States on behalf of its nationals against the foreign country. Other states followed suit and 'gradually this jurisprudence attained an increasing influence on the development of international law'. [Quoting Professor Stuyt]

While the mixed claims commission promoted the rule of law in that it substituted a legal for a political determination, and while in a sense it relieved the Department of State of the burden of severally presenting many essentially nongovernmental claims, it soon became apparent that the success of a mixed commission depended to a disproportionate degree upon the ability of its commissioners. Indeed, the very nature of the device was such as to produce commissioners of nonjudicious, adversary temperament. If commissioners performed their duties with speed and impartiality the mixed commission was a useful device for the settlement of international claims and the development of customary international law. But too often this was not the case.

One of the Jay Treaty commissions, for instance, was rendered so ineffective by the conduct of the commissioners that it was eventually abandoned, the United States paying

<sup>18</sup> *Ibid.*

<sup>19</sup> Or at least those occurring after 1927. For the Mexican agrarian expropriations, see Section 2, below, which reproduces the US–Mexican correspondence of 1938. A further round of expropriations of British and American property in 1938 were settled by means of expert determination instead, in which both sides appointed expert assessors. See further A. Lowenfeld, *International Economic Law*, 2nd edn (Oxford University Press, 2008), 479–480.

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a lump sum to Great Britain and the latter establishing a national commission to distribute the money. The failure of this mixed commission was undoubtedly one reason why a year later, in 1803, the United States accepted a lump sum from France in settlement of certain American claims which it distributed by means of the first United States national claims commission. Thus it can be seen that 'the domestic claims commission is not an innovation' [Quoting Coerper] of recent years but a device dating back to the earliest days of modern international arbitration.

National commissions have been utilized frequently by the United States during the past 150 years. Such commissions have distributed funds under treaties, conventions, or agreements with Spain in 1819, Great Britain in 1826, Denmark in 1830, France in 1831, the Two Sicilies in 1832, Spain in 1834, Peru in 1841, Mexico in 1848, Brazil in 1849, China in 1858, Rumania, Italy, the U.S.S.R. and Czechoslovakia. Lump sum settlements with Rumania and Poland were concluded in 1960, and the Department of State currently is conducting negotiations with several Eastern European countries in an effort to achieve a settlement of outstanding claims. Future lump sum settlements with these countries will be handled by the Foreign Claims Settlement Commission, which is now processing Czech and Polish claims.

The wholehearted adoption by the United States of the lump sum method of handling large groups of international claims, indicated by the various settlements mentioned above and commented upon by many writers, was due less to the superior features of this method of adjudicating claims than to the inherent defects and repeated failures of mixed claims commissions. The ineffectiveness of one Jay Treaty commission leading to the utilization of the first United States national commission established a pattern which has been followed many times over. Indeed, in the case of the 1826 Convention with Great Britain, the 1848 Treaty with Mexico, and the 1934 and 1941 Conventions with Mexico, there had been prior attempts to settle these claims by means of mixed commissions which each time had failed. The failure of these mixed commissions led not only to an assumption of their work by national commissions, but also caused the Department of State to place increased reliance on the national commission technique of settling international claims. Following the 1826 Convention with Great Britain, for example, the United States negotiated lump sum settlements in 1830 with Denmark, in 1831 with France, in 1832 with the Two Sicilies, in 1834 with Spain, and in 1841 with Peru. After the 1848 Treaty with Mexico, lump sum settlements were concluded in 1849 with Brazil and in 1858 with China. The breakdown of the prewar mixed commissions with Mexico, followed by the 1934 and 1941 Conventions with that country, resulted in the national claims commission device being used by the United States almost to the exclusion of any other type.

Even if commissioners on a mixed commission could function smoothly, there is doubt whether the mixed commission would be adequate to handle the wholesale claims of the postwar period. As far back as 1938, McKernan noted that 'a large number of claims demands a certain speed of adjudication which is impossible if the claims are to be decided by commissioners of different nationalities, and language, and who are educated in different legal systems'. Six years later Hudson pointed out that extraordinary delays were a common characteristic of mixed commissions and had tended to jeopardize confidence in them.

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The best-known modern successors of the mixed claims commissions of old are the Iran–US Claims Tribunal and, though fundamentally different for being strictly a claims-processing facility, the UN Compensation Commission.<sup>20</sup> The Iran–US Claims Tribunal in particular has contributed significantly to the jurisprudence on investment claims. Professor Lillich’s account of mixed international claims commissions and national claims commissions provides a helpful introduction to a part of the controversy over the nature of the Iran–US Claims Tribunal.

The tribunal had been established under the Second Algiers Declaration (‘The Claims Settlement Declaration’). One question had concerned the status of the tribunal since it was at least unclear whether the Algiers Declaration was a treaty. It was argued that it was a treaty albeit concluded through an intermediary, and the tribunal itself considered it a treaty. Still it was not clear even then that what resulted was necessarily an international tribunal, even though Article II(1) of the Claims Settlement Declaration called it such.<sup>21</sup> This is Professor Lillich’s point in the extract above – namely, that a treaty could be used to establish an agreement between two States, but, although still obligated under treaty, a State might establish a national, rather than an international, commission for the settlement of the relevant claims.

The Iran–US Claims Tribunal was established, as was typically the case, as a response to traumatic events flowing from the Iranian Revolution of 1979 and the Iran Hostage Crisis. The First Algiers Declaration dealt broadly speaking with, among other things, the hostage crisis, the return of Iranian assets, the settlement of Iranian bank loans and Iran’s commitment to pay into a fund from which awards in successful claims against it may be paid. The second, the Claims Settlement Declaration, with which we are primarily concerned, established a nine-member tribunal, three appointed by each side and three more by mutual agreement.<sup>22</sup> The UNCITRAL Arbitration Rules applied. Importantly, the tribunal was entrusted with, among other things, claims by the nationals of each against the other (i.e. the United States and Iran) in respect of the assertion of private law rights.<sup>23</sup> There lies the resemblance with the mixed international commissions of old. Here, it is a mixed international tribunal.

<sup>20</sup> The UNCC, whose tasks are now practically completed, was not entrusted to decide upon the question of liability itself, but merely questions of causation and quantum. There are other modern examples, such as the commissions for German forced labour during the Second World War, and the claims of Austrian holocaust survivors and their heirs. See Dolzer, ‘Mixed Claims Commissions’.

<sup>21</sup> See S. J. Toope, *Mixed International Arbitration: Studies in Arbitration between States and Private Persons* (Cambridge: Grotius, 1990), 266–268; citing, inter alia, *Case A-I* (1982), 1 Iran–USCTR 144 (First Phase).

<sup>22</sup> G. H. Aldrich, *The Jurisprudence of the Iran–US Claims Tribunal* (Oxford University Press, 1996), 2–6.

<sup>23</sup> Article II(1) of the Claims Settlement Declaration, see Toope, *Mixed International Arbitration*, 268; Aldrich, *The Jurisprudence of the Iran–US Claims Tribunal*, 6. Part of the complexity over determining the true nature, or status, of the tribunal concerns its varied mandate, for the tribunal was also charged with contractual claims between the United States and Iran themselves, as well as with the interpretation and application of the two Algiers Declarations (Aldrich, *ibid.*, 6). The other part concerns whether claimants have direct rights, or whether the right of espousal by the State of nationality is retained (Toope, *Mixed International Arbitration*, 268). Yet, this is not unique to the tribunal, and is a question which arises even with investment treaty arbitration, as this chapter goes on to discuss, immediately below.



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A further, contemporary example of a bespoke arrangement is the UN Compensation Commission (UNCC),<sup>24</sup> which was established by the UN Security Council in Resolution 692 after the end of the Gulf War.<sup>25</sup> The UNCC was established to effect war reparations, excluding such costs and losses, and damage or injury borne by the Allied Coalition Forces during the Gulf War following Iraq's invasion and occupation of Kuwait. An important difference between the UNCC and the Iran–US Claims Tribunal is that Iraq's liability for injury, death, loss and damage to individuals, corporations and countries had already been determined by the UN Security Council itself.<sup>26</sup> All that remained were issues of claims management, and the determination by three-person panels of UNCC Commissioners of issues of causation and the assessment of damages for a total of some 2.6 million claims subsequently filed against Iraq. Because liability had already been determined beforehand and was not an issue before the panels of Commissioners, the UNCC is most aptly termed a claims-processing facility dealing only with the screening of claims and the actual disbursement of funds. Be that so, the panels applied international law principles as well as internal UNCC law,<sup>27</sup> and there was an acute sense of the requirements of due process as with any tribunal proceedings. Moreover, as with other dispute resolution methods such as in the World Trade Organization (the WTO), the Commissioners did not hand down awards, but only made 'recommendations' for approval by a higher political body. That body was the UNCC Governing Council comprising all the Members of the Security Council, sitting in committee in Geneva.

The following section goes on to describe the emergence of modern international investment arbitration, following an initial attempt to turn, first, to contract law both in respect of the provision of substantive legal standards of protection and as the basis of the agreement to arbitrate. Eventually, however, those who sought a more effective system of investment protection reached for another, wholly innovative device – namely, treaty-based investor-State arbitration in which the promise to arbitrate was made by the host State to the claimant's home State. The following is therefore a tale about the shift from what initially was a substantial reliance upon general, customary international law principles, to a contractual and thereafter to a treaty-based system of law and dispute settlement which we now tend to think of when we refer to 'investment treaty arbitration'. Such investment treaty arbitration should be distinguished from the other examples

<sup>24</sup> The UNCC's official internal designation within the United Nations was Ad Hoc Committee 26 of the UN Security Council. See further R. B. Lillich (ed.), *The United Nations Compensation Commission: Thirteenth Sokol Colloquium* (Irvington, NY: Transnational, 1995); M. Frigessi di Rattalma and T. Treves (eds), *The United Nations Compensation Commission: A Handbook* (The Hague: Martinus Nijhoff, 1999); C. S. Gibson, T. M. Rajah and T. J. Feighery (eds), *War Reparations and the UN Compensation Commission: Designing Compensation after Conflict* (Oxford University Press, 2015); C. L. Lim, 'On the Law, Procedures and Politics of United Nations Gulf War Reparations' (2000) 4 *SJICL* 435.

<sup>25</sup> Resolution 692 (UN Doc. S/RES/692 (1991), 20 May 1991) established the UNCC and the Compensation Fund.

<sup>26</sup> UN Security Council Resolution 687 (UN Doc. S/RES/687 (1991), 8 April 1991), para. 16: 'Reaffirms that Iraq, without prejudice to the debts and obligations of Iraq arising prior to 2 August 1990, which will be addressed through the normal mechanisms, is liable under international law for any direct loss, damage, including environmental damage and the depletion of natural resources, or injury to foreign Governments, nationals and corporations, as a result of Iraq's unlawful invasion and occupation of Kuwait.'

<sup>27</sup> This included the Decisions of the UNCC Governing Council, such as that adopting the UNCC's rules of procedure (officially, 'Provisional Rules for Claims Procedure') (UN Doc. S/AC.26/1992/INF.1).

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discussed earlier of investment claims settlement, inter-State forms of investment arbitration in which the claim is brought by the home State against the host State,<sup>28</sup> and international adjudication.

## 2. LEGAL UNCERTAINTY AND CONFLICTING ATTEMPTS TO RESTATE THE LAW IN THE UNITED NATIONS (1945–1970s)

In both contractual and treaty-based investment arbitration, a procedural innovation of great importance was that unlike diplomatic espousals of the past, the claim would be the investor's own and in the case of a treaty between the investor's home State and the host State conferring the right to bring a claim, the home State has no business in respect of the claim; meaning, it has no legal interest and no control over its commencement, advancement and management.<sup>29</sup> This idea may be traced to the manner in which diplomatic espousal had evolved into mixed claims commissions in which agreements between disputing States had allowed commissions before which claimants may pursue their claims 'directly' against the host State.<sup>30</sup>

Yet, in order to understand how contractually based and treaty-based investment arbitration emerged, we should begin with the fluid state of customary international law principles during the 1960s which persisted well into the 1980s. This had prompted multilateral diplomatic attempts to clarify such principles of customary law at the UN General Assembly. The initial efforts at the United Nations, as we shall see, ultimately led to: (1) the articulation of principles (under UNGA Resolution 1803, for example) which sought to ensure that investors' *contracts* with host States had themselves some international law basis;<sup>31</sup> (2) investor rights being eventually placed upon a firm treaty footing instead;<sup>32</sup> and (3) the procedural innovation of allowing claimants to 'own' their claims without requiring the adoption of such claims by their home States.

### 2.1 Legal Chaos

In the *Don Pacifico* incident referred to earlier, there had been discussion of compensation, but no principles apart from the sanctity of foreign-owned property had apparently been relied on. The classical view on the appropriate standard of compensation for the expropriation of foreign-owned property is that expressed in the *Chorzow Factory* case, a case decided in 1927 by the Permanent Court of International Justice, the predecessor to the International Court of Justice. The case had involved the Polish forfeiture of two German companies in violation of a German–Polish treaty commitment.

<sup>28</sup> Although investment treaties can and do provide for both investor-State and inter-State claims, and thus there is a certain looseness even to the term 'investment treaty arbitration'.

<sup>29</sup> This view is at least forcefully argued in Z. Douglas, *The International Law of Investment Claims* (Cambridge University Press, 2009), 10 and esp. 19. Regarding this section of this chapter generally, see further, e.g., Lowenfeld, *International Economic Law*, 483–485.

<sup>30</sup> Douglas, *The International Law of Investment Claims*, 11.

<sup>31</sup> Section 3, below. See also the theory of the internationalisation of State contracts in Chapter 2 of this book.

<sup>32</sup> Section 4, below.