INTERNATIONAL LAW AND FOREIGN INVESTMENT: A REAPPRAISAL

SAMUEL K. B. ASANTE*

THIS article addresses some international legal issues posed by foreign investment and, more broadly, the relations between host countries and foreign companies. Few areas of international law have generated more debate than this subject. The controversy derives not only from the clash of juristic opinion and traditions but also from deep-seated and perennial differences about the concept and role of property in the political and social order and about the international economic structure. A major factor in this regard is the emergence of numerous States from colonialism and their quest for a new international legal system reflecting the needs of an expanded international community. In political parlance, the subject is riddled with the pervasive disputes associated with both East–West and North–South conflicts. This article reappraises the current position in the light of major international developments, particularly in the post-World War II era.

The development of international norms relating to foreign investment followed the substantial expansion of transnational business operations from Western Europe and the USA to Latin America, Asia and Africa. These norms were preoccupied with the protection of the person and property of aliens in distant lands. Much of the contemporary disenchantment in the developing countries with the traditional principles relating to foreign investment is traceable to the failure of these principles to address the interests of host countries by defining the responsibilities of investors and their home countries in this regard.

The debate about the international regime for foreign investment has been intensified by the growth of the phenomenon of transnational corporations (TNCs) as major actors in international economic relations. This phenomenon has been treated with ambivalent attitudes. On the one hand, it has been stressed that TNCs have the requisite economic power and resources to act as effective instruments of development, particularly in developing countries, and that they have, in fact, played a meaningful and constructive role in this regard. On the other hand, the pervasive role attributed to TNCs in the world and the disclosure of cer-

* Director, UN Centre on Transnational Corporations; formerly Solicitor-General, Ghana. This paper represents the personal views of the author.

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tain instances of corporate misconduct have generated a grave concern about their impact on economic development and political and social affairs, both at the national and international level. The emergence of TNCs as major instruments of international investment has raised the fundamental question whether traditional principles of State responsibility for injuries to aliens, sometimes perceived as an apparatus for protecting human rights, should be applied indiscriminately to TNCs—powerful economic organisations with elusive nationality—without a corresponding body of restraints on these corporations to safeguard the public interest in host as well as home countries.[1]

The various international and regional efforts towards the promulgation of a multilateral system for the regulation of TNCs stem from this concern about the negative aspects of their operations as well as the recognition that national regulation and control by themselves, unaided by some international mechanism, are clearly inadequate to deal with the global strategies of TNCs.

A realistic appreciation of the current status of international law relating to investments entails an examination of the standards prescribed by traditional customary international law in the light of State practice, including national laws governing investment, resolutions of the UN and other international declarations, decisions of arbitral tribunals, the opinions of publicists around the world, bilateral and regional arrangements for the protection of investment, and regional and multilateral instruments regulating foreign investment and other activities of TNCs.

I. CUSTOMARY INTERNATIONAL LAW

THE above-mentioned controversy with respect to the international legal regime for investments is most acute in the elucidation of the applicable principles of customary international law. Traditional principles of customary international law, asserted and advocated in this area by Western governments and jurists, have been strenuously challenged since the turn of this century by Latin American jurists, the socialist States of Eastern Europe and, more recently, the newly emergent States of Asia and Africa and by some Western jurists. Thus a meaningful and realistic assessment of the current status of international law relating to investments requires a survey of these divergent approaches. Such a survey, albeit a brief one, appears in the following sections.

1. A. A. Fatouros, "Transnational Enterprise in the Law of State Responsibility", in R. Lillich (Ed.), *The International Law of State Responsibility for Injuries to Aliens* (1983), Chap. VIII.

A. Traditional Principles of Customary International Law: The Law of State Responsibility for Injuries to Aliens

Traditional principles of customary international law relating to investments revolve around the law of State responsibility for injury to aliens and alien property.[2] According to this doctrine, which was developed in the nineteenth century, host 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—an objective international standard—is not necessarily discharged by according to aliens and alien property the same treatment available to nationals. Where national 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 alien, a right predicated on the inherent right to protect nationals abroad.

Traditional international law recognises that, in general, a person established in a foreign territory is subject to the territorial legislation of the host country for the protection of his person and property, under the same conditions as nationals of that country. However, where such a person is deprived of his rights in the host State, that person's home State has a right to intervene if the injury sustained constitutes a violation of international law. Such a violation occurs where the acts or omissions of the host State fall below the international minimum standard for the treatment of the person or property of an alien, and the alien has sustained a denial of justice.

The development of the law of State responsibility was inspired by Western *laissez-faire* ideas and liberal concepts of property. From the juristic standpoint, one of the underlying principles is the duty of the host State to display fair and equitable treatment or good faith in its conduct towards aliens.

The law of State responsibility, which was originally conceived for the purpose of protecting individual aliens, was subsequently extended to foreign companies and other foreign business concerns.

Some of the important elements of the traditional law of State responsibility are the doctrine of acquired rights, particularly the requirements with respect to expropriation of foreign property, the rules governing State contracts, such as *pacta sunt servanda*, and the prescription of non-discriminatory treatment for aliens and alien property or economic interests, which are examined below.

2. For detailed discussion of minimum standard see E. M. Borchard, "The Minimum Standard in the Protection of Aliens" (1939) 33 A.S.I.L. Proceedings. Also see generally G. Schwarzenberger, *Foreign Investments and International Law* (1969), and Lillich, *ibid.*

1. Latin American objections to the international minimum standard

The theoretical foundations as well as the practical implications of the traditional law of State responsibility have been strenuously resisted by Latin American officials and jurists.

This opposition, developed as early as the late nineteenth century and reinforced in the early twentieth, was fuelled by the reaction to the more blatant forms of the exercise of diplomatic protection by Western States in Latin American nations. The doctrine of State responsibility was challenged on procedural and substantive grounds. Latin American nations saw the practice of diplomatic protection as an "unwarranted and oppressive burden", involving excessive and unconscionable demands for indemnity accompanied by veiled threats of the use of force.[3]

The substantive basis of the objection, which was elaborated by Calvo,[4] a renowned jurist, had two main elements. First, Calvo maintained that a sovereign independent State was entitled, by reason of the principle of equality, to complete freedom from interference in any form, whether by diplomacy or by force, by other States. Second, aliens were entitled to no greater rights and privileges than those available to nationals. Accordingly the national courts of the host State had exclusive jurisdiction over disputes involving aliens, and aliens could seek redress only in such national courts. Thus, the Latin American response to the international minimum standard was the doctrine of national treatment. According to this doctrine, customary international law merely requires a host State to accord to aliens essentially the same rights as those enjoyed by nationals.

Latin American States enshrined this doctrine in their national constitutions, various regional declarations such as the Seventh Latin American Conference held in Montevideo in 1933, and in stipulations in contracts with foreign companies.

The Foreign Investment Code promulgated under the Andean Pact reaffirmed well-known Latin American positions on the treatment of investors. Under Article 50 of the Code member States are forbidden to accord to foreign investors more favourable treatment than national investors, while Article 51 prohibits any provision for international adjudication of investment disputes in any instrument relating to investors.

The impact of the Calvo doctrine on the legal traditions of Latin American States is reflected in the following propositions.

3. E. Vattell, *Law of Nations and Sovereigns* (1916), Chap.6.
4. Carlos Calvo, *Le Droit International Théorique et Pratique* (1896).

1. International law merely requires the host State to accord national treatment to aliens.
2. National law governs the rights and privileges of aliens.
3. National courts have exclusive jurisdiction over disputes involving aliens, who may therefore not seek redress by recourse to diplomatic protection.
4. International adjudication is inadmissible for the settlement of disputes with aliens.

Latin American nations have demonstrated their attachment to these traditions by rejecting with a few exceptions the International Convention for the Settlement of Investment Disputes and by their overwhelming opposition to the conclusion of bilateral investment treaties with developed countries.

2. *The position of socialist States of Eastern Europe: the implications of new concepts of property*

The establishment of socialist States in Eastern Europe entailing extensive nationalisations of private property challenged the philosophical assumptions underpinning the traditional doctrine of State responsibility. The inviolability of private property, the sanctity of contract, the requirement of non-discriminatory treatment of foreign companies and other elements of a *laissez-faire* regime were overtly repudiated in the light of the radical restructuring of the economic and social systems in these countries. Thus, the Soviet Union, for example, at first rejected any international legal obligation to pay compensation for nationalisation of private foreign property.

Although subsequently the socialist States undertook to pay compensation for nationalised Western economic interests under lump-sum compensation settlements, they have firmly rejected the traditional idea of an international minimum standard. Socialist countries maintain that the regulation of alien property falls exclusively within the province of national law. According to Soviet jurists,[5] "international law does not consider the nature of property rights nor does it regulate property relations within a State". It follows that the treatment of a foreign company by a host country falls outside the purview of international law. This position is reinforced by the contention that international law, being exclusively concerned with the regulation of relations between States, does not apply to relations between a State and an entity such as a TNC which lacks international legal personality and is not a subject of international law.

Furthermore, equality of treatment between foreign and domestic

5. Vitkov, "Nationalisation and International Law" (1960) Soviet Y.B.I.L. 78.

enterprises is basically incompatible with the structure of the political and economic system of a socialist State, as well as the role and function of socialist enterprises. Socialist States unequivocally reject the traditional doctrine of State responsibility which, in their view, was developed "to protect Western economic interests". They maintain that such a doctrine has no validity in contemporary international law, and contravenes the basic principles of international law, namely "principles of respect for State sovereignty, non-interference in internal affairs, equality of States . . . good neighbourly fulfilment of international obligations".[6]

The principle of non-discriminatory treatment, for example, reflects "the desire of the rulers of the main capitalist powers to take advantage of international law to protect their foreign investments and the privileges enjoyed by their nationals".[7]

The socialist States have maintained this position in international forums. Thus they abstained from the adoption of General Assembly Resolution 1803 discussed below which commanded the overwhelming support of other regional groups.

3. *The impact of the emergence of new nations in Asia and Africa in the post-World War II era*

The emergence of new nations from colonialism after World War II and the sustained attempts of these nations to assert their economic independence and to restructure their internal economic systems unleashed a further onslaught on traditional principles of State responsibility. The new nations generally challenged the universal validity of these principles on the ground that they had been developed by Western Europeans without the participation or consent of the new nations. Furthermore, the principles of State responsibility were assailed as unjust, inequitable and essentially colonial in character. The application of these principles to the newly independent States meant the perpetuation of an exploitative system beneficial to the stronger Western countries.

Rejecting the traditional doctrine of State responsibility, the Indian jurist Guha-Roy argued that an equitable international legal system reflecting a profound understanding which accommodated the interests of the new as well as the old members of the enlarged international community was

> probably impossible as long as the old international law of responsibility continues to be weighted in favour of the stronger States, for that, as already stated, is the way to the perpetuation of existing injustices. Yet this is the effect of the extension of the existing law on the subject to

6. Tunkin, *Theory of International Law* (1974), p.86.
7. *Ibid.*

States which neither were parties to the growth of this law in custom nor ever adopted it on a reciprocal basis with other States. Unless two States have their nationals in each other's territory in appreciable numbers, the question of reciprocity hardly arises. This basis of reciprocity was available among the European States when their practices laid the foundation of this law. But the era of colonialism did not provide any such basis of reciprocity between the colonial powers on the one hand and their victims on the other, the relations between them being principally those between the exploiter and the exploited.[8]

The post-World War II period witnessed dramatic nationalisations and other forms of economic restructuring in several developing countries, affecting major Western economic interests, particularly in the natural resource sector. In taking these measures, these countries rejected the traditional concept of the international minimum standard, and asserted that the measures were a legitimate exercise of national sovereignty which did not admit of qualifications or limitations. In their view, the sovereign right to restructure the political and economic order in their respective countries and to safeguard their economic independence, a critical ingredient of the decolonisation process, would be frustrated if it was encumbered by the exacting requirements of the traditional doctrine of State responsibility.

The foregoing measures taken by individual States were paralleled, as well as inspired, by concerted action at the international level to assert the permanent sovereignty of States over their national wealth and resources, to safeguard their economic independence and underscore their self-determination, to restructure the world economic system on a more equitable basis, and to control foreign investment and other activities of foreign companies. These endeavours have coalesced around two basic concepts in contemporary international law and relations, namely permanent sovereignty of States over natural resources and the quest for a new international economic order.

The concept of permanent sovereignty over natural resources, which has been enshrined in numerous UN resolutions, is now a well-settled principle of international law, emanating from the *jus cogens* principle of self-determination. The concept has been vigorously asserted by developing countries as a *sine qua non* of national independence and economic self-sufficiency. It has been invoked as a fundamental premise of the right of States to nationalise foreign property or regulate the operations of TNCs, particularly in the natural resource sector, in short, the right to exercise full and effective control over the development of their economic resources.

8. Guha-Roy, "Is the Law of Responsibility of State for Injuries to Aliens a Part of Universal International Law?" (1961) 55 A.J.I.L. 863. Also in Leo Gross (Ed.), *International Law in the Twentieth Century*, pp.556–557.

More specifically, developing countries have asserted the following basic principles, *inter alia*, in responding to the international minimum standard.

1. States have the sovereign right to control the entry of foreign investment or the acquisition of property in their territories and to regulate the activities of foreign companies in their territories.
2. The right to nationalise foreign property is an inherent attribute of national sovereignty, and the exercise of their fundamental right is not subject to any condition beyond the duty to pay appropriate compensation having regard to all the circumstances.
3. State contracts or investment agreements freely entered into with foreign companies are to be observed, subject to the sovereign power of the host State to call for renegotiation or revision or even take unilateral action for the modification of such contracts on the basis of changed circumstances or other public interest.
4. While a host State may grant special incentives or concessions to attract foreign investment in accordance with its development objectives, it is not required to accord preferential treatment to foreign companies.

It is now proposed to examine the current status of some of the elements of the law of State responsibility.

II. EXPROPRIATION OF FOREIGN PROPERTY

A. *Traditional Principles*

As intimated above, the standards prescribed by traditional international law with respect to alien property are predicated on the basic assumptions prevalent in a liberal regime of private property, in particular the inviolability of private property and sanctity of contract.

The fundamental premise for the international minimum standard governing the treatment of foreign property is respect for acquired rights. The classical formulation of this doctrine in its extreme form originally prohibited the expropriation of foreign property, and imposed the sanction of restitution upon the expropriating State.[9] The modern formulation of the doctrine of acquired rights concedes the sovereign right of the host State to expropriate foreign property, but requires that the expropriation must be for a public purpose, non-discriminatory in

9. *Chorzow Factory Case* (1927) P.C.I.J. Series A No.13.

form, effected with due process of law and accompanied by prompt, adequate and effective compensation.[10]

As to compensation, the postulated standard is "full" or "adequate", which demands that the quantum of the expropriated property or undertaking be determined on the basis of its fair market value as a going concern plus the future earning prospects, the goodwill associated with it and other intangible assets.[11]

A further requirement is that the compensation be prompt and effective. Prompt means that compensation must be paid with reasonable promptness, that is to say, as soon as is reasonable under the circumstances in the light of prescribed international standards of justice. Effective compensation is defined as compensation in effectively realisable form. To satisfy this criterion, the compensation must be in the form of cash or property readily convertible into cash. Furthermore, the compensation must either be in the currency of the State of the alien whose property was acquired or must be convertible into such currency and, subject to such restrictions as are absolutely necessary to ensure the availability of foreign exchange for the goods and services essential to the health and welfare of the people of the taking State, must be transferable to the country of the alien.

Traditional doctrine does not distinguish between nationalisation and expropriation in the application of the foregoing rules. Furthermore, expropriation is not limited to direct or outright taking of property,

> but also any such unreasonable interference with the use, enjoyment or disposal of property as to justify an inference that the owner thereof will not be able to use, enjoy and dispose of the property within a reasonable period of time after the inception of such interference.[12]

Thus other forms of State intervention that fall short of direct taking are subject to the international minimum standard.

The foregoing traditional rules governing expropriation of foreign property have been sharply contested by the socialist countries of Eastern Europe, Latin American States, the developing countries of Asia and Africa and a substantial number of Western jurists. Notwithstanding the formal affirmation of the traditional rules by the governments of Western European States in international forums and bilateral investment agreements, a realistic assessment of the evidence and sources within the past forty years, namely State practice in all regions, diplomatic exchanges, multilateral and regional endeavours towards an inter-

10. Secretary of State, C. Hull in his diplomatic exchange with the Mexican government in respect of the Mexican nationalisation, 1938. Quoted in Steiner and Vagts, *Transnational Legal Problems*, 2nd edn.
11. *Chorzow Factory Case*, *supra* n.9, p.47.
12. *Ibid.*

national regime for investments, *opinio juris* on a global basis, the relevant resolutions of the United Nations and other declarations of the preponderant majority of the members of the international community cannot sustain the Hull formula as valid principles of contemporary international law.

Before analysing the more fundamental objections to the traditional rules of expropriation, it is worth noting that the validity of these rules has been increasingly challenged in the West. Thus, while the revised American Restatement of Foreign Relations Law substantially endorses the traditional rules by stipulating the requirements of public purpose, non-discrimination and just compensation, it is constrained to point out that "no formula defining just compensation can suit all circumstances" and that despite its strong advocacy by the US government and its incorporation into a substantial number of bilateral investment treaties negotiated by Western governments, the "prompt, adequate and effective compensation" formula has been strongly resisted by developing States and "has not made its way into multilateral agreements or declarations or been universally utilised by international tribunals".

Although most Western jurists and publicists subscribe to some concept of an international minimum standard, a substantial body of juristic opinion rejects the traditional formulations of the standard, particularly with respect to nationalisation. Some, such as Schacter,[13] maintain that the "prompt, adequate and effective compensation" formula was never a rule of traditional international law[14] and certainly has no validity in contemporary international law in all cases of nationalisation. After reviewing State practice with respect to nationalisation and compensation in the post-World War II period, Bishop concluded that

> there seems no clear agreement internationally today as to whether a State is, or is not, obligated by international law to pay adequate compensation to aliens whose property is taken by the State for public purposes deemed to be of importance to the national welfare, where there is no discrimination between aliens and nationals of the expropriating State.[15]

Schacter maintains that a study of State practice in cases of post-war nationalisation shows that compensation fell short of the full value and that payments were often made in non-convertible currency. After a similar study, Bring concludes that the classical formula of prompt,

13. O. Schachter, "Compensation for Expropriation" (1984) 78 A.J.I.L. 21–130.
14. Mendelson maintains, however, that the decisions of international tribunals support the substance of the quantum of compensation enunciated in the Hull formula although the words "prompt, adequate and effective" were not used: M. H. Mendelson, "Compensation for Expropriation" (1985) 79 A.J.I.L. 414.
15. W. Bishop, *International Law: Cases and Materials* (1971), p.866.

adequate and effective compensation is obsolete, and that the only element substantially supported by State practice is effective compensation.[16] Furthermore, Bring asserts that no generally recognised international standard or formula can be inferred from State practice with regard to the quantum of compensation; what can be inferred is a duty to pay compensation which is to be discharged bona fide, having regard to all the relevant circumstances. Some jurists, for example Lauterpacht[17] and Brownlie,[18] distinguish conceptually between expropriation of isolated items of property and "cases in which fundamental changes in the political system and economic structure of the State or far-reaching social reforms entail interference, on a large scale, with private property". While the traditional compensation standard is applicable to the former, partial compensation would be appropriate in the latter case.

In this regard, Doman contends that the post-war nationalisation acts do not come under any traditional category of a legal system based on capitalist economy, and should be treated as *sui generis*.

From a philosophical standpoint, some Western writers such as Wieghel and Weston have argued that a more equitable redistribution of the world's resources would be torpedoed by the requirement of fair market value as a basis of compensation.[19] Such a concept is equally subversive of the legitimate attempts of the poorer countries to achieve fundamental economic and social reforms. In such cases, the traditional compensation standard must yield to a formula that takes into account the country's political instability or its capacity to pay.[20]

B. *Attitudes of Non-Western States*

The inauguration of a socialist concept of property in the Eastern European States administered a more radical challenge to the traditional doctrine of acquired rights. The extensive property deprivations carried out in the course of the fundamental restructuring of the political and economic orders of these States rejected the *laissez-faire* underpinnings of the traditional rules. Thus the socialist States have asserted an unfettered sovereign right to nationalise foreign property and have denied that international law imposes any limitations on such a right or indeed plays any role in regulating the relations between governments and foreign property owners.

16. O. E. Bring, "Impact of Developing States on International Customary Law Concerning Protection of Foreign Property" (1980) Scandinavian Studies in Law 99.
17. H. O. Lauterpacht, *International Law; A Treatise* (3rd edn., 1955).
18. I. Brownlie, *Principles of Public International Law* (3rd edn, 1979), Chap.XXIII.
19. R. Lillich (Ed.), *Valuation of Nationalized Property in International Law* (1972) Chap.1. Also Weston, "The New International Economic Order and the Deprivation of Foreign Proprietary Wealth," in Lillich, *op. cit. supra* n.1.
20. Doman, "Post-War Nationalization of Foreign Property in Europe" (19XX) 4x Col.L.R. 1125–1128.

This position appears to be qualified by the recognition of a duty to pay some compensation for nationalised property as reflected in the lump-sum compensation settlements concluded by these States with Western States in respect of the expropriation of Western economic interests, although compensation paid under such arrangements falls far below the requirements of the traditional formulation.

Latin American States have also unequivocally rejected the traditional rules governing expropriation. In the famous diplomatic exchanges with the US government in respect of the Mexican nationalisation of agrarian land, Mexico rejected the Hull formula, arguing, *inter alia*[21]:

(a) that nationalisation was a legitimate exercise of its sovereign right to restructure its economy;
(b) that the compensation requirements demanded by the US government would constitute an inadmissible fetter upon such a right—"the future of the nation could not be halted by the impossibility of paying immediately the value of the property belonging to a small number of foreigners who only seek a lucrative end"; and
(c) that US investors were not entitled to higher compensation than Mexican owners.

While the developing States of Asia and Africa have not fully endorsed the Calvo doctrine, in particular its insistence on the reference of investment matters or disputes exclusively to national law, they share with Latin American States a fundamental rejection of the traditional principles relating to expropriation. This is demonstrated by the similarity of their approach in taking individual expropriatory measures and their solidarity in UN resolutions and other international declarations in this area.

The salient features of developing country attitudes to nationalisation may be summarised as follows.

1. Developing countries maintain that the right to nationalise foreign property is an inherent attribute of national sovereignty, and that the essential legitimacy of the exercise of this right does not admit of any conditions that constitute

21. Reply of Mexican Minister of Foreign Affairs dated 3 Aug. 1938. Cited in Steiner and Vagts, *op. cit. supra* n.10.

unacceptable limitations on sovereignty. Thus the assertion that it is in the national interest to nationalise is not open to challenge by other countries on the ground such a measure offends the traditional requirements of a public purpose or non-discrimination.

2. The traditional formula of "prompt, adequate and effective compensation" is rejected as unduly onerous and tantamount to the imposition of a virtual embargo on the ability of developing countries to take appropriate measures to restructure their economies. If extensive or strategic deprivations considered essential by developing countries for assuming effective control of their respective economies and for promoting their development goals were to be governed by traditional compensation standards then the dominant capital-exporting countries would exercise a veto power over the legitimate attempts of poorer countries to achieve fundamental economic and social reforms.
3. The concept of fair market value implicit in the "adequate" or "just" compensation is particularly inappropriate in major economic restructuring involving exclusive deprivations such as those entailed in large-scale land reform or nationalisation of strategic sectors such as natural resources. The concept is inadmissible because it purports to apply traditional commercial and property concepts in a situation which is not a normal commercial purchase but more properly characterised as the intervention of State power to restructure capital and the economic system. Furthermore, on ordinary commercial principles, it is misconceived to apply the fair market value to a major foreign investment such as a mineral undertaking, which does not operate in traditional market conditions and is often accorded a special regime of facilities, privileges and incentives from the State. In the case of land reform, the application of fair market value would introduce inappropriate commercial principles in circumstances dominated by the political objective of equitable social distribution and not the operation of commercially viable undertakings. With respect to nationalisation of undertakings in natural resources, the application of fair market value is flawed to the extent that the concept includes not only the value of the mine and installations established by the foreign investor, but also the value of the natural resource itself or the concession or other rights relating to the exploration of that resource. Developing countries contend that a claim of compensation based on the value of the latter is inadmissible since it amounts to the State paying

compensation for property already vested in it, and would in any case result in prohibitive figures which would frustrate the measures.

In view of the foregoing, many developing countries maintain that the appropriate compensation in such extensive or strategic nationalisations within the context of a major economic restructuring or reform is some standard less than the fair market value, such as net book value of the property.

4. As to the requirement of prompt and effective compensation, this is rejected as an intolerable imposition on the balance of payments position of developing countries and incompatible with the well-established right of States under the IMF Articles of Agreement to control capital transfers from their jurisdiction. Most developing countries, therefore, insist on the right to phase the payment of compensation, through bonds or other mechanisms, over a period of time. In some cases, the strained foreign exchange resources of the country may call for the initial payment of the compensation in local currency to the country's central bank pending the availability of foreign exchange to effect the transfer of the compensation.
5. In various UN resolutions declaring the permanent sovereignty of States or peoples over their national resources, developing countries have overwhelmingly affirmed that the right to nationalise prevails over the private economic interests of foreigners, and that appropriate compensation is to be paid in the event of such nationalisation having regard to all the circumstances.
6. In their endeavour to attract foreign investment, numerous developing countries have, particularly more recently, concluded bilateral investment treaties with capital-exporting States that incorporate some variant of the traditional formulations regarding expropriation and general treatment of foreign property. However, there is little evidence that these treaties represent anything beyond the special bundle of benefits and impositions in the circumstances of a purely bilateral relationship. Many of these States have declared in international forums that the obligations they have assumed under bilateral arrangements do not represent their views on general international law, and have accordingly adopted a different posture on the same issues in the context of multilateral negotiations towards the promulgation of general international legal standards. Further, there is hardly any empirical data to sustain the proposition that the standards stipulated in the bilateral arrangements have in fact been adhered to by the

developing countries concerned in the event of nationalisation or other rupture of investment relations.

C. Case Law

In discussing the impact of the decisions of international tribunals on the current status of the traditional principles of State responsibility, it is worth pointing out that "case law is far from being the only, or the most important source of international law".[22] The significance of case law in this area is further diminished by the paucity of international arbitral decisions on expropriations in the post-war era. In some of these cases, the decisions were complicated by the interpretation and application of specific treaty commitments outside the purview of general customary international law. The jurisprudence of international tribunals thus pales into insignificance in the face of the formidable array of State practice and international declarations during this period.

In enunciating the applicable standards of international law with respect to expropriation, the decisions of international tribunals have been varied. In the *Aminoil* case, the tribunal cited the terminology of UN resolutions on permanent sovereignty over natural resources in holding that the sovereign right of a State to nationalise foreign property prevailed even over an express stabilisation clause, and that the standard of compensation was appropriate compensation having regard to all the pertinent circumstances.[23]

Nevertheless, such a standard did not preclude the award of substantial compensation particularly in the light of the State's general posture on foreign investments. In the *Topco/Calasiatic* arbitration, involving nationalisation of foreign concessions by Libya, the arbitrator ruled that Resolution 1803 of the General Assembly faithfully represented the customary international law on expropriation, while the Charter of Economic Rights and Duties of States was a "political rather than a legal declaration concerned with the ideological strategy of development and, as such, supported only by non-industrialised states".[24] As to the remedy, the arbitrator held that the affected foreign companies were entitled to *restitutio ad integrum*. Yet in a similar Libyan case, *Liamco*,[25] another arbitrator denied such a remedy on the ground that it was incompatible with national sovereignty, and further held that contemporary developments did not sustain the award of *lucrum cessans* (loss

22. Mendelson, *op. cit. supra* n.14.
23. *Kuwait* v. *American Independent Oil Company (Aminoil)* (1982) 21 I.L.M. 976. See also S. K. B. Asante, "Restructuring Transnational Mineral Agreements" (1979) 73 A.J.I.L. 335.
24. *Topco/Calasiatic* v. *Libya* (1978) 17 I.L.M. 3.
25. *Liamco* v. *Libya* (1981) 20 I.L.M.

of profits). Instead, the applicable standard was equitable compensation which included damages for loss of concession rights resulting, however, in a substantially reduced quantum of compensation. With respect to tangible property, the arbitrator held that Liamco was entitled to compensation including "as a minimum *damnum emergens*, e.g. the value of the nationalised corporeal property, including all assets and the various expenses incurred".[26]

It is significant that none of the above three cases endorsed the full implications of "prompt, adequate and effective compensation". Furthermore, while the quantum of compensation awarded in the particular circumstances of the *Aminoil* and *Topco/Calasiatic* cases approximated to the traditional concept of full compensation, the decisions in both cases declared appropriate compensation as the generally applicable standard and took cognisance of the post-World War II developments relating to permanent sovereignty over natural resources. In *Liamco*, the progression from traditional principles went much further.

The awards of the Iran–US Claims Tribunal cannot be regarded as reaffirmations of traditional rules since they rested essentially on the specific provisions of the two countries' treaty of friendship, commerce and navigation. Such general observations as were made on customary international law were inconclusive.

Two recent decisions of the Iran–US Claims Tribunal illustrate the pervasive controversy over the applicable principles of customary international law with respect to nationalisation. In *American International Group Inc.* v. *Iran*,[27] involving the Iranian nationalisation of the plaintiffs' interests in an insurance company, the Tribunal rejected the contention of the plaintiffs that the nationalisation was unlawful for want of "prompt, adequate and effective compensation", but held that they were entitled to compensation and further that the appropriate standard was the going concern value "taking into account not only the net book value of its assets but also such elements as goodwill and likely future profitability had the company been allowed to continue its business under its former management".

Ina Corpn v. *Iran*[28] departed from traditional doctrine by endorsing the distinction alluded to earlier between large-scale nationalisation and the expropriation of isolated items of property. In the case of the former, the tribunal declared that "international law has undergone a gradual reappraisal, the effect of which may be to undermine the doctrinal value of any 'full' or 'adequate' (when used as identical to 'full') compensation standard as proposed in this case". However, the Court held

26. *Ibid.*
27. (1983) 4 Iran–US Claims Tribunal Rep. 96.
28. AWD 184–161–1 Iran–US Claims Tribunal, The Hague, 13 Aug. 1985, cited in (1986) 80 A.J.I.L. 181.

that since the nationalisation in the case did not fall into this category, the applicable standard was compensation in the amount equal to the fair market value of the investment.

On the general question of the standard of compensation, two arbitrators delivered sharply conflicting opinions. One rejected the validity of the traditional rule of prompt, adequate and effective compensation where a government carries out large-scale nationalisation within the context of fundamental economic reform. In such a case partial compensation would be admissible. Another forcefully affirmed the traditional principles.

The foregoing cases cannot be said to be a resounding restatement of all the ingredients of the Hull formula. Hardly any addressed the requirements of "prompt" and "effective" compensation in depth. Sharp differences emerged as to the quantum of compensation, and it is arguable that the decisions do not preclude a flexible compensation standard sensitive to the peculiar circumstances of each case.

It has to be further pointed out that the value of the case law is diminished not only by the paucity of the decisions and the limited universe of juridical traditions represented in the tribunals but also by the fact that some of the decisions were not implemented but replaced by extrajudicial settlements that departed from the award. This underscores the crucial importance of State practice as a source of customary international law relating to investments.

D. State Practice

State practice as to the incidence of expropriation of foreign property, the compensation arrangements actually made in respect of such expropriation, and the content of the laws of the host States constitute some of the most pertinent data for the purposes of elucidating the legal and practical aspects of the relations between host countries and foreign investors. Yet the juridical impact of this formidable body of material has virtually been ignored by writers wedded to traditional principles. Such writers conceive of State practice almost exclusively in terms of bilateral investment treaties, which have been celebrated as a renaissance of traditional principles.[29] They further contend that State practice does not supersede traditional norms, just as, out of court settlements have no impact on the validity of the principles of liability. This is, however a confusion of the legal methods of municipal and international legal systems. In a municipal legal system, the principles of

29. Peter, Schrijver and De Waart, "Foreign Investment and State Practice", in Hossain and Chowdhury, *Permanent Sovereignty over Natural Resources in International Law Principle and Practice* (1984), LC 84–16076–2507. Discussions with officials of ICC in April 1986 in Paris.

liability are so well settled that an occasional settlement out of court does not upset the normative system. In international law State practice is itself a source of the norm, and the prevailing State practice therefore does establish an international norm, notwithstanding the existence of a few isolated decisions to the contrary. International norms clearly cease to have any validity or relevance if they are ignored or indeed contradicted by overwhelming and sustained State practice.

An examination of such State practice in the post-World War II period establishes that the numerous and strategic nationalisations of foreign property which took place in many developing countries were not effectively challenged for failure to comply with the requirements of "public interest", "non-discrimination" or "due process of law". As to compensation standards, a study by Bring of some 30 compensation settlements in respect of nationalisations between 1953 and 1976 asserts that "the compensation afforded met the traditional requirement of adequacy" in only three cases: Zambia, 1969; Peru, 1976; and perhaps Brazil, 1964.[30] Bring also demonstrated that prompt compensation, an index of market value standards, is not the rule in modern nationalisation practice. Most of the settlements provided for deferred payments. He found that the quantum of compensation seemed to be based "more or less" on the book value of the property taken. He accordingly concluded that the classical formula of a "prompt, adequate and effective compensation" was largely obsolete. The only requirement supported by State practice is "effective" compensation. Bring thus substantively endorses Bishop in his finding that no generally recognised international standard or formula with regard to the quantum of compensation can be inferred from State practice, beyond the duty to pay compensation in good faith.[31]

Similar findings were made in a study by the UN Centre on Transnational Corporations of the compensation settlements in respect of 154 cases of expropriation of foreign property by developing countries in Africa, Asia and Latin America in the 1970s.[32] In virtually all the settlements, the traditional standards of fair market value, going concern and replacement costs, though vigorously asserted by foreign companies in the negotiations, did not prevail. Where specific standards of valuation were applied, the invariable practice was to apply the net book value concept. The major significant modification of this concept was the application of the concept of updated book value in the New York petroleum-production participation agreement between a number of OPEC countries and international petroleum companies in 1972. How-

30. O. E. Bring, *op. cit. supra* n.16.
31. *Idem*, pp.117 *et seq.*
32. R. B. Sunshine, *Terms of Compensation in Developing Countries' Nationalization Settlements—A Study for the UN Centre on Transnational Corporations* (1981).

ever, this valuation still fell substantially below the traditional fair market standards. The study further indicated that actual compensation settlements often did not faithfully reflect particular valuation methods even where they were specifically invoked. A significant finding was that the formula of "prompt, adequate and effective compensation" from the investor's perspective or "appropriate compensation" from the host government's perspective appeared to have played no role in the final settlements, although they were sometimes vigorously asserted in the negotiations. The final settlements were sometimes packages of trade-offs encompassing compensation amounts and ancillary benefits such as credit facilities, management fees and tax concessions. The study disclosed some incidence of deductions by host governments from gross compensation for back taxes and employee benefits. But insistence on these deductions was more emphatic during the initial pronouncements than in the final settlement.

As to the mode of payment, most settlements provided for deferred payments of compensation, although in some cases a substantial down payment was made prior to the deferment. Payment of the compensation was effected in hard currency, except in special circumstances where the foreign company was satisfied with local currency.

The foregoing trends are by no means peculiar to the State practice of the developing countries. The lump-sum compensation settlements concluded by Eastern European States with Western countries in respect of the nationalisation of Western economic interests fell significantly below the traditional compensation standards. For example, the compensation of £2.5 million sterling paid by Poland to the UK for nationalised property represented less than a quarter of the value claimed by the British companies.[33]

The question may be raised whether this formidable body of State practice as to measures and arrangements effected with respect to nationalisation and compensation has been superseded in any way by the proliferation of bilateral investment treaties between developing countries and capital-exporting countries incorporating some form or another of traditional formulations for the protection of investments. Within the past decade, over 200 such treaties have been concluded with a total of 65 developing countries mostly in Africa and South East Asia. About 40 of these agreements have not yet entered into force. The spread of these treaties has been intensified in recent years in the wake of the world recession, with many developing countries turning to foreign companies as a source of increased capital or technology flows. Bilateral investment

33. See Schwarzenberger, *op. cit. supra* n.2. As to the normative value of lump sum agreements, see an instructive analysis in Lillich and Weston "Lump Sum Agreements: Their Continuing Contribution to the Law of International Claims" (1988) 82 A.J.I.L. 69.

treaties have thus been concluded as a significant part of the strategies of developing countries in attracting foreign investment, and are seen by most of these countries as the appropriate signal to give to capital-exporting countries and investors for promotional purposes.

Apart from their juridical character as bilateral as distinguished from multilateral treaties, the value of these bilateral instruments as a source of general international law is diminished by the following. First, there is little empirical evidence that these treaties have actually been implemented or relied upon in live situations involving nationalisation and compensation. The special circumstances of the creation of the Iran–US Claims Tribunal and the few decisions involving the FCN Treaty between Iran and the USA do not seriously contradict this assertion. There is hardly any evidence that the standards enunciated in these treaties have been applied to the computation of the quantum of compensation or the treatment of foreign companies generally. In this regard it is irrelevant to assert that the mere existence of these treaties has deterred nationalisation. Even if this were true, the issue is not deterrence but whether the standards for nationalisation have been applied, an issue which does not arise where there has been no nationalisation. Second, and more important, there is little empirical evidence that the standards stipulated in these treaties represent the *opinio juris* of developing countries. The assurances and privileges conceded to foreign companies in return for the bundle of benefits expected from a purely bilateral relationship are not regarded by developing countries as a reflection of their views on general international law. It is, therefore, not surprising that countries which have accepted traditional standards under bilateral investment treaties have generally opposed such formulations within the framework of multilateral negotiations for an international regime for TNCs. Third, the essentially promotional character of these investment treaties cannot be overemphasised. While it may be difficult to demonstrate that hard-pressed developing countries, eager to attract foreign investment, sign these treaties under undue pressure, there is evidence that these treaties are sometimes signed by enthusiastic investment promoters without the knowledge of the officials principally responsible for handling critical investment issues.[34] Thus, Peter, Schrijver and De Waart, who otherwise argue that bilateral investment treaties constitute highly significant State practice, acknowledge that: "Experience has shown that the existence of bilateral investment treaties is sometimes unknown to Ministers and senior civil servants concerned with investments in the countries concerned."[35]

They point out further that there have been nationalisation measures

34. Peter, Schrijver and De Waart, *op. cit. supra* n.29.
35. *Idem*, p.88.

despite the existence of these treaties. Such a state of affairs hardly sustains the thesis that the standards incorporated in these treaties represent the considered *opinio juris* of the developing countries concerned.

Finally, the general normative effect of bilateral investment treaties ultimately depends to a considerable extent on how far they are perceived as fair and balanced regimes for foreign investment outside the immediate context of the bilateral relationship. These arrangements are preoccupied with the protection of foreign investment. They impose restraints and obligations on host States without corresponding undertakings by home countries and foreign investors. Bilateral investment treaties are at best only a part of the body of instruments relating to investments. They cannot be extrapolated into general investment regimes without reference to the substance of the laws of host States, the State practice as to actual nationalisations, and regional and international arrangements governing investment relations such as the plethora of codes of conduct relating to TNCs.

A review of the laws of host States discloses a wide diversity of legislative approaches to foreign investment. Many developing countries do have legislation specifically providing investment incentives and guarantees as inducements for foreign investment. These guarantees sometimes include assurances against expropriation without fair or just compensation and provision for arbitration of investment disputes. Other enactments over time have effected nationalisation or acquisition of certain levels of foreign equity interests in accordance with particular development strategies and stipulated special formulae and procedures for the computation and payment of compensation which depart from the traditional concepts, and preclude reference to international arbitration. The compensation standards stipulated in the municipal laws of Western European States in respect of nationalisation deviate considerably from the traditional law of "prompt, adequate and effective compensation".[36] It would, therefore, be untenable to maintain that the legislation of host States overwhelmingly reinforces the traditional standards incorporated in bilateral investment treaties.

E. Inter-Governmental Declarations and Resolutions

The evaluation of the current status of customary international law on expropriation would be incomplete without a reference to the effect of the numerous UN resolutions on permanent sovereignty over natural resources. It is now well settled that a State's permanent sovereignty over its natural resources is an established principle of international law.

36. Dolzer, "New Foundations of the Law of Expropriation of Alien Property" (1981) 75 A.J.I.L. 533.

Dupuy's assessment that Resolution 1803 represented current international law is generally accepted.[37] That resolution reaffirmed the sovereign right of a State to expropriate foreign property in the public interest and prescribed the duty to pay "appropriate" compensation as the consequential obligation in such a case. It further proclaimed the right of each State to control investments.

While Article 2(2) of the Charter of Economic Rights and Duties was rejected by the major Western industrialised countries, principally by reason of the absence of an express reference to international law, the Charter is at least significant as a declaration by the overwhelming majority of States of their concept of international law. It is not without significance that the *Aminoil* case echoed the language of the Charter that the payment of compensation must have regard to all the relevant circumstances.

Lack of unanimity on international legal principles governing expropriation is by no means limited to developing countries. In the formulation of the European Convention on Human Rights, Western European States engaged in a tortuous debate as to the precise formulation for the protection of property rights.

The final text which emerged in Article I of the First Protocol of the European Convention prohibited deprivation of every person's possessions "except in the public interest and subject to the conditions provided for by law and by the general principles of international law". However, a proviso was stipulated preserving "the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest . . ."[38]

The classical formula of "prompt, effective and adequate" compensation was significantly modified in the draft OECD Convention of 1967,[39] which was never finalised. In Article 3 of the Convention it was stipulated that expropriation must be accompanied by provision for the payment of just compensation. Such compensation is to represent the genuine value of the property affected, be paid without undue delay, and be transferable to the extent necessary to make it effective for the national entitled thereto.

While it is arguable that the traditional requirement as to quantum was satisfied by the terms "just" and "genuine value", the provision for paying compensation without undue delay and for transferring compensation "to the extent necessary to make it effective" recognises the constraints on the foreign exchange resources of developing countries and

37. Dupuy, *Texas Overseas Petroleum Co./California Asiatic Oil Co.* v. *Government of Libyan Arab Republic*, (1978) 17 I.L.M. 3, 29.

38. Higgins, "The Taking of Property by the State. Recent Developments in International Law" (1983–III) 176 Hague Rec. 239.

39. OECD, Draft Convention on the Protection of Foreign Property.

the fact that in some cases the particular circumstances of the investor may justify payment of compensation in local currency.

Article 10(1) of the draft agreement for the promotion, protection and guarantee of investment among member States of the Organisation of Islamic Conference guarantees the ownership of the investor's capital or investment.

Article 10(2), however, provides that it is permissible to

> expropriate the investment in the public interest in accordance with law without discrimination and on prompt payment of adequate and effective compensation in accordance with the laws of the host state regulating such compensation, provided that the investor shall have the right to contest the measure of expropriation in the competent court of the host state".

Thus, while this provision uses language reminiscent of the Hull formula, such as "prompt", "adequate" and "effective", the exclusive reference to the law and judicial organs of the host State represents a radical departure from the traditional formulation.

The controversy over the applicable standards in this area has been fully reflected in the ten-year-long negotiations at the UN towards a code of conduct on TNCs. The clash between traditional standards and various modern formulations has persisted throughout the deliberations of the UN Commission on Transnational Corporations, which is entrusted with the elaboration of the Code, particularly with respect to the prescription of norms on such issues as the applicability of international law, nationalisation and compensation, and the principle of according national treatment to foreign companies.

Thus a realistic evaluation of the relevant sources and materials does not sustain the validity of the traditional formulation of prompt, adequate and effective compensation in contemporary customary international law. Furthermore, there is no consensus on the applicable standards. It appears, however, that contemporary developments support the following minimum principles.

1. A State may in the exercise of its sovereign powers nationalise foreign property in the public interest.
2. An assertion by a State that its expropriatory measure is in the public interest is not open to challenge by another State.
3. A State is required to pay compensation to the owner of the affected property. However, no rigid or exclusive standard of compensation is either feasible or admissible in all cases of nationalisation. The quantum of the compensation and the timing and modalities of its payment must take into account all relevant factors including the nature and objectives of the State measures, the nature of the property or investment affected, and the circumstances of the foreign company or investment.

While the preponderance of State practice within the past 40 years lends little support to the traditional market value concept in the computation of compensation, the flexible standard canvassed here does not preclude the application of such concepts in appropriate cases.

III. STATE CONTRACTS

ALTHOUGH a contract between a host State and a foreign company would normally be governed by a system of municipal law in accordance with ordinary principles of private international law, traditional principles of State responsibility impose certain international legal obligations on the State party to such a contract for the purpose of protecting the contractual rights or other economic interests of the alien. Some jurists contend that a State contract, in particular a concession or long-term investment agreement, acquires the status of an international agreement by virtue of its special features such as the involvement of a State as a party, the strategic importance of the subject matter of the contract or provision for international arbitration. In such a case the contract falls within the purview of international law and is subject to such well-settled international legal principles as *pacta sunt servanda*.[40]

Others seek to insulate the investment agreement from the operation of the law of the host State by classifying the agreement as an independent and self-sufficient system of law regulating the entire range of relations between the host government and the foreign company without reference to any municipal law. In effect the investment agreement creates a separate, self-contained and coherent body of legal principles which exclusively governs relations between the host State and the TNC. Other writers, while stopping short of assimilating the transnational contract to the class of international agreements, would still argue that unilateral modification or abrogation of such agreements constitutes an international delict imposed by international law irrespective of the effect of private international law on the contract.[41]

Other writers, particularly jurists representing host governments, have countered these doctrinal and conceptual arguments as follows.

An agreement between a host State and a private corporation, albeit a transnational corporation, does not enjoy the status of an international agreement and on well-settled principles of private international law, such an agreement should be governed by the law of the

40. Dupuy, *op. cit. supra* n.37, at p.17.
41. R. Y. Jennings, "State Contracts in International Law" (1961) 37 B.Y.I.L. 156.

host State and not public international law. It follows that analytically it is admissible to characterise subsequent changes in the law of the host State which modify the agreement as a breach of contract.[42] However, assuming that such an agreement were subject to public international law, the doctrine of *pacta sunt servanda* would be effectively qualified by the equally well-established international legal principle, *clausula rebus sic stantibus*, which sanctions the revision of international agreements on the basis of a fundamental change of circumstances. Thus, it is argued that international law does not ordain absolute immutability of agreements.

As to the theory that the investment agreement creates an independent, exclusive and self-sufficient legal system, this is dismissed as patently untenable on the grounds that the validity of every agreement must itself be derived from some external legal order—be it international or municipal. It follows that the concepts of immutability implicit in this theory cannot be sustained without reference to some legal system.

In certain formulations of the traditional rules as to State contracts, the emphasis is placed not so much on the international status of the contract as on the consequences in international law of the State's repudiation or breach of the contract. Thus the American Restatement of Foreign Relations Law (third) acknowledges that "a State party to a contract with a foreign national is liable for breach of that contract under applicable national law, but not every repudiation or breach by a State of a contract with a foreign national constitutes a violation of international law". Under the Restatement, a State is responsible for breach or repudiation only if such a breach is discriminatory or motivated by non-commercial considerations and compensatory damages are not paid, or where the foreign national is denied an adequate forum to determine his claim for breach or compensation for any breach determined to have occurred.

It is finally argued that in as much as reliance is placed on general principles of law in the representative legal systems, sanctity of contract has never been treated as an absolute and an unqualified principle in any of the major legal systems.[43] The French doctrine of *imprévision*, the corresponding doctrine of *Wegfall der Geschäftsgrundlage* in German law and the concept of good faith in other civilian systems, all provide for the revision of contracts in appropriate cases by reference to objective criteria not traceable to the will of the parties. According to the civilian doctrine of *imprévision*, an alteration in contractual rights between a State and foreign company can take place upon the occurrence of a subsequent event not foreseen by the parties which has rendered the obligation of one party so onerous that it may be assumed that if he had contemplated its occurrence, he would not have made the contract. With particular reference to agreements concluded with governments and public authorities, the civil and common law systems all recognise the principle that such contracts may not only be renegotiated at the instance of the government, in appropriate cases, but may even be unilaterally modified by the government in certain circumstances by virtue of the government's sovereign rights.

42. F. A. Mann, "State Contracts and State Responsibility" (1960) 54 A.J.I.L. 581. See also Fatouros, *Government Guarantees for Foreign Investors* (1962) and R. Brown. "Choice of Law Provisions in Concession and Related Contracts" (1976) 39 M.L.R. 625.

43. R. Geiger, "The Unilateral Change of Economic Development Agreements" (1974) 23 I.C.L.Q. 73.

It is well established in the USA and the UK[44] that police powers and other forms of regulatory powers rooted in eminent domain may legitimately be exercised by the government notwithstanding that such State measures may adversely affect individual contractual rights or other economic interests. The UK and Norway invoked similar sovereign rights in unilaterally revising the fiscal regimes for the exploration of petroleum resources in the North Sea despite the financial burden such a revision imposed on foreign companies operating in the North Sea.

A rigid application of the principle of *pacta sunt servanda* to long-term agreements between host States and foreign companies spelling out complex business arrangements for some 20 or more years is neither warranted by doctrine nor sound on practical and functional grounds. The complexity of these long-term transnational agreements, their vulnerability to numerous political vicissitudes, the highly fluid and unpredictable international economic environment in which they operate all argue for some sensible mechanism of adjustment from time to time to accommodate changing circumstances or developments and other eventualities which had not been contemplated during the negotiation of the agreement, and to ensure that the legitimate interests of both parties are reconciled.[45]

Modern developments indicate a substantial modification of the traditional concept of a rigid contractual apparatus for State contracts. A recent decision of the Iran–US Claims Tribunal (*Questech Inc.* v. *Ministry of National Defence of Iran*) invoked the doctrine of changed circumstances to justify Iran's termination of a contract under which the claimant had been engaged to expand the Iranian Air Force's electronic intelligence-gathering system.

Among the specific factors cited by the Tribunal as constituting the changed circumstances were:

44. Michael Singer, "The Act of State Doctrine of the UK: An Analysis with Comparisons to United States Practice" (1981) 75 A.J.I.L. 283.

45. See generally S. K. B. Asante, "Stability of Contractual Relations in the Transnational Investment Process" (1979) 28 I.C.L.Q. 401.

> The fundamental changes in the political conditions as a consequence of the revolution in Iran, the different attitude of the new government and the new foreign policy, especially towards the US which had considerable support in large sections of the people; the drastically changed significance of the highly sensitive military contracts . . . especially those to which the United States companies were parties . . .[46]

During the past 25 years, the principle of *pacta sunt servanda* has yielded to the sovereign right of host governments to restructure State contracts on grounds of changed circumstances or for other considerations of public interest. The relations between host governments and TNCs have been marked by numerous revisions, partly by legislation and partly by renegotiations with the corporations. Sometimes, renegotiation has taken place at the instance of TNCs in circumstances where insistence on the original terms would have caused considerable hardship to the corporations. Although the bulk of this restructuring took place in the post-colonial phase as part of the decolonisation process, it is now recognised that the complex nature of long-term contractual arrangements requires modification from time to time in the light of the fluid and unpredictable economic circumstances. Appropriate mechanisms such as review clauses and variable fiscal regimes have been incorporated in such contracts to facilitate a systematic revision in the light of changed circumstances and to ensure that the legitimate interests of both parties are protected.

The UN Commission on Transnational Corporations has recognised the force of these developments by making an appropriate provision for renegotiation of contracts in the draft Code of Conduct on TNCs. This provision qualifies the general principle of *pacta sunt servanda* as follows:

> Contracts between governments and transnational corporations should be negotiated and implemented in good faith. In such contracts, especially long-term ones, review or renegotiation clauses should normally be included.
>
> In the absence of such clauses and where there has been a fundamental change of circumstances on which the contract or agreement was based. transnational corporations acting in good faith, shall/should co-operate with governments for the review or renegotiation of such contract or agreement.[47]

The principle of review of investment agreements on the basis of changed circumstances is also reflected in the Lomé Convention II.

An aspect of *pacta sunt servanda* which is of particular relevance to long-term transactions between governments and TNCs is stabilisation

46. Cited in (1986) 80 A.J.I.L. 362.
47. Para.11 of the Draft Code on Transnational Corporations; see Appendix II, UN Doc. E/C.10/1983/S/5/Rev.1.

clauses, that is, stipulations designed to stabilise or freeze the essential provisions of the agreement by strictly prohibiting any legislative or administrative act which derogates from or is otherwise inconsistent with the provisions of the agreement or the legal environment of the transaction. Some jurists contend that such clauses constitute valid restraints on the legislative or executive powers of the host State irrespective of the nature or duration of such restraint, since a State may use its sovereign powers to impose restraints on itself.[48]

Other jurists maintain that contractual limitations in the form of stabilisation clauses are essentially incompatible with national sovereignty, in particular to the extent that such clauses purport to impose comprehensive and unlimited constraints on the legislative competence of the State. In the *Aminoil* case,[49] the tribunal held that a limitation on Kuwait's sovereign right to nationalise could not be lightly inferred from a general stabilisation clause, particularly where the nationalisation involved no confiscatory measures.

While the tribunal recognised the theoretical possibility of contractual limitation on the State's right to nationalise, it stressed that it should be strictly construed:

> what that would involve would be a particularly serious undertaking which would have to be expressly stipulated for, and be within the regulations governing the conclusion of State contracts; and it is to be expected that it should cover a relatively limited period.[50]

The *Aminoil* decisions would seem to support the following principles.

1. The principle of *pacta sunt servanda* does not prevail over sovereign power to nationalise provided appropriate compensation is paid.
2. A general stabilisation clause does not constitute a valid restraint on a State's sovereign right to nationalise unless the prohibition against nationalisation is expressly stipulated in the clause, the prohibition complies with the regulations governing the conclusion of State contracts, and the prohibition against nationalisation covers only a relatively limited period.

The concept of limited stabilisation clauses is reflected in a number of recent transactions between States and TNCs. Thus in the 1984 revised agreement between Ghana and Kaiser Aluminium & Chemical Co. in respect of the sale of electric power to an aluminium smelter, the original classical and all-inclusive stabilisation clauses have been replaced by

48. Dupuy, *op. cit. supra* n.37.
49. *Kuwait* v. *American Independent Oil Co.* (1982) 21 I.L.M. 976.
50. *Ibid.*

limited stabilisation of the fiscal regime for five years.[51] A similar limited tax stabilisation was conceded to Kaiser in the late 1970s by the Jamaican government after the restructuring of the Jamaican bauxite agreements.

IV. REGULATION OF FOREIGN INVESTMENT

A. *The Right to Regulate Entry of Foreign Investment*

It is a well-settled principle of international law that, in the exercise of its sovereign power, a State has the right to regulate the entry of foreign capital or investment into its territory. This involves the right to exclude foreign investment or impose conditions on the entry of foreign investment or the acquisition of property by foreign capital or the operations of foreign companies in the territory of the host State, and the exercise of general jurisdiction over such companies. The national laws of many host countries provide elaborate rules for the regulation of foreign investment and deny an automatic right of entry to foreign companies. A host State may in accordance with its economic strategies grant special incentives to attract foreign investment or impose restrictions on the operations of foreign companies, in particular restrictions as to the economic sectors in which they may operate or limitations on their equity interests. Host States do not acknowledge an obligation to grant preferential treatment to foreign investors. Both capital-exporting and capital-importing countries subscribe to the foregoing principles.[52]

There is however no such consensus on the principle of non-discrimination.

B. *Non-Discrimination*

A further illustration of the international minimum standard which is implicit in the examples discussed above is the prohibition of discrimination against foreign companies and aliens. Traditional international law recognises the sovereign right of the host State to regulate, and stipulate conditions for, the entry of foreign companies into its territory. Beyond that, a host State is required to accord equal treatment to aliens and nationals under its laws. Non-discrimination is a basic ingredient of the pervasive norm of fair and equitable treatment. However, contemporary customary international law does not appear to endorse an unqualified prohibition against discrimination.

51. Agreement dated July 1984 between the government of Ghana and Kaiser Aluminium and Chemical Co., USA.

52. See G.A. Res. 1803 on Permanent Sovereignty over Natural Resources and para.47 of the draft Code of Conduct on Transnational Corporations.

While most host countries do not subject foreign investors to arbitrary discrimination, they would not subscribe to a policy of according total and unqualified non-discrimination to foreign companies *vis-à-vis* domestic enterprises or other foreign companies. Such a policy ignores the transnationality of foreign companies, their resources and strength compared with those of domestic enterprises and the requirements of public order, national security and development objectives of these countries. Thus a strict application of the non-discrimination principle would require host countries, for example, to admit foreign companies to any sector of the economy without reference to national security, make scarce local credit available to foreign companies irrespective of their international resources, deny special assistance to weak domestic enterprises, and exclude the grant of special incentives to induce foreign investment or special arrangements for the repatriation of income by foreign companies. Such a principle would indeed negate the emerging international legal principle of preferential treatment for developing countries.

As indicated above, the notion of national or non-discriminatory treatment for foreign companies is basically incompatible with the political and social order of the socialist countries of Eastern Europe, although a few of these countries have in recent years enacted legislation providing for investment guarantees and incentives to attract foreign investment.

Neither is the principle of non-discrimination faithfully adhered to in all Western industrialised countries (Canada, France, Japan, West Germany). It is significant that the OECD draft convention mentioned earlier qualified the prohibition against discrimination in two respects. While Article I on the treatment of foreign property included the general standard of fair and equitable treatment and the assurance of the most constant protection and security to such property, it introduced two highly significant qualifications. First, it provided that the prohibition against discrimination was not violated by reason only that more favourable treatment accorded to the nationals of another State is not available to the nationals of the complaining State. This was an implicit recognition of the policy grounds often adduced by developing countries for according special treatment to investors of a foreign country in consequence of particular benefits conferred upon the host country by such a foreign country. Second, Article II expressly reserved the right of a State to allow or prohibit the acquisition of property or the investment of capital within its territory by the nationals of another party. This reservation echoed the sovereign right asserted in various UN resolutions to exclude foreign capital or to regulate the entry of investments by

imposing limitations thereon or to require the divestiture of investment or property owned by aliens.

V. INTERNATIONAL REGULATION OF TRANSNATIONAL CORPORATIONS: EMERGING STANDARDS

A. Overview

As discussed above, such principles of traditional international law as were established with respect to investments were exclusively devoted to the protection of investments. Within the past 20 years, the Western industrialised countries have responded to the erosion of traditional principles of State responsibility by resorting to a network of regional and bilateral investment protection treaties, incorporating resounding affirmations of traditional principles.

However, attempts to establish international norms for the protection of investments through the mechanism of a regional treaty—the Abs-Shawcross and OECD draft contentions—failed. For the purposes of maintaining traditional principles, OECD countries are placing substantial reliance on the plethora of bilateral investment treaties concluded with capital-importing countries. The legal impact of these treaties, which were inspired by the OECD drafts, has already been discussed.

While the burden of traditional international law relating to investments has been the protection of investments, international regulation of TNCs has, largely at the instigation of the developing countries, emerged as one of the major endeavours of the world community within the past 15 years. Various organs of the UN, regional organisations and international business and labour associations are all, with varying degrees of success and enthusiasm, engaged in the code movement—namely the formulation of a plethora of international or regional instruments spelling out discrete standards and principles for the regulation of international business.

The philosophical inspiration for this regulatory regime is the quest by the developing world for a new international economic order involving a more equitable restructuring of the international economic system, including the pattern of international investments. In more prosaic and functional terms, host countries see regulation as a necessary mechanism for curbing the abuses and costs of foreign investment and for ensuring that TNCs and other foreign investors operate in accordance with the public interest.

While most countries welcome foreign investment or some form of co-operation with TNCs, international concern has been expressed about the potentially adverse effects of the activities of TNCs, such as excessive resource outflows through unregulated repatriation of capital profit and fees, abusive transfer pricing, exploitative transactions, tax evasion, oligopolistic arrangements, depression of domestic enterprises, foreign dominance of the economy, improper interference in internal political affairs, sometimes downright subversive, ineffectual or inappropriate transfer of technology, corruption of public officials, harmful advertising practices and restrictive business practices. These concerns are shared by developed as well as developing countries, and some of the more significant regional endeavours to regulate TNCs have been initiated by OECD countries.

Whatever the political and economic motivations for the code movement may be, the major participants all proceed from the common premise that the shortcomings of national regulation of TNCs argue strongly for the inauguration of some international mechanism of control. Many States have found it virtually impossible to regulate effectively transnational corporate conduct in such areas as transfer pricing, tax evasion, anti-trust, illicit payments, disclosure of information and consumer protection without recourse to the assistance and co-operation of the appropriate agencies of other States. The transnational character of TNC operations compels some multilateral scheme to supplement national efforts at regulation.

The need for regulation is further reinforced by the magnitude of the phenomenon of TNCs as major actors in the world economy.

A notable sub-regional regulatory scheme was launched under the Andean Foreign Investment Code "Decision 24" on 31 December 1970, whereby members of the Andean Group adopted a common regulatory framework for foreign investment. Decision 24 provided for appropriate restraints on the entry of new foreign direct investment; exclusion of foreign direct investment from certain areas of the economy; and the regulation of repatriation of capital and profits and the regulation of transfers of technology. The regulatory regime inaugurated under Decision 24 has, however, been replaced by a more liberal regime under Decision 220 of April 1987.

A major regional regulatory instrument was adopted by OECD in June 1976 in the form of the Declaration on International Investment and Multinational Enterprises. This declaration consists of a preamble and five substantive parts dealing with:

1. guidelines for multinational enterprises;
2. national treatment;
3. international investment incentives and disincentives;
4. consultation procedures; and
5. review.

The guidelines prescribe standards of corporate conduct in such areas as questionable corporate payments, involvement in local political

activities, competition, taxation, employment and industrial relations, science and technology and disclosure of information.

B. *The UN Code of Conduct on Transnational Corporations*

Within the UN system, attempts at international regulation of transnational business have, except the case of the UN Code of Conduct on TNCs discussed below, focused on particular or specialised aspects of the activities of TNCs. Among these are:

1. the ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy, adopted in 1977;
2. the set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices negotiated under the auspices of UNCTAD and adopted in 1980;
3. the UNCTAD Code on Transfer of Technology, which has not yet been finalised;
4. the draft International Agreement on the Prevention and Elimination of Illicit Payments, sponsored by ECOSOC but now suspended;
5. the International Code of Marketing of Breast Milk Substitutes negotiated under the auspices of WHO and UNICEF;
6. the International Guidelines for Consumer Protection adopted by the General Assembly in 1985 (GA Resolution 39/248 of April 1985);
7. a Code of Conduct on the Distribution and Use of Pesticides (November 1985).

However, the Code of Conduct on TNCs being formulated by the UN Commission on Transnational Corporations is the most comprehensive, both as to the subject matter of regulation and geographical scope of application.

The most noteworthy feature of the code movement in the 1970s was the emergence of internationally prescribed standards of corporate conduct to be observed by TNCs and foreign investors with respect to their transnational activities. Whether these standards are characterised as "soft" international law or sources of customary international law or non-binding guidelines, they represent a notable departure from the traditional preoccupation with prescribing standards to be observed by host States in the treatment of investments. Investor protection is now matched by investor regulation, spelling out the obligations of TNCs to the host as well as home countries. In this regard, the formulation of the UN Code of Conduct on TNCs is instructive.

This exercise was stipulated by the General Assembly in its programme of action on the establishment of a new international economic order and was originally conceived, at least by the developing countries, as an international endeavour to curb the excesses of TNCs. In the course of the negotiations, however, the OECD countries succeeded in expanding the purview of the Code to encompass the treatment of TNCs by host States. Notwithstanding this development, no consensus has emerged as to the standards for such treatment. What is significant is that, although the negotiations of the entire Code are far from being concluded, there is an impressive measure of international agreement on standards of corporate conduct. Some of these standards are now established principles of international business, whose validity will persist irrespective of the fate of the Code negotiations.

Thus, it is not disputed that TNCs must observe the laws, regulations and administrative practices of the host countries. It is a trite proposition that TNCs are subject to the jurisdiction of the countries in which they operate.

A provision of considerable developmental impact requires TNCs to carry on their activities in conformity with the development objectives, policies and practices of the host States and to make a positive contribution to the achievement of such goals and to the development process generally.

The draft UN Code enjoins TNCs to refrain from improper interference in the internal political affairs of host States, though the precise formulation of this prohibition is yet to be settled. TNCs would also be required to respect the social and cultural objectives, values and traditions of the countries in which they operate. An important prescription ordains respect for basic human rights and fundamental freedoms and proscribes discriminatory employment practices on the basis of race, colour, sex, religion, language, social, national and ethnic origin or political or other opinion. Special provisions address collaboration with the apartheid regime of South Africa.

The UN Code's prescriptions on the economic and financial aspects of the activities of TNCs deal specifically with such subjects as ownership and control, balance of payments, taxation, transfer pricing—all areas which have generated perennial conflicts in the relations between host governments and TNCs. More specifically, TNCs would be required *inter alia* to:

(i) so allocate their decision-making powers among their various entities as to allow them to contribute to the economic and social development of the countries in which they operate;
(ii) co-operate with host governments with respect to the repatriation of capital and accumulated profits to avoid adverse effects on the balance of payments position of the countries concerned;
(iii) avoid, with respect to their intra-corporate transactions, pricing policies that do not reflect relevant market prices or the arm's-length

principle and have the effect of distorting the tax assessment of their entities or evading exchange control measures.

The Code also requires TNCs to operate in accordance with national laws and other norms relating to the preservation of the environment of the countries in which they operate with due regard to relevant international standards. More particularly, they are to take steps to protect the environment and develop and apply adequate technologies for this purpose. A similar prescription is stipulated with regard to consumer protection. TNCs should perform their activities with due regard to relevant international standards and operate in a manner that does not endanger the health or safety of consumers.

C. *UNCTAD Codes of Conduct*

The UNCTAD Code on Restrictive Business Practices adopted by the General Assembly prohibits specific practices or agreements that limit access to markets or otherwise unduly restrain competition and generally have adverse effects on international trade, particularly that of developing countries and on the economic development of these countries. Enterprises are required to refrain from acts which, through an abuse or acquisition and abuse of dominant position of market power, limit access to markets or otherwise unduly restrain competition and have the above-mentioned adverse effects.

The draft UNCTAD code on transfer of technology *inter alia* prescribes specific restrictions in transfer of technology arrangements deemed harmful to developing countries such as grant-back provisions, exclusive dealing, restrictions on research, restrictions on use of personnel, price-fixing, restrictions on adaptations, exclusive sales or representation agreements, tying arrangements, export restrictions, restrictions relating to patent pool or cross-licensing arrangements and restrictions on publicity.

D. *Evaluation of Codes of Conduct*

The practical impact of the various codes of conduct for TNCs referred to above cannot be definitively assessed at present since the codification movement is a recent phenomenon. Indeed, as noted earlier, some of the instruments have not yet been promulgated. The only code which has yielded a significant body of experience as regards implementation is the OECD Guidelines. Nevertheless, there has been no lack of appraisal of the likely effect of these instruments. The code movement has attracted considerable academic attention in recent years, and many commentators have, in particular, discussed the effect of voluntary codes of conduct. It may be useful to summarise these views.

Baade challenges the popular assumption that a "voluntary" code has no legal effect.[53] He contends that an international code of conduct, such as the OECD Guidelines, may create valid and binding legal obligations, notwithstanding explicit declarations or disclaimers characterising the instrument as "voluntary" or "not legally enforceable". The legal effect of an international code of conduct, like that of a unilateral declaration by a State, is ultimately referable to the intent of the parties, to be ascertained by interpreting the specific provisions of the code. Good faith and the intention to create legal obligations, rather than the form of the instrument, are the major determinants of the legal character and effects of the provisions of a code. For example, to the extent that a provision in a voluntary code is a formal and unequivocal affirmation of a well-settled principle of international law, it may be legitimately inferred that the parties to such a code have manifested an intention to be bound by the principle in question. The result of this eclectic or pragmatic approach to the legal effect of specific provisions is that a code may have a "zebra" legal effect. Some of its provisions may be legally binding, while others may fall short of that status.

Baade concedes that the mere adoption of a voluntary code of conduct does not invest such an instrument with the status of international law. However, he maintains that such an instrument is "not inherently incapable of rising to that level through State practice, especially through host and home country participation in inter-governmental follow-up proceedings". He stresses that the express characterisation of a code as voluntary does not preclude its incorporation into the national laws of States adopting the code, or form the ultimate transformation of the substantive provisions of the code into treaties or customary international law. Since such instruments at least constitute declarations of international policy, they legitimise the transformation of the code's provisions into domestic law. Finally, Baade argues that voluntary codes "have legal effects as agreed on data and criteria of international public policy and legal terminology"[54] which may find recognition both in the judicial enunciation of public policy in domestic courts and in the interpretation of relevant treaties and similar instruments.

Horn[55] draws a distinction between the legal character of codes of conduct and their effectiveness. Like Baade, he stresses that an instrument that is not a binding international agreement can be implemented and recognised if backed by adequate follow-up procedures, such as the

53. H. W. Baade, "The Legal effects of Codes of Conduct for Multinational Enterprises", in Horn (Ed.), *Legal Problems of Codes of Conduct for Multinational Enterprises* (1980), pp.4–38.
54. *Idem*, pp.37 and 38.
55. N. Horn, "Codes of Conduct for Multinational Enterprises and Transnational Lex Mercatoria", in Horn, *op. cit. supra* n.53, at pp.45–81.

OECD procedures, and it may have legal effect both in public international law and in business law. The effectiveness of a code of conduct depends on the political commitment of States parties to the undertakings of the code and not on the juridical quality of the instrument. Horn is much more sanguine about the effectiveness of the OECD procedures than Pursey, a trade unionist. Pursey[56] claims that the empirical evidence of corporate compliance with the OECD Guidelines does not sustain the much-canvassed theory that voluntary codes "seem more likely to encourage multinational companies and governments to adopt policies and regulations which would cause multinational enterprises to continue to develop as socially responsible institutions to the advantage of world economic growth".[57] In his view, the formidable problems posed by the operations of these corporations in such fields as security of employment, tax avoidance or capital movements, justify the adoption of tougher regulatory measures than undertakings of goodwill.

Fatouros[58] is also sceptical about the claim that TNCs will comply voluntarily with codes of conduct without any governmental constraint:

> Even if a code were to include nothing but formulations accepted as reflecting desirable business practices, it is still highly probable that some transnational enterprises might occasionally find it profitable to disregard the code, in spite of the presumed disapproval of their more ethical brethren.

As to the juridical character and effect of codes of conduct, Fatouros's central thesis is that proponents of mandatory and of non-mandatory codes of conduct both err in attributing too much importance to legal form. He contends that it is not particularly helpful to consider the legal effect of a code of conduct, an international instrument, on the basis of criteria that are meaningful in a particular national system. For example, the proposition that a legal instrument is binding if non-compliance with it will engage a State's responsibility has little value since it presupposes the existence of centralised and well-established law enforcement mechanisms in the international arena. He accordingly suggests a more pragmatic test of the code's effectiveness, namely: does it or does it not impose limitations on possible courses of action for the governmental authority concerned, as compared to the choices available in the absence of the instrument?

> If, after an instrument has been adopted, the consequences that follow the exercise of an option are the same as those that would have resulted before the instrument's adoption, the legal effect of the instrument is nil

56. S. K. Pursey, "The trade union view on implementation of codes of conduct", in Horn, *idem*, pp.277–293.
57. *Idem*, p.283.
58. A. A. Fatouros, "On the Implementation of International Codes of Conduct: An Analysis of Future Experiences" (1981–4) 30 Am. U.L.R. 941–972.

> the behaviour of the party has been unaffected. When, however, any courses of action open before the adoption of the instrument are now closed or have been made either more attractive or more difficult after the instrument's adoption, then the instrument has some practical legal effect. It influences the conduct of the party concerned in the desired direction.[59]

Vagts[60] assesses the likely effect of voluntary codes of conduct on host countries, home countries and TNCs. In his view, host countries would be able to claim that their policies and measures relating to the corporations are unquestionably legitimate if these are consistent with the codes of conduct. They would accordingly resist any argument by home countries that such policies and measures constitute a violation of international law or some other universally applicable international norms. Codes of conduct might also reinforce the negotiating position of host countries *vis-à-vis* TNCs, since their provisions are likely to be invoked by other host government officials with a readily available body of information about emerging international standards in this area that would be educative.

Vagts argues that codes of conduct could also place some limitations on home governments' freedom of manoeuvre, despite the voluntary character of the instruments. Their ability to question the legitimacy of action taken by a host government would be undermined if such action is based on the provisions of the guidelines. Conversely, some home countries may be able to invoke the provisions of the code in imposing restraints upon the activities of TNCs.

Relying on the OECD experience, Vagts points out that considerable moral pressure can be brought to bear on a TNC whose behaviour is characterised by the host State as not conforming to the norms stipulated in the code, particularly if the corporation lacks the active support of its home country. Vagts indicates a number of possible reasons for voluntary compliance by TNCs. They hoped that

> a certain degree of stability and security could be obtained for the price of accepting somewhat clearer limitations; they hoped that being able to point to such provisions could help them deflect pressures for nationalisation or contract renegotiation. They know that they would find demands to live up to the new standards hard to resist but felt that they, on the whole, were in compliance (whatever the defaults of their competitors might be).[61]

Rubin[62] maintains that the emphasis on effectiveness rather than the legal form of codes of conduct blurs the distinction between mandatory

59. *Idem*, p.952.
60. D. F. Vagts, "Multinational Corporations and International Guidelines", in Steiner & Vagts, *op. cit. supra* n.10.
61. *Idem*, pp.471–472.
62. Rubin and Hafbaur, *Emerging Standards of International Trade and Investment* (1983), p.1183.

and voluntary codes, although it does not entirely dispose of the question of implementation. He, however, concludes that as a practical matter the effect of a mandatory or non-mandatory code is the same as far as remedial action among States is concerned, namely "graded retaliation for transgressions thought to have been committed by another State".

Whether this plethora of codes of conduct is characterised as "soft" or "hard" international law, it cannot be contested that the intense activity in the development of discrete norms for regulating transnational business will lead to the gradual evolution of international standards governing the activities of major international economic actors that have traditionally been excluded from the category of subjects of international law. This development poses a challenge to the traditional confines of international law and presages a new era in which the international community, aware of the potential impact of powerful international economic entities such as transnationals, is shaping the corpus of international law to encompass the imposition of appropriate restraints on these entities, thereby recognising them as subjects of international law. This expansion of the purview of international law is already reflected to some extent in two major international conventions dealing with aspects of foreign investment, namely ICSID, which addresses investment disputes between host States and foreign investors, and MIGA, which provides a multilateral framework for investment insurance.

VI. THE EVOLUTIONARY NATURE OF INTERNATIONAL LAW AND INTERNATIONAL STANDARDS RELATING TO INVESTMENTS

THE foregoing assessment of the status of the various concepts of State responsibility and the emergence of a network of international regulatory regimes for investments and TNCs demonstrates that the development of international law is essentially an evolutionary process. International norms are not immutable or static. They are influenced and shaped by the changing needs and realities of the international community.

The traditional concept of State responsibility originally fashioned by the Western world as a body of civilised and liberal international standards for the protection of individual aliens subsequently came under attack when it was perceived as either inequitable or inadequate for the purposes of addressing the concerns of an enlarged international community which lacked homogeneity as to political, economic or developmental values and goals. While it cannot be unequivocally asserted that a new doctrine of State responsibility now commands universal support, it is equally clear that the traditional concept no longer prevails. The international legal scene is both fluid and uncertain, and calls for the formulation of new standards. The case for evolving or formulating new norms for the regulation and treatment of foreign companies and alien property rests on several premises.

1. The persistent contention of developing countries that the traditional principles of State responsibility were established without their participation and consent and indeed prior to their attainment of independence cannot be dismissed by merely asserting the validity of the traditional principles. Whatever the legal merits of this contention, the viability or functional efficacy of any international legal system depends on the extent to which it enjoys wide international support. The formulation of a new set of norms with respect to foreign companies does provide the developing countries with an opportunity of meaningful participation that can only enhance the viability if not the validity of the principles.
2. The traditional concept of State responsibility will be perceived as inequitable so long as it remains primarily preoccupied with the protection of foreign investment against the legitimate sovereign interests of the host State. An international system which exclusively addresses the concerns of one party to an investment relationship cannot inspire confidence as a fair, international regime. Such a system should also protect the interests of host States by imposing appropriate restraints and obligations upon foreign companies and TNCs.
3. The law of State responsibility is sometimes conceived of as emanating from international concern for the protection of human rights. However, a law designed to ensure liberal and civilised protection of individuals against arbitrary violations and deprivation is liable to abuse if extended mechanically to powerful economic entities such as TNCs in their dealings with host developing countries. The fragile political and economic structures of these countries and the problems posed by the transnationality of TNCs all demand the establishment of viable international standards that will make TNCs responsive to the public interest of host States as well as the general international community.
4. For the past two decades, the issues discussed in this article have generated bitter controversies in the international community. These issues have *de facto* been internationalised by the onslaught on the traditional concept of State responsibility launched in international forums by the developing and social-

ist States, the determined attempts of these countries to devise international mechanisms for the control of TNCs, and the equally persistent attempts of the Western States to uphold the classical formulations through bilateral investment treaties, retaliatory legislation and punitive action at international development agencies. The internationalisation of issues such as nationalisation and compensation, regulation of TNCs, and permanent sovereignty over natural resources all point to the need for the adoption of appropriate international standards to regulate international business. The process has, in fact, already begun with the proliferation of the various codes of conduct spelling out international standards for the regulation of restrictive business practices, transfer of technology, labour and employment practices, and the marketing of infant products. Whether these norms are legally non-binding or mandatory, they are all part of a process of evolution resulting in the elaboration of international standards—standards which are formulated with the participation of the entire international community.

5. The demonstrated willingness of States from all regional groups to participate in this process of creating new norms for the regulation of international business supports the submission that there are no doctrinal impediments to the elaboration of international standards as such. What is contested is not so much the idea of international standards as the content of the prescribed norms.
6. The impelling need for the establishment of international standards relating to the operations of TNCs has been recognised by the international community. The interactions between governments and TNCs are a fact of international business. These interactions have in the past generated bitter international disputes. While sovereign governments continue to admit TNCs, and TNCs continue to seek ventures abroad and operate on a global basis, potential sources of conflict, which defy solution exclusively within national legal systems, will persist. The elaboration of international standards such as the code of conduct is, therefore, an essential prerequisite to the establishment of a viable system of international economic co-operation.

THE IRAN–IRAQ CONFLICT IN THE GULF: THE LAW OF WAR ZONES

ROSS LECKOW

THROUGHOUT the course of the hostilities between Iraq and Iran, merchant shipping in the region has fallen victim to devastating attacks from the forces of both warring States. As the losses suffered by commercial vessels continue to mount, the global community has condemned these raids as flagrant violations of international law. However, the right of innocent passage historically enjoyed by merchant vessels is no longer beyond dispute. Twentieth-century State practice has stood in direct conflict with the traditional international law of naval warfare, belligerent parties seeking to restrict severely the rights of commercial ships in order to permit more aggressive military operations on the high seas. Yet international protest against such activity has attempted to maintain the traditional law in the face of contrasting belligerent conduct. It is for this reason that the present state of the law of naval warfare has been a subject of disagreement among modern legal analysts.

I. THE TRADITIONAL LAW OF NAVAL WARFARE

A. The Law of Neutrality

The conduct of hostilities on the high seas inevitably involves commercial vessels from countries not party to the conflict. Attacks in the Iran–Iraq crisis have been directed primarily against such ships. Historically, merchant ships from neutral States enjoyed legal rights more favourable than those afforded to commercial vessels of the combatants. However, legal developments since 1945 have aroused serious doubt whether nations may still claim the status of neutral.[1] As a result, the validity of the distinction between neutral and belligerent is subject to question. In order to examine the customary law of naval warfare more effectively, one must first consider the present state of the law of neutrality.

With the adoption of the UN Charter and its outlawry of war, the law

1. See generally W. L. Williams, "Neutrality in Modern Armed Conflicts: a Survey of the Developing Law" (1980) 90 Mil. L.R. 9; C. Fenwick, "Is Neutrality Still a Term of Present Law?" (1969) 63 A.J.I.L. 100; F. Deak, "Neutrality Revisited", in W. Friedman, L. Henkin and O. Lissitzyn (Eds.), *Transnational Law in a Changing Society* (1972), p. 137.