Investment Contracts and Arbitration

The World Bank Convention on the Settlement of Investment Disputes

by

Joy Cherian

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1975
A. W. SIJTHOFF – LEYDEN

ISBN 90 286 0435 9

Printed in The Netherlands

To
MY LOVING PARENTS

ACKNOWLEDGMENTS

The author wishes to express his heartfelt appreciation to Professor Philip E. Chartrand (The Catholic University of America, Washington, D.C.) for his great guidance and sincere assistance in the preparation of this book and to Professor James A. R. Nafziger (American Society of International Law), Dr. C. Felix Amerasinghe (The World Bank), and Professor Maxwell H. Bloomfield (The Catholic University of America) for their constructive comments.

The writer is indebted to Mr. Alan John Leidecker, Attorney, Washington, D.C., for his reading of the different drafts of the Manuscript, and for his helpful suggestions.

Acknowledgments are also made to the following persons and institutions who have assisted in the preparation and publication of this work: Mr. Charles R. Norberg, General Counsel of the Inter-American Commercial Arbitration Commission, Mr. and Mrs. Kavanakudyils of New York, Mrs. Helen Philos of the American Society of International Law Library (Washington, D.C.), Mrs. Katherine Seide of the American Arbitration Association Library (New York); The Catholic University of America, Law Department and Publications Division of the American Life Insurance Association, A. W. Sijthoff International Publishing Company,

Leiden, Netherlands; and especially to Mr. Michael Schneider of Washington, D.C.

Finally, special thanks and deepest appreciation is due to the wife of the author, Alice, for her greatest devotion and most valuable assistance which contributed to the completion of this book.

Washington, March 1975 Joy Cherian

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APPLICABLE LAW OF ICSID ARBITRATION

INTRODUCTION

Usually an international investment agreement between a sovereign government or governmental agency and a foreign private corporation is aimed at developing the economic power latent in the natural resources of a state party with the help of foreign money and advanced technology and utilizing local manpower and raw materials. In addition, such an agreement is also designed to provide a profit for the foreign private investor. For this purpose, the foreign partner is granted the rights needed to conduct his investment activities in the capital-receiving country. The role of foreign private investments in the process of economic development is an important ingredient in the progress of developing countries. However, various aspects of foreign private investment contracts invoke serious conflicts especially in the matter of selecting the arbitration law to be used to settle legal disputes arising out of such contracts.

If the countries of the developing world are to continue to receive substantial investment from private sources in the developed world, it is essential that an appropriate arbitration law or suitable principles or legal systems be generated which would be acceptable to both private investors and the capital-receiving countries as equitable and impartial when applied to legal disputes arising between

these two parties. A variety of answers has been proposed in legal literature to the question of which body of law should be applied in such cases, and differing choices have been made by national, regional, and international organizations concerned with the settlement of these and analogous disputes, including the domestic law of the capital-receiving state, the domestic law of the state of the private investor, *lex arbitri*, public international law and private international law. Each of these choices has its proponents and its critics, but none of them entirely fulfills the tests of acceptability set forth above.

In the absence of a prior agreement on the applicable law of arbitration between a host government and a foreign private investor, a transnational arbitration tribunal will face a question: which law will be the most appropriate one to apply so as to achieve an equitable and impartial award. This book examines that question of choice of law through a comparison of existing approaches with a new institutional approach to the question—that offered by the 1965 Convention on the Settlement of Investment Disputes.[1] The comparison is guided by the following criteria:

1) how well does the approach specify what arbitration law is to be applied to these disputes?;

2) how adequate is the law specified for the handling of the issues which are central to these particular disputes?; and

3) how well does the approach provide for the development of a uniform and coherent body of enforceable law which will, by its equitable nature, prove acceptable to the largest possible number of disputants?

To further the purposes of the study, a legal analysis of the views of eminent publicists concerning investment arbitration has been undertaken, followed by an institutional analysis of the choice of law provisions directly or indirectly provided by three major existing foreign private dispute-settling institutions—the American Arbitration Association, the Inter-American Commercial Arbitration Commission, and the International Chamber of Commerce. The criteria mentioned above have been applied to the respective rules and regulations of these institutions as explicated by their legal officers and exemplified in selected arbitration proceedings. The same criteria have been applied to the relevant provisions of the 1965 Convention as interpreted by the parties to that Convention and by the officers of the International Center for the Settlement of Investment Disputes, the creation of which was the key function of the 1965 Convention.

This book is divided into four chapters. The first part of chapter one touches briefly on the meaning and the scope of economic development in an historical perspective. It also describes various types of economic development contracts between developing countries and foreign private investors, and possible legal conflicts arising out of such contracts.

The second part of the first chapter analyzes in general the question of choice of law as seen in arbitrations designed to settle legal disputes originating from different economic development contracts, and specifically the relevance of adopting different types of laws such as the municipal law of the host state, the municipal law of the investor's state, *lex arbitri*, international law, and transnational law.

The second chapter examines the legal techniques accepted and practiced by the American Arbitration Association (AAA), the Inter-American Commercial Arbitration Commission (IACAC), and the Court of Arbitration of the International Chamber of Commerce (ICC). An attempt to understand the historical and operational background of the International Center for the Settlement of Investment Disputes (ICSID) has been undertaken in chapter three in order to examine applicable law proposed by the ICSID in order to find whether or not acceptance of such applicable law is more adequate, specific, equitable, uniform, and enforceable than other approaches designed by the AAA, the IACAC, and the Court of the ICC.

In the concluding chapter, the book reaches a finding that the arbitration mechanism designed by the 1965 Convention on the Settlement of Investment Disputes proves responsive to the question of choice of law arising out of an arbitration between a host government and a foreign private investor. It also reveals that a similar capability with respect to the question of choice of law is not seen in any of the prominent economic dispute-settling institutions and it is this difference in approach which makes ICSID's arbitration mechanism such a potentially significant contribution to dispute settlement in an area where the choice of law problem has loomed so large.

Chapter I

THE DEVELOPMENT OF LAW OF ARBITRATION FOR THE SETTLEMENT OF TRANSNATIONAL ECONOMIC DISPUTES

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