THE ROLE OF THE INSTITUTE OF DIPLOMATIC PROTECTION IN INTERNATIONAL INVESTMENT RELATIONS

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Abstract

The article is dedicated to the phenomenon of diplomatic protection which may arise from the injured rights of a natural or legal person on the territory of another state. The historical context of occurrence of diplomatic protection and general approach to this institute which is shown both in doctrine and international legal practice are examined. Author refers to several judgments held by the International Court of Justice in order to describe the tendency concerning the application of diplomatic protection in practice. This has been examined on cases concerning the protection of natural persons and legal persons separately. The role of diplomatic protection in the settlement of international investment disputes of diagonal character was studied.

Keywords*: law, investment, diplomatic protection, international law, international investment law, investment relations, transnational corporation, natural person, legal person, International Court of Justice.*

The principle of state sovereignty, which is expressed by the supremacy and independency of the state in relation to other authorities within the state and in international relations, entitles states for diplomatic protection over their nationals and national legal persons on the territories of other states. According to the Article 1 of Draft Articles on Diplomatic Protection of the International Law Commission "diplomatic protection consists of the invocation by a State, through diplomatic action or other means of peaceful settlement, of the responsibility of another State for an injury caused by an internationally wrongful act of that State to a natural or legal person that is a national of the former State with a view to the implementation of such responsibility" [8]. At the same time it should be noted that diplomatic protection is far from being a right to a state but is an action itself – this is a procedure which is realized by the state in order to restore the injured rights of its nationals on the territory of another state.

The institute of diplomatic protection has a historical context and has been known to the international law back in XVIII century, as in 1758 the Swiss lawyer E.Vattel expressed the fundamental principle of diplomatic protection as following: "Whoever ill-treats a citizen indirectly injures the State, which must protect that citizen"[10]. He noted that the sovereign state has to revenge for the injury caused to its national by another State, it has to make that State reimburse the harm, and otherwise the citizen will not be able to get the major wealth of the society which is the safety. Diplomatic protection has traditionally been seen as an exclusive state right in the sense that a state

exercises diplomatic protection in its own right because an injury to a national (no matter whether it is a natural or legal person) is deemed to be an injury to the state itself. This is the general approach which has also been reflected in the report of the United Nations International Law Commission on preparing Draft Articles on Diplomatic Protection [16].

The early rules on diplomatic protection were devised in the context of injuries suffered by US citizens in Latin American states. The struggle again reflected the binary nature of the norms in this area. The United States sought to externalize the norms that governed aliens and their property. It argued for an international minimum standard in accordance with which the foreigner should be treated. It built into the international minimum standard, norms that were favorable to the foreign investor and were, to a large extent, based on US domestic law standards [12].

Today the realization of diplomatic protection varies from one which has been at the rise of the phenomenon. Now diplomatic protection can take two forms: first, that of diplomatic action, whether it takes place according to traditional techniques, or according to more elaborate techniques such as conciliation and, secondly, the form of international judicial action which includes both the recourse to the judge and the recourse to the arbitrator. The exercise of diplomatic protection is at the discretion of the state, as it is at its discretion the choice of means, taking into account of course the rules on the recourse to the international judge and the arbitrator. This point must be borne in mind in order to appreciate the scope of international practice in this area with regard to the case of legal persons.

The twentieth century was the beginning of the globalization of the entire world economy. These processes have gained momentum in Europe since the middle of the last century. Economic integration has turned into a political one and has changed the situation on the European continent for many years. Today, the processes of economic globalization are taking place all over the world. The states themselves, their individuals and legal entities actively cooperate with each other in various areas of economic activity. This impacts development and intensification of investment relations in modern economy and enhancement of legal regulation of international investment relations. Within the context of international investment relations the institute of diplomatic protection has gained a new importance. It seems that the diplomatic protection became one of the means for settlement of international investment disputes.

The international investment presumes transfer of the capital from one state to another. It can be done in a form of a direct investment which includes the direct transfer of cash or property by natural or legal persons in order to provide participation on the territory of another state or in a form of portfolio investment which is realized in a way of purchase of securities of foreign issuers on specialized stock exchange markets. Those two forms are different from each other by several aspects but both provide the international element within a state receiving the investment.

The difference between these types of investments is based on the following: having a portfolio investment the control and administration over the eminent is apart from his shared ownership. The foreign investor does not aim to take part directly in administration over the entity according to securities - his main objective is to receive quick profit from increasing price of those securities. Foreign investor is trying to form such a portfolio which can bring him maximum profit in a short period of time. Investor

which has portfolio investment has to accept all kinds of risks, the same thing cannot be applied to direct investment as this kind of investment has long-term objectives and they usually receive better guarantees and protection in this period of time. Direct investment can have both support from the national law of receiving country and diplomatic protection from their national country.

Generally the distinction of direct and portfolio investment is made based on risks. Portfolio investor can cancel his investment by a simple contract for purchase and sale, which will help him to sell his securities and later to acquire new different ones. Direct investments usually cannot be canceled so much easily as they are considered for mid or long-term. Portfolio investments do not require constant control and administration from investor, while direct investments cannot give profit without proper administration by investor and his presence in receiving country.

Also as a specific characteristic of direct investments we can note their popularity within the activity of Transnational Corporations. Portfolio investment does not let the same advantages considering economic and political influence which are given by direct investments, this is why they are largely used in practice of TNCs and this is the principal form of their economic activity on the territory of another country.

The investment of international character requires a firm ground to be realized as the only purpose of the investor, no matter whether it is a natural or legal person, is to gain profit (except some cases when an international investment becomes sort of foreign expansion realized by the national state of investor). First of all this is based on the necessary security which should be provided for the investment in order that to ensure the investor that he will get the profit. Criterions of safety have different aspects including the political situation in the recipient state, protection from nationalization and confiscation of property, the possibility of repatriation of profit and others.

The elaboration of Draft Articles on Responsibility of States for Internationally Wrongful Acts by the International Law Commission of the United Nations unquestionably offers an additional argument of weight to the thesis that the responsibility that may be incurred by a State because of the violation of an investment protection agreement is an international responsibility, whose conditions of engagement and content are both governed by the international legal order [9]. Contrary to a practice as constant as it is abundant today, and of a largely concordant doctrine on this point, some authors dispute well the possibility of transposing this instrument in this discipline of the international economic law on the ground that the rules that it intends to codify would only be relevant in the context of "classic" interstate relations. It is true that article 33 (1) of the Draft Articles intends, in principle, to define the scope of this type of relationship to the exclusion of situations in which the responsibility of the State would be questioned by a private entity. This provision, however, reflects, first of all, a bias assumed by the Commission, since the sixties, in order to circumvent the problem of the international status of private persons, which then provoked much more intense controversy than today. It will be noted later that the work of the Commission has been abundantly practice of international courts and tribunals that have to rule in contexts directly - in the case of mixed courts - or indirectly - through diplomatic protection [11]. It is also quite remarkable that the judgment of the Permanent Court of International Justice (PCIJ) in the context of the Chorzów Factory case, which is one of the founding decisions of the customary law of the international responsibility, precisely the situation

of a private person confronted by a State's breach of its international commitments. In that case, the Court also confirmed that state responsibility, in such a "transnational" context, was in accordance with the rules and principles of international law, including the definition of its content and to specify the consequences. Lastly, and above all, it is clear from Article 33 (2) that the relevance of the Commission's draft on State responsibility, in the case where it is invoked by a private individual, is not definitively principle, but that it must be assessed with regard to the primary rules the violation of which is alleged. The commentary to this provision states that "it is the particular primary rule which is to determine whether and to what extent persons or entities other than states may invoke responsibility in their own name" [7]. However, this is precisely the purpose, in general terms, of investment protection agreements: to offer investors a capacity which the diplomatic protection of their state of origin conferred on them until now possibly and indirectly by allowing them to invoke "in their proper name" the international responsibility of the host State for their operation. As for the point of determining the extent to which these instruments actually confer such power to investors, it is appropriate to refer, on a case-by-case basis, to the relevant provisions of these agreements, which may naturally regulate or circumscribe their capacity for action by imposing certain conditions on it or limiting the consequences that may result from violation of their material provisions. In accordance with the principle of lex specialis, customary international law, as codified in the Articles of the Commission, must be deleted in favor of the special provisions contained in the investment promotion and protection agreements.

The comparison must necessarily be made because, as regards the state responsibility in the field of investment, international law has been developed by a long series of inter-state arbitrations resulting from the exercise of diplomatic protection of the home countries of investors. Are the rules of this international law, which are largely part of customary international law, relevant to arbitrations on the basis of protection treaties? One recent author denies that there is a difference in nature between the rules of State responsibility for internationally wrongful acts in the context of diplomatic protection and those applicable to the implementation of cause of a State on the basis of protection treaties [15].

Thus Z. Douglas argues that "the investment treaty regime for the arbitration of investment disputes [...] cannot be adequately rationalized as a form of international public or private transnational dispute resolution". And indeed, since the dispute between a host State and the investor would always relate to the private interests of the latter, the law applicable to this type of dispute could only be a "hybrid" of international law and domestic law and not only international law as in inter-state arbitration. It follows from this general view that the customary rules of State responsibility in the field of investment, which have been established in the context of inter-State arbitrations set up as a result of the exercise of diplomatic protection, do not would be irrelevant to actions based on investment protection treaties. The customary rules, on which the work of the International Law Commission was based, concerned inter-state relations and not mixed reports between a private person and a state, reports which were, by nature, outside the sphere of international law [15].

It is clear and unmistakable that the foundation of both actions is not the same. On the one hand, with regard to the implementation of diplomatic protection, the widely

accepted pattern is that the state that takes up the cause of its national does not defend its right but the right, which its own, to ensure compliance with international rules concerning the treatment of aliens that the receiving state has violated vis-à-vis one of its nationals. These results in the liability of the latter being put in play by the national state of the investor.

Thus the practice of investment relations demonstrates that investment brings the occurrence of relations between states and nationals (natural or legal persons) of another state. States sign BITs mostly in order to provide protection and security for their own individuals and legal persons who realize investments on the territory of another state party. Contractual rules of international law enlarge limits of possible protection which is provided to investors. This is the essential objective of any BIT - to provide guarantees and protections for investors in order that they could have their economic activity on the territory of another state without violation of their rights. The question is that how this kind of relation which can be referred to as "diagonal relations" are regulated by international law as one party involved is a natural or legal person which is not a subject of international law. In this case the institute of diplomatic protection arises and is aimed to help states to protect their nationals.

The biggest flaw in international customary investment protection law, however, was the lack of an enforcement mechanism. Instead of giving interested investors the direct right to file a lawsuit against the host country at the international level, it was stipulated that they should first have applied to the courts of the host state, which, especially in developing countries, were not necessarily an effective remedy, and then ask their relevant state of origin on the exercise of diplomatic protection. The state of origin could then make claims about the violation of the rights of the investor by the host country at the international legal level, for example, by initiating proceedings in an international court or arbitration. For the "classic" international law, the fundamental idea was that the violation of the rights of foreign investors constituted a violation of the rights of the state of origin. In fact, the International Court of Justice was from time to time forced to deal with investment protection issues; in addition, special tribunals were also established at the international legal level. However, the investor did not have the unconditional right to exercise diplomatic protection by his state of origin and in this respect was completely dependent on the latter's discretion. Concerning the protection of natural persons it should be noted that according to the rules of customary law states themselves can define conditions for conferment of nationality (to give citizenship) based on their national law, but foreign states can recognize this law only if it does not contradict international conventional, international customary law and general principles of law concerning nationality.

Along with that the international law limits realization of diplomatic protection of states. States can apply diplomatic protection only if there is actual connection (close relation) between state and citizen. Nottebohm case [13] is very significant in this aspect. This is the case heard by the ICJ in 1955 between Liechtenstein and Guatemala. Liechtenstein has asked the Court to oblige Guatemala to realize restitution and pay compensation due to illegal acts of Guatemala towards Nottebohm who was citizen of Liechtenstein. But the ICJ has refused to examine this action and motivated it by the fact that the nationality of Liechtenstein was acquired by Nottebohm only in order to change his legal status without a real actual connection between him and the state. The

Court has refused to take into account the procedure and order of acquiring nationality indicating that this is fully the exclusive right provided by national law. This approach has become a classical one and is applied in some international investment treaties. For example the BIT between Germany and Israel stipulates that the notion "Israel national" presumes "national of Israel, who permanently live on the territory of the state".

What if a natural person has more than one nationality? In this case according to the principle of actual connection the right to realize diplomatic protection belongs to state with which the natural person has the closest links. But the international customary law and international practice mostly allow the realization of diplomatic protecttion by any of those countries.

Diplomatic protection is therefore today not the only instrument of international law that may be used by an individual who's personal or property rights have been unlawfully violated abroad by a foreign government. BITs provide protection for the investments of foreigners and human rights treaties offer remedies for the violation of personal human rights. Still diplomatic protection remains a mechanism of international law that is employed by States to secure just treatment for their nationals abroad. Moreover it has largely lost its reputation as a procedure used by rich, developed nations to interfere in the domestic affairs of developing nations. This is evidenced by the manner in which developing nations have not hesitated to invoke international law's oldest mechanism for the protection of aliens abroad. Regarding the realization of diplomatic protection for the legal persons, it is remarkable that the development of business entities in a form of joint-stock companies and the increasing role of foreign investments have led to possibility of diplomatic protection which can be applied to legal persons.

This aspect was examined by the ICJ during the Barcelona Traction Case [5]. The Barcelona Traction, Light and Power Co. Company were registered in Toronto (Canada) in 1911. Subsidiary companies have been established in order to hold business in Spain. After the end of the World War One Belgian natural and legal persons have become stock holders of the company. But civil war in Spain which occurred in 1931-1939 has led the company to the bankruptcy. Spanish stock holders have addressed to the Spanish municipal court with the action on bankruptcy of the Canadian company. The court has accepted the action. After this the ICJ has examined the action of Belgium about the protection of rights of Belgian stock holders of Barcelona Traction. Representatives of Belgium claimed that acts of Spanish authorities concerning the company were the reason of massive damage which was occurred to Belgian stock holders. ICJ by its decision of 5 February 1970 has refused the action, pointing out that "the application of theory of diplomatic protection to stock holders could be the cause of appearance of concurrent objections by different states which could lead to creation of unstable conditions in international economic relations". This is why the Court held the absence of cause of action for Belgium. This is the fact that stock holders of big transnational corporations are nationals of different countries from all over the world. The realization of diplomatic protection by each state could cause great number of disputes. In its decision on Barcelona Traction Case the ICJ has emphasized that according to the generally recognized rule of international law the diplomatic protection can be realized "only by the national state of legal person".

But such kind of approach does not tell us anything about how to define the nationality of legal person. The definition of nationality of a legal person is necessary because they do not have an international legal personality. The ICJ in Reparations Case [14] has given the definition of a subject of international law, which is according to the opinion of the Court is characterized by "the ability to acquire international rights and obligations, and also the ability to realize its rights by submitting an international request". Legal persons can have rights and obligations within the national law this is why they cannot become subjects of international law. Here we have to refer once again to theories of definition the nationality of legal persons: theory of incorporation (states of common law), theory of location of principal organ (Germany), theory of center of principal economic activity (mostly used in combination with other theories), theory of property and control (mostly used in combination with other theories, Switzerland).

In conformity with the theory of incorporation the legal person has the nationality of the state where it is registered, i.e. has the closest legal link with the state. The theory of location of principal organ is based on the legal relation between corporation and state based on the location of its main administrative organ, which hold the general control and management over the administration of the legal person's business activities and its assets. The other one which is the theory of center of principal economic activity leads to definition of nationality of a legal person based on the state on which territory it generally has its business activity and gains profit as a purpose of its general functioning. The last theory defines the nationality of a legal person according to the nationality, more precisely the citizenship of its founders [1].

As we can understand, in Barcelona Traction Case the ICJ addressed the theory of incorporation and refused the theory of property and control which is understandable taking into account the fact as mentioned above – it can mislead states while activating their right on diplomatic protection for their nationals who may be founders of different corporations all over the world, it may bring chaos to the international economic order and provoke big number of unjustified diplomatic protection cases or as the ICJ stated itself "could create an atmosphere of confusion and insecurity in international economic relations". The ICJ stated that "international law has had to recognize the corporate entity as an institution created by States in a domain essentially within their domestic jurisdiction. This in turn requires that, whenever legal issues arise concerning the rights of States with regard to the treatment of companies and shareholders, as to which rights international law has not established its own rules; it has to refer to the relevant rules of municipal law" [6].

Diplomatic protection covers in principal the protection of those nationals which are not engaged in business affairs of international character on behalf of the state itself. These officials are protected by different rules and norms of international law. Here we can refer to the Vienna Convention on Diplomatic Relations of 1961 and Vienna Convention on Consular Affairs of 1963. At the same time in case that diplomats and consuls are injured in relation to activities which are out of their direct functions, they are covered by the rules and norms of the diplomatic protection. Such cases may occur as a result of the expropriation of the property belonging to the official on the territory of the accredited state without compensation. As we can see from the practice of the ICJ it is the link between the injured person (natural or legal) and the state of his nationality which gives rise to exercise of the diplomatic protection.

Diplomatic protection remains an important mean for aliens, rights of which were injured while abroad. It is true, as the International Court of Justice observed in Diallo case (para. 88), that the role of diplomatic protection has "somewhat faded" [2] in respect of investment disputes, and that human rights conventions provide international mechanisms for bringing complaints against governments responsible for violating the rights of aliens. The ILC may have already missed an opportunity to advance the relevance of diplomatic protection when it failed to promote the right to diplomatic protection in respect of nationals subjected to the violation of peremptory norms abroad [3]. Probably, if the articles are transformed into treaty form, states will be encouraged by article 19 of the articles and the "responsibility to protect" doctrine proclaimed by the General Assembly in its 2005 World Summit Outcome Document [4] concerning serious international crimes, to endorse a right to diplomatic protection.

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