

## PROTECTING FOREIGN INVESTMENTS USING THE CALVO DOCTRINE

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### *Abstract*

*In a globalised world, investment relations between states are fundamental for the growth of countries. Therefore, there is no question on the significance of foreign investments on economic development. As such, protection of foreign investments has occupied a position at the core of international law since its very inception. Historically, the protection of investors and their property in foreign states was the direct responsibility of the home State of the investor. However, the expansion of trade and investment increased attention to the legal status of foreign nationals abroad and to the protection of their property. Capital exporting States advanced the view that foreign nationals and their property were entitled to a minimum standard of treatment. The capital importing States instead advocated for the National Treatment Standard embodied in the Calvo doctrine. This standard required that foreigners and their property be accorded treatment no more favourable than that accorded to the nationals of the host State. Over time, Bilateral Investment Treaties emerged with the aim of granting international legal protection to foreign investments. This protection in turn increased the flow of foreign investment, which is one of the key forces of economic growth and development*

**Key words:** Foreign nationals, investment, Calvo doctrine, bilateral investment treaties

### 1. INTRODUCTION

During and in the aftermath of the decolonisation process, foreign policies of many developing countries put emphasis on principles such as national sovereignty, territorial integrity and non-intervention as well as the primacy of national law and domestic courts. This was intended to serve as a shield for defending their political and economic independence and their freedom to regulate their own affairs. In light of foreign investment regulation, the principles served as the legal foundation to exclusively subject foreign investors to the national law and jurisdiction of the courts of the country in which they invest. This principle also called the ‘national standard’ was developed by Carlos Calvo and it led to major arguments between capital exporting and capital importing States regarding the protection of foreign national’s investments. In the recent years however, there is less emphasis on Calvo’s doctrine and this is reflected in the increased willingness of countries entering into Bilateral Investment Treaties (BITs), which serve to attract and protect foreign investment by granting

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investment rights to investors and creating flexibility in the resolution of investment disputes through international arbitration. This article therefore seeks to assess the impact, which the Calvo doctrine has had on the principles of the protection of foreign nationals in the area of investment. This is important especially that foreign investment is critical for purposes of injecting finances into faltering economies, expanding trade opportunities and strengthening infrastructure, which result in growth and development.

The article is structured in five sections. The first section provides a brief introduction, which is followed by a discussion on the evolution of the principles governing the protection of foreign nationals and their property in part two. In particular, this section focuses on the emergence of the principle of diplomatic protection for aliens abroad and the international minimum standard. Section three of this article provides a detailed discussion on the Calvo doctrine. The article will trace its development and thereafter show the impact which the doctrine has had on foreign investments. In analysing the protection of foreign investment through Bilateral Investment Treaties the subject of discussion in section four, the article explains how finance and development has occurred by giving protection to foreign national's investments. Section five of the article discusses the shift from the customary notions which previously governed the protection of foreign investments towards a more liberal interpretation of the standards of investment treaties. Through cases, laws and scholars, this part will show the resurgence of elements of the Calvo doctrine in BITs that protect national sovereignty and foreign investments by allowing local litigation to resolve disputes.

## **2. EVOLUTION OF THE PRINCIPLES OF THE PROTECTION OF FOREIGN NATIONALS AND THEIR PROPERTY**

There is no comprehensive history of the treatment of foreigners and their property under international law (Newcombe & Paradele, 2009). However, there is evidence showing that early communities denied legal capacity and rights to those who originated from outside their community (Anold, 1992). Over the years, the treatment of foreigners gradually changed from that of complete outlawry to a more practical assimilation with nationals, at the present time (Borchard, 1915). Protection of foreign nationals was particularly recognised by scholars such as Francisco de Vitoria who acknowledged the principle of 'free movement' as a universal norm that bound every State (Padgen et al, 1992). Vitoria argued that foreigners had the right to travel, live and trade in foreign lands and that this right derived from the duty of hospitality, that was grounded on the natural sociability of human beings (Chetail, 2016). The principle of free movement was later upheld and developed by Hugo Grotius, who delineated the principle's key components as: the right to leave one's own country and the right

to remain in a foreign country (Gordon, 2008). This, Grotius said, was not limited to common properties such as seas but, that it also applied to the territories (Borschberg, 2006). In the 18<sup>th</sup> Century, affirming the free movement principle, Emmerich de Vattel observed that a State had the right to control and set conditions on the entry of foreigners (Chetail et al, 2011).

The recognition of free movement across borders put an obligation on the States to protect foreigners in the same manner as its own subjects and this protection extended to both their life and property. This was calculated to facilitate trade and investment into host States with the capability to expand investment overseas that in turn developed the foreigner's home economies (Sornarajah, 2017)). As a result, a State's mistreatment of foreigners or their property was an injury to the foreigners' home State (Okpe, 2017). It is from this view that the principle of diplomatic protection emanated. Recognised as a principle of international law, diplomatic protection means that an injury to a state's national is an injury to the state itself, for which it may claim reparation from any responsible state (ILC, 2006). However, for the state to espouse a claim; the foreigner has to be a national; local remedies must have been exhausted; and the right to exercise diplomatic protection is at the discretion of the espousing state (Denza, 2018).

The expansion of trade and investment increased attention to the legal status of foreign nationals abroad and to the protection of their economic interests. Capital exporting States advanced the view that foreign nationals and their property were entitled, under customary international law, to a minimum standard of treatment (MST) which was essentially similar to standards of justice and treatment accepted by civilized states (Brownlie & Crawford, 2012). They argued that such a standard was necessary to provide satisfactory protection to the life of nationals as well as to their properties and investments against expropriation. In his address to the American Society of International Law, Elihu Root stated it thus:

*Each country is bound to give to nationals of another country in its territory the benefit of the same laws, the same administration, the same protection, and the same redress for injury which it gives to its own citizens, and neither more nor less: provided the protection which the country gives to its own citizens conforms to the established standard of civilization. There is a standard of justice, very simple, very fundamental, and of such general acceptance by all civilized countries as to form part of the international law of the world. A country is entitled to measure the standard of justice due an alien by the justice it accords its own citizens only when its system of law and administration conforms to this general standard. If any country's system of law and administration does not conform to that standard of justice, although the people of the country may be content or compelled to live under it, no other country can be compelled to*

*accept it as furnishing a satisfactory measure of treatment to its citizens. (1910, p.517)*

The minimum standard treatment is a norm of customary international law which governs the treatment of foreigners by providing for a minimum set of principles which States, regardless of their domestic legislation and practices, must respect when dealing with foreign nationals and their property (Sattorova, 2018). The MST was first discussed in *U.S.A. (L.F. Neer) v. United Mexican States, 61 1926* in which court observed that:

*“The propriety of governmental acts should be put to the test of international standards, and... The treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency. Whether this insufficiency proceeds from deficient execution of an intelligent law or from the fact that the laws of the country do not empower the authorities to measure up to international standards is immaterial”.*

The judgment above clearly reflected the view that States owe a duty to other States to treat foreign nationals and their property according to a minimum standard of treatment especially since such treatment would create an investment environment that rids the investor of concerns over regulatory uncertainty in a developing country and the possibility that the host State government will unfairly take away the investments from the investor (Ginsburg, 2006). This protection had the ability to promote foreign investment and the economic benefits it brings.

However, the capital importing States many of which were developing countries from Latin America, Asia and Africa, challenged the existence of a customary international law of minimum standard and the notion that international law could regulate their conduct towards, and control of, foreign investments (Schwebel, 2004). For these countries, many of which were newly independent nations that were grappling for freedom from their former colonial power's economic dominance (Spies, 2018), recognition of the international law concept would result in allowing exorbitant and fatal privilege, especially favourable to the powerful nations and injurious to the weaker nations establishing an unjustified inequality between national and foreign investors. And in a bid to reclaim their economic sovereignty, they instead advocated for the National Treatment Standard (NTS), which required that foreigners and their property be accorded treatment no more favourable than that accorded to the nationals of the host state (OECD, 2004). The NTS was initially found in the statements and

writings of Carlos Calvo.

### 3. THE CALVO DOCTRINE

Carlos Calvo in arguing against the existence of a minimum standard of treatment, stressed that state equality required that there be no intervention, diplomatic or otherwise, in the internal affairs of other states, and that foreigners were not entitled to better treatment than host state nationals (1896, 231). In light of investments, this view also known as the ‘Calvo doctrine’ followed three elements: the principle of equality before the law between domestic and foreign investors; the subjection of foreigners and their property to the laws and judicial jurisdiction of the state in which they invest; and abstention from interference by other governments, notably those of the home states in disputes over the treatment of foreigners and their property rights (Shan, 2007).

In essence, by granting the same level of legal protection to both foreign and national investors, the Calvo doctrine aimed at removing any legal basis to intrusive intervention from capital exporting states (Montt, 2009). This however disrupted the stability of foreign investment in developing host States that adopted it because it placed foreign investors at risk. For instance, the requirement to use domestic laws and courts had the effect of deterring foreign investors as many times the foreign investors are not familiar with the local legal system or are mistrustful about local judiciary. This affected the development of these States since the foreign investors were not ready to inject finances in a State which they felt did not adequately protect their investments.

In spite of the capital exporting states’ criticism that the Calvo doctrine was too extreme (Subedi, 2012) and because the doctrine supported their arguments, many developing countries inserted a ‘Calvo clause’ in investment contracts with foreigners in which the foreign investor commits him/her self not to seek diplomatic protection from his state in case of a dispute with the host state but only to seek redress through local remedies (Brownlie, 2003). This clause was inserted to preserve sovereignty and independent authority over the country’s investment interests. An interpretation of the clause was analysed in *North American Dredging Company of Texas, Vol IV 29, 1926* where the commission observed that:

*Where a claimant has expressly agreed in writing, attested to by his signature, that in all matters pertaining to the execution, fulfilment, and interpretation of the contract he will have resort to local tribunals, remedies, and authorities and then wilfully ignores them by applying in such matters to his Government, he will be held bound by his contract and the Commission will not take jurisdiction of such claim.*

The capital importing States however, maintained the view that international law required a minimum standard of treatment to allow them to protect their investments abroad. This ideally would allow the foreign investor to receive additional profits by increasing its capital base as a return for bringing foreign investment into the host State (Chow et al, 2010).

In the 20<sup>th</sup> century, there was a shift in the way that developing countries viewed foreign investment and the role international law played in its regulation (Schwebel, 2004). This was because many of these countries saw foreign investment as a means of bolstering their economies. In particular, many states believed that it was in their self-interest to enter into bilateral relations as a means of attracting foreign investment into their countries (Valenti, 2018). Indeed, there arose a need to establish an international standard, which was through Bilateral Investment Treaties (BITs). Although the new rules under BITs contradicted the traditional view of developing States, which often relied on domestic law, the relaxation of the strict Calvo doctrine was justified due to the importance of foreign investment to the economic growth of developing States.

#### **4. BILATERAL INVESTMENT TREATIES IN LIGHT OF THE CALVO DOCTRINE**

After the global economy began to normalize in the aftermath of World War II, foreign capital flowed more freely and the significance of foreign investment grew. However, this was not so for foreign investors as there was no coherent legal framework in place to protect their interests (Salacuse & Sullivan, 2005). This situation did not last because of the rapid expansion of foreign investment which saw a shift from reliance on customary international law, to treaties as the basis for protecting foreign investments (Ryan, 2008). This shift was caused principally by the belief that customary international law could not adequately protect foreign investments, and also that it did not provide investors a direct right of action against host governments to pursue investment-related claims (Salacuse & Sullivan, 2005). At this time, bilateral investment treaties (BITs) were viewed as the most practical solution to these problems. They could be negotiated in such a manner as to suit the mutual interests of the parties. For instance, for the host State, BITs were critical for purposes of attracting foreign investment, which in turn increased the amount of capital flowing into the State, hence boosting the economy (Newcombe et al, 2011). Also, by attracting foreign capital, the host State would be more capable of directing the available domestic capital to other uses of public benefit (Sornarajah, 2017).

In addition, the treaties gave investors the right to submit disputes to international arbitration most often under the International Centre for Settlement

of Investment Disputes (ICSID) (Sattorova, 2018). The availability of this agency's services allowed foreign investors to bypass host countries' legal systems, guaranteeing an international arbitration process against the host State should a dispute arise. This was preferred by most foreign investors for the reason that it helped the foreign investor to avoid all the pressure and delay that may accompany the adjudication of investment disputes in national courts (Subedi, 2012). In addition, it reduced their fear of lack of impartiality from the courts of the host state. The creation of facilities for the arbitration of investment disputes thus, is a major protection of foreign investment and increases the inflow of capital into the host States (Goodman, 2014). The last few decades have witnessed a drastic increase in BITs concluded between and among developing, least developing and developed countries due to their origins as instruments governing investment in the developing world.

## **5. RECENT DEVELOPMENTS IN THE PROTECTION OF FOREIGN INVESTMENT**

The fact that foreign investment promotes economic development has been strongly used to impose greater levels of international protection for foreign investors. The standard used to protect investment in many BITs today is the Fair and Equitable Treatment (FET) standard (Poulsen, 2017). Article 1105 of the North American Free Trade Agreement (NAFTA) prescribes it as a standard that does not require treatment in addition to or beyond that which is required by the customary international law minimum standard (Garibaldi, 2006). The tribunal in the case of *Mondev International Ltd v United States, 2002*, emphasised that this standard requires that protection afforded shall be that generally accorded by the party concerned to its own nationals, but being set by international law. This standard coheres with the BIT's objective of promoting foreign investment. It ensures better treatment and protection for foreign investments. As such, it secures development through the finance that is brought into the country by the foreign investors who choose to invest in the host country.

It is therefore clear from the above discussion that references to the standard of treatment of foreign investments in BITs extend from international minimum standard to fair and equitable treatment and this is in a bid to strengthen the protection of foreign investments especially since such investments are crucial in injecting finances into economies of host states and the foreign investor's state. Therefore, on the face of it, one may conclude that BITs did away with the Calvo doctrine especially since they give investors the right to submit disputes to international arbitration through ICSID. However, this may not be the case. For instance, although creators of ICSID advocated for the application of international legal remedies they also saw certain attributes associated with the Calvo doctrine. This recognition led to the incorporation of the modified

version of the Calvo clause in Article 27 of the Convention on Settlement of Investment Disputes between States and Nationals of other States (ICSID Convention, 1966). Article 27 grants states the possibility of an effective waiver by an investor of the right to his state's diplomatic protection with regard to any matter that the host state is willing to take to the Center for arbitration. As a result, the ICSID potentially offers those states the same protection that Calvo doctrine does (Shihata, 1984).

In addition to the above, the exhaustion of local remedies is not obligatory in contemporary investment arbitration but the requirement to use domestic courts before resorting to international arbitration is re-appearing in a number of ways. In *Heritage Oil and Gas Ltd v Uganda Revenue Authority*, App. No. TAT 26, 2010, before referring the case to arbitration in accordance with the United National Commission for International Trade Law (UNCITRAL), Heritage Oil first referred the dispute to the Tax Appeal's Tribunal and the High Court of Uganda. Using national Courts reduces on the expense the host state may use for international arbitration and as a result, the state's domestic funds are channelled to other projects such as infrastructure, which lead to development. More so, allowing local litigation to resolve disputes protects national sovereignty.

The Multilateral Investment Guarantee Agency (MIGA) to which many states are party also comes easily to terms with the Calvo doctrine. This is seen in its criteria for eligibility of investments for coverage by MIGA under articles 12 and 15, which ensures that sovereign control over admission of foreign investment and MIGA's involvement rests with the host country. Further, in 2002 the U.S. Congress passed the Trade Promotion Authority Act instructing its trade negotiators to ensure that foreign investors are not accorded greater substantive rights than U.S. nationals. The language used in this law indicates the Calvo Doctrine.

Furthermore, in the re-negotiation objectives for NAFTA, the Trump administration ensured that NAFTA country investors in the U.S are not accorded greater substantive rights than domestic investors (Howse, 2017). This move is clearly part of the Calvo doctrine. Additionally, scholarly discussions also suggest that the Calvo doctrine is not dead. Shan (2007, 55) argues that the chief indicator of the Calvo Doctrine's revival is the dramatic increase of investment treaty-based arbitration cases, which have forced states world-wide, to re-think their approach towards investment liberalization in general and the acceptance of international arbitration in particular. These examples reflect elements of the Calvo Doctrine that are embedded in the National Treatment Standard that exists in many BITs today. The incorporation of the NTS aims at reducing the extent to which foreign investors can be put at a comparative disadvantage in comparison with national investors. Therefore, it reduces the



risk of foreign investors being treated less favourably. This protection leads to increased foreign investments in the host state, and these investments are a major source of capital for the states.

However, despite the discussion above and although some of the terms in the ICSID and MIGA do not contradict the Calvo doctrine the mere fact that such requirements have been laid down in a treaty means that the treatment of the foreign investor is no longer a matter exclusively of the host country, nor can it be maintained that the foreign investor will be treated in the same way as the domestic investor. Also, the fact that a majority, of states have accepted international arbitration, this demonstrates the decline of the exhaustion of local remedies view embodied in the Calvo doctrine. Arguably, although elements of the Calvo doctrine are resurfacing in many BITs today, it is unlikely that Calvos doctrine will be completely restored because no country can now afford to be entirely cut off from interactions with the world in this era of globalization. Especially since the increased globalisation and the rise in the number of cross border investment have increased the need for foreign investment in order to ensure continued growth of the global economy.

## **6. CONCLUSION**

Protection of foreign investments plays an important role in the financial prosperity and development of many countries. Hence, in order to promote the overall flow of foreign investments, international investment rules have been developed to protect investors and their assets. In this case however, the tussle between developed and developing states resulted in a long-term disagreement about the content of customary international law regarding the treatment of foreigners and their property. The developed States argued for an international minimum standard protecting foreign investments, whereas the developing States argued for national control over foreign investments as reflected in the Calvo doctrine because they wanted to secure their sovereignty and authority over the country's investment interests. This would in effect enable these states to control the finances arising from such investments.

Today, the controversies concerning the MST and NTS have lost much of their relevance as the debates are geared more towards bridging the gaps between these standards. This is seen through national investment laws that purport to generate confidence among potential foreign investors to maximise their contribution to national development. It is also seen through the increasing number of BITs and the increasing number of contracting parties to the ICSID Convention in the belief that international arbitration will protect the legitimate interests of the investor and host country more effectively. Bridging this gap will allow investment and cash flow into countries while investors are protected.

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