ICSID INVOLVEMENT IN ASIAN FOREIGN INVESTMENT DISPUTES: THE AMCO AND AAPL CASES

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1. INTRODUCTION

Almost all states of the Asian region are parties to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention).1 States in the region were cautious in becoming parties to the Convention. The travaux préparatoires2 show that the Asian states participating in the conferences that led to the drafting of the Convention indicated reservations to the Convention based largely on the fear that it would insulate foreign investment from domestic control by subjecting it to the jurisdiction of a foreign tribunal formed under the auspices of a body controlled by the capital-exporting countries – the World Bank. There was a general fear that international arbitration was inclined to favour the capital exporters to the detriment of the capital importing states and that it would impede the making of economic decisions by the states.3 At the time the Convention came into force in 1966, Asian states were still smarting under the colonial experience. They saw the effort to create an international tribunal to deal with foreign investment disputes as an attempt to continue with a situation

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1 The major exceptions are Myanmar and India. See 3 AsYIL (1994) 226. The People’s Republic of China ratified the Convention in 1993. India is reconsidering its stance, consistent with its new policy of liberalization towards foreign investments.


3 For the view that this perception may be changing, see J. Paulsson, ‘Third World Participation in International Investment Arbitration’, 2 ICSID Review (1988) p. 19. But, for the view that there has been no change, see M. Sornarajah, International Commercial Arbitration (1990), Chapter One.


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of economic imperialism through foreign investment. In the 1970s, there was a perception of multinational corporations as harbingers of new forms of economic dependence and as threats to newly won independence. There was a general developing country stance which emerged as a result of the attempts to formulate a New International Economic Order in which the Asian states participated vigorously. In the area of foreign investment, a principal purpose of these attempts was to ensure that a state had control over the whole process of foreign investment. But, the hostility that was generated in the 1970s has been progressively muted as a result of shifts in the foreign investment policies of leading Asian states.

There has been a dramatic shift in perceptions towards foreign investment in recent times. The United Nations undertook a study on multinational corporations as a result of the fears expressed by states as to the role that these corporations play in internal economic affairs and politics of states. The conclusion of the Committee of Experts that multinational corporations could be harnessed to the economic goals of developing states and that, if properly controlled, they could contribute to development, led to changes in attitudes to foreign investment. The report of the Committee identified the harmful practices of multinational corporations and methods of eliminating them through control. In the 1980s, a large number of Asian states, inspired by the example of the newly industrialising states of Asia, changed their attitudes to

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4 The few Asian states that participated in the conferences that led to the formulation of the Convention expressed these sentiments. See in particular the views of Mr. R. WANASUNDERA of Ceylon (Sri Lanka), in op. cit. n. 2.

5 The fear was triggered off in Europe where American multinationals were seen as dominating the European economy. See J.J. SERVAN-SCHREIBER, The American Challenge (1969). But the view that economic sovereignty of developing states was undermined by these corporations was stated in BARNETT and MUELLER, The Global Reach. Another principal contribution to the debate was R. VERNON, Sovereignty at Bay. In Latin America, the dependency school saw the multinational corporations as integrating the economy of developing states into the central economies of the developed states in a situation of permanent dependence. The dependency school does have influence in Asia as well. Generally see M. SORNARAJAH, International Law on Foreign Investment (1994), Chapter Two.

6 The vigour of participation differed from state to state. Some states, like Singapore and Thailand, for example, did not subscribe to the view in Article 2(2)(c) of the Charter of Economic Rights and Duties of States that compensation for nationalization was a matter entirely for the nationalizing states to decide. These states were committed to a strategy of development led by foreign investment and did not wish to frighten away investment by taking intransigent stances.

7 The principal newly industrialising states were Hong Kong, South Korea, Taiwan and Singapore. These were later joined by the South East Asian states of Malaysia, Thailand and Indonesia. China began an open door policy and India has begun to liberalize its foreign investment regime. Vietnam and other socialist states in South East Asia have also joined in the moves to attract foreign investment.
foreign investment and sought development led by foreign investment. Contrary to popular thought, the newly industrialising countries did not permit free access to foreign investment but employed judicious methods of controlling them through several means. The foreign investment laws of Asia came to be fashioned on the basis of achieving economic development without too much of an erosion of sovereignty. The employment of screening mechanisms to permit entry only to investments which are considered desirable from a developmental point of view is widespread. This has resulted in the heavy use of administrative techniques for the regulation of foreign investment. The use of joint ventures as the preferred method of permitting foreign investment entry maximises control while at the same time ensuring that skills and technology flow to the local partners of the ventures.8

The aims of the ICSID Convention must be reassessed in the light of these developments. There is little doubt that the basic aim of the Convention is to remove the settlement of disputes relating to foreign investment to a forum outside the state, acceptable to the foreign investor. The premise of the Convention is that this would promote the flow of foreign investments into developing countries. But the developing countries resent the idea that the adjudication of disputes arising between them and foreign investors will amount to a loss of control over foreign investors operating within their states. This loss of control over resolution of disputes concerning foreign investment assumes even greater significance at the present time now that the Asian states have instituted administrative measures of control over foreign investment. The ICSID Convention encapsulates this conflict. Its success will depend on the extent to which tribunals created under it will be able to resolve these mutually inconsistent interests, in a manner that is satisfactory to both the foreign investors and the developing states concerned.

The two ICSID awards involving Asian states must be examined in the light of the resolution of this fundamental conflict. After describing the disputes and the awards, the issue as to whether the two awards are a satisfactory reconciliation of the conflict of interests will be returned to. The two cases referred to are Amco (Asia) Corporation v. The Republic of Indonesia and AAPL v. The Republic of Sri Lanka. One purpose of this article is to state the main issues involved in these disputes and to critically examine the manner in which they were dealt with by the tribunals.9 Another is to examine the major

8 See M. SORNARAJAH, The Law of International Joint Ventures (1992), Chapter 6 in which relevant Asian laws are surveyed.
9 In a superficial sense, the applicants in the two disputes were also from Asia. Both applicants were subsidiaries of foreign companies which operated from Hong Kong. They acquired Hong Kong nationality through incorporation in Hong Kong.
issues involved in the arbitration of foreign investment disputes. Success of foreign investment arbitration depends on finding a satisfactory method of reconciling the interests of state sovereignty and control over foreign investment with those of the foreign investor(s). The latter would include: to ensure that the dispute is arbitrated in accordance with external norms that provide stability to his investment, by a tribunal in which he has confidence.

In this respect, the two arbitrations under review may both be disappointing, as will be explained below. Amco v. Indonesia had a tortuous passage through the whole procedure available for annulment and review under the ICSID Convention. The final result produced will not be considered satisfactory by the state party. AAPL v. Sri Lanka involved issues unsuitable for settlement by a foreign investment tribunal and raises the question whether such issues should be dealt with by tribunals which may not have expertise to deal with situations involving damage caused during hostilities. Both awards have a general significance for the international law on the settlement of foreign investment disputes.

2. AMCO (ASIA) CORPORATION V. INDONESIA

Amco (Asia) was a Hong Kong subsidiary of an American company. It entered into a joint venture with Wisma Kartika, an Indonesian corporation, for the building of a hotel complex, the Kartika Plaza, in Jakarta. Joint venture was the principal form of entry for foreign investment in Indonesia after the Foreign Investment Act, 1967. Pursuant to this legislation, Indonesia also established administrative mechanisms to screen the influx of foreign investment. It took various measures to ensure that the benefits of foreign investment to Indonesia were maximized. One such measure was to require that capitalization of the share of the joint venture by the foreign investor would take place with funds brought from outside Indonesia. Indonesia had previously terminated foreign control over its economy through nationalizations aimed principally at the property of the Dutch. Indonesia had been a colony of the Dutch and secured its freedom through an heroic armed struggle. As a result, Indonesian nationalism has a vigourous element which may be absent to the same degree in other states of Asia. Another feature was the role that

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10 The aim of the measure was to prevent locally formed capital savings from being diverted into the venture and also to ensure that foreign funds would come into the country. Indonesia supervised this regulation through its central bank, Bank Indonesia. Certificates issued by the Bank were the only method of proof of such capitalization having taken place.
the army played in securing independence; it continues to play a dominant role in the political life of Indonesia. Indonesian political life has so far been controlled by men who fought in the wars to secure independence from the Dutch.¹¹ A large amount of the shares in Wisma, the Indonesian company which was a party to the joint venture, was held by an army pension fund.

By early 1980 a dispute broke out between the parties to the joint venture resulting in a take-over of the control of the Hotel Kartika Plaza by Wisma, with the assistance of members of the Indonesian armed forces. The administrative authorities overseeing the project also had complaints against the foreign party to the joint venture. Sometime prior to the dispute, a Hong Kong businessman became the major shareholder in Amco without the knowledge or consent of the Indonesian authorities.¹² There were also allegations that capitalization was not in accordance with the plan approved by the Indonesian authorities and that the foreign investor had committed other irregularities. As a result Amco's investment was revoked in July, 1980.

When the dispute was not settled through negotiations, the foreign party invoked the arbitration clause submitting the dispute to ICSID arbitration.¹³ The applicants included not only PT Amco, the Indonesian subsidiary which had formed the joint venture with Wisma, but also its parent company Amco Asia Corporation, the Hong Kong subsidiary which controlled it, as well as Pan American Development Limited, to which Amco Asian shares had subsequently been sold.

2.1. The Award of the First Tribunal

The dispute was referred to an ICSID tribunal consisting of Professor BERTHOLD GOLDMAN, Mr. ISI FOIGHEL and Mr. EDWARD RUBIN. The tribunal first made an award on the issue of jurisdiction raised by Indonesia.

¹¹ An interesting historical survey of factors which shaped Indonesian attitudes to foreign investment can be found in C. HIMAWAN, The Foreign Investment Process in Indonesia (1980).
¹² The tribunal, however, found that there was knowledge of the transfer on the part of Indonesia as there was a letter, which the authorities knew of, in which Mr. TAN (the Hong Kong party who later took over) was asked to “assist Max in this project”. From this the inference of the knowledge of the existence of an interest of Mr TAN in the planned investment was made (Para. 14 of the 1983 award). The weakness of this inference is obvious. When the inflow of investment was controlled by the state, the identity of the investor should have been more clearly disclosed.
¹³ Difficult questions arise as to whether the Hong Kong investor succeeded to the right to invoke the arbitration clause. This matter was, however, not raised in the award.
2.1.1 The Award on Jurisdiction\textsuperscript{14}

2.1.1.1. Objection to jurisdiction: corporate nationality

Indonesia objected to the jurisdiction of the tribunal. The major issue raised was that the joint venture company was a corporate national of Indonesia and that a dispute that arose between a national and his/her state was not subject to ICSID jurisdiction\textsuperscript{15}, as ICSID was created to deal with disputes between states and nationals of other states. This jurisdictional dispute raised interesting points of corporate nationality. The issue had been previously raised in \textit{Holiday Inns v. Morocco}\textsuperscript{16} where an ICSID tribunal had refused jurisdiction on the ground that once there had been incorporation of the foreign investor’s venture under the laws of the host country, the venture became a corporate national of the host state, making a dispute between such a corporate national and the state a matter beyond the jurisdiction of ICSID. The rule is in accordance with the traditionally accepted principles of international law on corporate nationality.\textsuperscript{17} Article 25(1) of the ICSID Convention itself states that there must be a clear waiver of the issue of corporate nationality in the case of a foreign owned but locally incorporated corporation for ICSID to be seized of a dispute involving the corporation and the state of incorporation. ICSID has drafted a model clause the inclusion of which will enable it to exercise jurisdiction over a dispute between a foreign controlled but locally incorporated company and a host state. It seems that in the absence of such a clause, ICSID tribunals will not assume jurisdiction.

But, conventional wisdom was cast aside in rejecting this jurisdictional objection.\textsuperscript{18} In doing this, the tribunal contorted logic in seeking avenues of escaping the application of the conventional principles. The main argument used by the tribunal was that Indonesia was well aware that the applicant was a foreign company and that the papers associated with the processing of the

\textsuperscript{14} 25 Sep. 1983. The texts of all the awards referred to can be found in 89 ILR (1992) pp. 366-662.

\textsuperscript{15} Under Indonesian law, a foreign company can only operate after being incorporated as an Indonesian company. T.M. Radhie, S. Hartono, J. Barmawi and N. Yasuda, \textit{Corporation and Law in ASEAN Countries – With Special Reference to Indonesia} (1986) pp. 52-56.


\textsuperscript{18} See discussion in paragraphs 20-25 of the first award.
application for entry indicate this awareness. The eventual identity of the true controller of the foreign interests was held to be irrelevant.\textsuperscript{19}

The tribunal also found that the arbitral clause must be interpreted in the light of Indonesian legislation seeking to attract foreign investment into the country. Looked at in this context, the arbitration clause assumes a significance which does not depend on a profound examination of the issue of corporate nationality. In such situations the consent to waive the corporate nationality issue required by Article 25(1) of the Convention did not apply. While the ICSID recommends the inclusion of a model clause for the waiver of an argument based on corporate nationality, the tribunal was prepared to hold that the written formula required for a waiver need not be "expressed in a solemn, ritual and unique formulation".\textsuperscript{20} Some writing from which an inference of waiver could be drawn would be sufficient. The tribunal scoured hard to find such writing and used the arbitration clause itself as such a waiver. If that be sufficient writing for waiver, the question arises as to why ICSID had to recommend a model clause in the first place. The attitude of the tribunal that is evidenced shows an extreme eagerness to assume jurisdiction over the dispute.

2.1.1.2. Objection to jurisdiction: transfer of control of party

Indonesia objected to the jurisdiction over the claim of Pan American on the ground that it was not a party to the original contracts containing the arbitration clause. This objection was rejected by the tribunal on the ground that the transfer of the shares of Amco Asia Ltd to Pan American was communicated to the Indonesian authorities who had approved it.\textsuperscript{21} The tribunal's view was that the right to arbitration was attached to the investment as represented by the shares and was transferred with the shares, provided there was approval by the government that the transferee should acquire all the rights attached to the shares. But, this formulation is followed by a looser formulation in the next paragraph that such government approval is not necessary as the transfer will include the right to invoke the arbitration clause as well. This looser formulation must be rejected. It is inconsistent with the fact that arbitration is a consensual process. There cannot be such a consensual relationship between any transferee and the original party. It would mean that

\textsuperscript{19} Such a holding was necessary to get over the fact that the controlling interests had passed into the hands of the Hong Kong businessman. The undermining of the intent of Article 25(2)(b) was continued in Klöckner v. Cameroon, 1 JIA (1984) p. 145.

\textsuperscript{20} Paragraph 23 of the award.

\textsuperscript{21} Paragraphs 30-31.
the obligation to arbitrate, that is assumed by a party, can be multiplied several times over after the obligation is created by one party deciding to sell shares to a large number of others. Such a technique could be abused in international business as it could be used to bring into the dispute parties with whom the state did not wish to engage. Besides, it defeats the very purpose of a state instituting screening legislation which seeks to ensure that only carefully selected investors are permitted access to operate in the country. It should not be open to a foreign investor to disperse the privileges conferred on him by the state through transferring shares to others. Besides, as a matter of company law, the view taken by the tribunal is of doubtful validity. The arbitration agreement was concluded with the company as a legal person. The idea that all shareholders acquire rights under contracts concluded by the company is one for which support cannot be found in company law systems. The tribunal would have done well to have pegged its view on its finding that the transfer of control was approved by the Indonesian government and stopped at that, instead of straying into an area which it had not handled with any degree of acceptability. Such essays merely reinforce the suspicion that tribunals in foreign investment disputes are usually in favour of the foreign investor and seek to articulate principles in broad terms so as to favour the foreign investor.

After dismissing the objections to jurisdiction, the tribunal found jurisdiction and rendered an award on the merits of the dispute.

2.1.2 First Award on Merits

Applicable law: the issue of the applicable law was not argued before the tribunal. The tribunal interpreted Article 42 of the ICSID Convention which deals with applicable law and held that Indonesian law applied but also “that appropriate rules of international law are to be applied by the Tribunal”. The tribunal did not concern itself with the relationship between Indonesian law and international law. The parties themselves were happy to argue the case on the basis that Indonesian law applied in general.

Issue of taking: one preliminary issue was whether the taking of the property by the army from Wisma could be attributed to the Indonesian
government. The tribunal held that though there was a close relationship between Wisma, the army and the government, this link by itself would not be sufficient to attribute the act to the government.

The tribunal, however, relied on the fact that the army had assisted a private party to deprive an alien of property. This situation, according to the tribunal, called for the application of the rules of state responsibility in international law. Under these rules, there is a duty on the part of the state to protect aliens and their property. This duty was not satisfied when the army and police participated in the deprivation of the property of Wisma. That there is such a rule in international law is not subject to doubt. But, the issue is whether the rules of state responsibility for failure to render protection to an alien are independent of the contract of foreign investment which created jurisdiction in the tribunal and therefore fell outside the jurisdiction of the arbitration tribunal. The arbitration clause in a contract creates jurisdiction in the tribunal over matters arising from the contract. Here, the issue concerned a matter of general law of state responsibility and not a matter which arose from the contract itself. Hence the question was whether the tribunal could have jurisdiction over a matter relating to the foreign investment even though it did not directly arise from the contract on the basis of which the foreign investment was made. This is a matter that was not raised or considered by the tribunal. Ordinarily, under the rules of state responsibility, the acts of the army of a state will be attributed to the state.25 This would be so, particularly in a situation where there was subsequent omission on the part of the state to disown the acts of the army and make reparation to the alien. Whether responsibility arising from these rules of state responsibility can be applied by an arbitration tribunal which is given jurisdiction by contract, as well as by the convention creating it to deal with disputes arising from the foreign investment, remains a moot point.

One writer has expressed the view that the tribunal erred in applying the rules of state responsibility to the case. TOOPE stated his objections in the following terms:

There is no doubt that such a seizure would *prima facie* amount to an internationally wrongful act, but the responsibility for such an act is engaged, it must be remembered, *vis-à-vis* the national state of the expropriated party. By using the terminology of state responsibility, without caveat, in the context

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of an arbitration between a state and a foreign private party, the Tribunal muddled the true relationship of the parties. [. . .] Under the basic principles of international law, the remedies for a private investor will typically arise solely from its contractual relationship with the host state. The private party cannot invoke the principles of state responsibility directly.26

An arbitral tribunal obtains jurisdiction from the arbitral clause in the foreign investment contract. It has jurisdiction to deal with disputes arising from the contract. An issue of state responsibility which concerns the host state and the home state of the foreign investor can hardly be said to arise from the contract. It should be a matter settled by the two countries concerned and not at the behest of the foreign investor to whom the responsibility is not due in terms of international law.

Use of Pacta Sunt Servanda: the tribunal emphasized the doctrine of *pacta sunt servanda* and its application to foreign investment contracts. One feature of investment protection after the Second World War was built up around the notion of contractual sanctity. The rule of treaty law, *pacta sunt servanda*, was taken over to give the false impression that the foreign investment contract amounted to a treaty when in strict theory it cannot be so for the simple reason that it is concluded with a foreign corporation, an entity which lacks personality in international law. The rule was also imported into this area of the law as a general principle of law, again a shaky basis to build up a proposition which is intended to have universal validity. Besides the fact that general principles are very weak sources of law, it will be difficult to establish contractual sanctity as an inflexible proposition of the law in modern contracts jurisprudence. The progress in modern contract law has been achieved through a movement away from contractual sanctity as recognized in nineteenth century contracts law, towards notions which seek to stress the need for equality in bargaining strengths. The tribunal used nineteenth century case law to establish contractual sanctity.27

The tribunal also cited arbitral awards made in disputes involving Middle Eastern states and oil corporations to support the proposition that *pacta sunt servanda* is a 'principle of traditional Islamic law'. The relevance of Islamic

27 Paragraph 258. The two cases cited are from common law jurisdictions. *Printing and Numerical Registering Co v. Samp* (1875) LR 19 Eq. 465 and *Stees v. Leonard* (1874) 20 Minn. 494. The text on contract law by FARNSWORTH, *Contract* (1982), is referred to but this text only mentions the proposition as a starting point of the discussion. No civil law discussion is entered into although Indonesian law is civil law-based.
law to the dispute is unclear. Indonesia is predominantly Islamic but professes a political ideology which does not emphasize any single religion. The first case referred to, *Saudi Arabia v. Arabian American Oil Company* hardly supports the proposition for there it was held that general principles were being applied because Islamic law, which would otherwise have applied as the law of the host state (Saudi Arabia), did not contain any principles applicable to sophisticated contracts like oil concession contracts. The other awards cited did not discuss Islamic law, but decided that there was a principle of contractual sanctity which could be derived from general principles of law.28

There was a need to transfer the rule of *pacta sunt servanda* developed in the context of oil concessions to foreign investment contracts generally. The transference which the tribunal seeks to make is contained in the drawing of an analogy between the concession and the granting of rights to invest in the case of ordinary foreign investment contracts. The tribunal observed:

"[. . .] even if the relationship here in dispute does not constitute, properly speaking, a concession contract, nor derives from such a contract, it remains that there is a significant resemblance between these two legal structures: indeed, when authorizing a company to invest, the State grants it rights to create and operate local economic enterprises. This a State also does by a concession contract [. . .]."

The analogy is inappropriate. The concession contracts were made with absolute rulers of the Middle East, bartering away rights to exploit oil for a long period of time in exchange for royalties on oil produced. The control of investment by a modern state is entirely different. Most states have established administrative machinery for the screening of foreign investment to ensure that the foreign investment which enters their states does not engage in practices harmful to their economies. Indonesia is no exception. By its foreign investment law enacted in 1967 it established an entity, the BKPM, to screen the entry and operation of foreign investment in Indonesia. The function of this body is administrative. It does not make contracts as the oil sheikhs did. It acts in the public interest to ensure that foreign investment is attracted to Indonesia but that the foreign investment so attracted is of the right variety and would mesh in with the development goals of the Indonesian state. The foreign

28 *Texaco Overseas Petroleum Company v Libyan Arab Republic* 53 ILR (1977) 422. Among the Libyan awards, the view that *pacta sunt servanda* constituted a proposition of Islamic law was discussed by Arbitrator MAHMASSANI in *Liamco v Libya*. But, reference to Islamic law in the case under review is puzzling. Indonesia does not apply Islamic law to contracts as the Middle Eastern states involved in the oil concession disputes do.
investment contract is never made with the BKPM in Indonesia but with some state entity or private company. This is so in any other state which has a similar screening mechanism and legislation, requiring authorization by the mechanism prior to entry of foreign investment. The authorization could be conditional. The screening mechanism performs a purely public law function. To assimilate its authorization procedures to the making of concession agreements is an error. The tribunal failed to see the transformation that was introduced into the process of foreign investment as a result of the active participation of the state through its regulatory machinery. Whereas in the case of the concession there was a two-way contractual relationship, with the Middle-Eastern ruler being a passive and satisfied partner as long as he received sufficient royalties, the modern foreign investment process is a continuous three-way relationship. It is a dynamic relationship through which the state seeks to achieve its goal of economic development. There may be an initial contract between the foreign investor and a local entity but interposed on it is the public law function of the regulatory body which oversees the process of foreign investment. It is the failure to see this change which led to the facile reasoning of the tribunal that the new type of foreign investment relationship could be assimilated to the concession agreement. Modern arbitrators seem unwilling to give up the notions of foreign investment protection devised in a past age of protectorates and oil sheikhs, simply because they are more comfortable with the ideas devised by their predecessors imposing a system of property protection.

The arguments which had been made earlier to assimilate the foreign investment contract to administrative contracts under French law were dismissed in the same manner as they had been dismissed in earlier awards on the basis that the French system of administrative contracts is a peculiarity of the French law. This view has been consistently challenged and it has been pointed out that the French doctrine that government contracts are defeasible in the larger public interest is to be found in all legal systems.29 But, such a

29 Thus, the French professor Bernard Audit, to whose "enlightening explanations" the tribunal referred to in another context (paragraph 266), has disagreed with the Tribunal's view. Referring to the argument that administrative contracts are a peculiarity of French law, he observed: "These arguments make the form unduly prevail over the substance. Comparative law indicates that everywhere contracts concluded by public authority are not altogether governed by the same regime as purely civil contracts", B. Audit, Transnational Arbitration and State Contracts (1988) p. 108. Also see the view of the Greek jurist A.A. Fatouros, to the effect that the administrative contract is not peculiar to French law. A.A. Fatouros, Government Guarantees to Foreign Investors (1962) pp. 197-200. In the Texaco Arbitration 53 ILR (1979) 389, which was decided by the French jurist Professor Dupuy, administrative contracts were regarded as a peculiarity of French law.
position is hostile to the building up of a doctrine based on contractual sanctity is consequently dismissed with the sophistry that the doctrine is peculiar to French law. Where arbitration tribunals make such partial choices, the whole system of international arbitration will attract contempt and distrust. The consideration of the view that the foreign investment contract is akin to administrative contracts is long overdue especially in view of the changes that have taken place in the structure of the foreign investment relations in most host state legislation.

Requirement of due process: Indonesia argued that it had revoked the license as requirements imposed upon entry concerning the capitalization of the venture through funds brought in from outside Indonesia had not been met. Since capital flows is one of the presumed advantages of foreign investment, host states require that such flows must take place by insisting that capital is brought into the country by the foreign investor and not raised on the local capital markets. Financing the venture through capital raised on local markets would deprive local entrepreneurs of the funds and enable the foreign investor to repatriate profits he had made through the use of locally existing funds without in any way adding to the capital resources of the host state. Hence, host states emphasize the importance of capitalization of ventures through money raised from foreign sources.

Indonesia alleged that the capitalization measures that were required of Amco had not been satisfied. The best evidence that could have been given against this allegation was that the capital that was brought in had been registered as required with the Bank Indonesia, the central bank of the country. There was no proof of such registration of capital by Amco. One would think that if there had been a fraudulent intention not to fulfil the requirements, entry had been secured by fraud and there would have been a nullity. If the requirement had not been satisfied subsequently as required, then the permission or license which was given on condition that there be such capitalization was revocable on the ground that the condition had not been satisfied. In the case of Amco, there was little doubt that the license was revocable at the least, as capitalization requirements imposed by the regulatory body had not been met.

The tribunal, however, got over this point by pointing out that there had been procedural irregularities in the manner in which Indonesia had handled the matter. There was an assumption that no lawful right existed in the Indonesian government to terminate the contract. Even if the fact that the contract involved was a public law agreement is put aside, the issue still remains as to whether there had been fulfilment of the contractual duties of the foreign party. The imposed capitalization requirements certainly form part of
the agreement, if an agreement can be construed with the foreign investor. These requirements had not been met. There had been a prior breach of the agreement on the part of the foreign investor in not fulfilling what could be construed to be essential terms of the agreement. The tribunal did not consider this factor. It was more intent on finding a breach by the Indonesian government. According to the award the procedural irregularity implied withholding due process and amounted to denial of justice, involving state responsibility. The finding of denial of justice in these circumstances is unwarranted. As a later tribunal also based its decision primarily on the issue of denial of justice, discussion of this issue is postponed until later.

**Remedy:** the tribunal granted damages, presumably on the basis of denial of justice but the exact basis was not clearly identified in the award. Damages were awarded for the loss suffered (*damnum emergens*) as well as for expected profits which were lost (*lucrum cessans*). Justification for this was sought both in Indonesian law as well as in international law. It was also suggested that these principles were common to all legal systems.

The tribunal used the *Chorzow Factory Case* in support of its view that actual loss as well as future profits may be granted as damages in the event of an unlawful taking of foreign property. But, it has been pointed out by numerous scholars that the *Chorzow Factory Case* does not support such a wide proposition. It concerned a taking in violation of treaty obligations and the methods of awarding damages used by the Court must therefore be confined to takings which are illegal. The relevance of the *Chorzow Factory Case* to modern interferences with property must be doubted for the case was decided at a time when the legal attitudes to state takings were different. In modern times, it is not questioned that the taking by a state is lawful, provided it is for a public purpose and is not discriminatory.

**Calculation of damages:** the tribunal used the discounted cash flow method of assessing damages. It took the net value of the investment and deducted the discounted cash value of the property to arrive at the sum that was to be awarded as damages. It suggested that this method ensured that the damages came “as close as possible to the full compensation prescribed by international law”. Issues of valuation of property are secondary to the standard of compensation which should be paid. The tribunal obviously had concluded that the standard of compensation was full compensation. Again, the conclusion is

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30 1928 PCIJ, Ser. A no. 17.
one that is contestable in view of the movements away from the standard of full compensation, among others in scholarly opinion.

2.2. The Annulment Proceedings

Indonesia then sought annulment of the award under Article 52(2) of the ICSID Convention on the basis of five grounds: (1) that the tribunal had exceeded its powers in deciding that the revocation of Amco's license was not material; (2) that it had erred in not considering all grounds justifying the revocation of Amco's licence; (3) that it had not stated reasons for holding that Indonesia had violated due process in revoking the licence of Amco; (4) that the tribunal had not stated reasons for holding that Indonesia incurred state responsibility for failure to afford sufficient protection to a foreign investor; (5) that no reasons were given for deciding on the compensation.

The annulment tribunal, which bore the official name of 'ad hoc committee', consisted of Professor I. SEIDL-HOHENVELDERN, an Austrian professor who has written much on international economic law, Dr. FLORENTINO FELICIANO, a distinguished international lawyer and judge from the Philippines and Professor ANDREA GIARDINA, an Italian academic who has written widely on issues of foreign investment. The main points of interest to arbitration and international law found in the award of the annulment tribunal will be examined below.

1. The applicable law: in the absence of an express choice of law by the parties, the tribunal followed the direction in Article 42 in determining the law applicable. It found that the provision required it to apply Indonesian law, subject to the dual role permitted to international law. The first role is that lacunae in the applicable domestic law could be filled by resorting to principles of international law. This presupposes the existence of rules of international law amounting to a comprehensive code on foreign investment, more exhaustive than that which is provided by domestic legal systems. Such a body of rules does not exist in international law. Hence, the role for international law contemplated by the tribunal cannot be satisfied by that system. The

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31 Professor SEIDL-HOHENVELDERN is the author, among other works, of the following books: Corporations in and under International Law (1987); Principles of International Economic Law (1990).
32 Among Dr. FELICIANO's publications is Law and Minimum World Public Order (with M.S. McDOUGAL, 1961).
33 Decision of 16 May 1986, 89 ILR 514.
second role is that international law rules have precedence if domestic rules are in collision with them. Here again, the difficulty is in identifying these rules of international law for there is little consensus among states as to what they are. Such identification must at best depend on the personal preferences of arbitrators and other decision-makers as to what these rules are, rather than on rules that will satisfy the standards for recognition of rules in public international law. The tribunal, however, gave an explanation for using international law as a validating and overriding system. The reasoning was that the award of ICSID was binding and enforceable in all states and this result could not come about unless there was a body of overriding principles to which all states subscribed. This theoretical justification may be acceptable only if it can be established that there is in fact such a body of overriding principles which have been accepted by all states. The absence of any concrete rules of international law on foreign investment, apart from the existence of state responsibility for wrongful treatment, continues to defeat the claim that validity of national standards is assessable on the basis of international standards.

(2) The nature of the annulment procedure: the tribunal also considered the nature of the annulment procedure, having regard to earlier precedent. The annulment proceedings took place immediately after the annulment of the award in Klöckner v. Cameroon and served as an embarrassment to the ICSID system, for an arbitral system which did not lead to quick and effective disposal of disputes will prove to be unattractive.34 The tribunal concluded that all ICSID awards should contain “sufficiently pertinent reasons” and that the supporting reasons for the award should “constitute an appropriate foundation for the conclusions reached through such reasons”.35 The appellate nature of the annulment proceedings is evident.

(3) The issue of state responsibility: the annulment tribunal found that the finding on the merits, that the conduct of the Indonesian army and police in interfering with Amco’s possession and control of the enterprise was a violation of Indonesian law, was sound. It found a duty to confer such protection in Article 21 of the Indonesian Foreign Investment Law. Having done so, the tribunal refused to pronounce on the issue whether there was a duty in public international law to confer protection upon foreign investment

35 Paragraph 43; the tribunal relied on Klockner as well as the decision of the ICJ in Honduras v. Nicaragua, ICJ Rep. (1960) 216, though the tribunal said that these decisions were not binding on it.
and that failure to do so gives rise to state responsibility. The tribunal noted
that the existence of such a duty in public international law "was at best a
controversial matter" as a considerable number of states rejected such a notion.
The annulment tribunal was unhappy with the attribution of responsibility to
the Indonesian state though it did not feel called upon to pronounce on this
issue in view of its finding that Indonesian law had been violated. This is
an indication of the fact that the much vaunted role of international law as
supplemental and supervisory to domestic law is one that that system is
inadequately equipped to fulfil. The rules of international law on foreign
investment, if any in fact exist, are hazy and contested. A tribunal which can
conclusively declare a proposition of international law on foreign investment
will find itself accused of partiality. No universally accepted rule of customary
law exists in the field of foreign investment protection. Nor are there
substantive rules which have been created by treaties.

(4) Exhaustion of local remedies: the tribunal dismissed the argument of
Indonesia that there was no prior exhaustion of local remedies on the ground
that under the ICSID Convention such resort to local remedies was unnecess­
ary.

(5) Errors on findings: The Indonesian government argued that the first
tribunal had committed two errors relating to its finding that the revocation
was unlawful. It pointed out that the first error was the finding that BKPM’s
revocation was not a supportable one. The facts showed that AMCO had
assigned the management of the hotel to third parties without prior approval
from BKPM. This constituted sufficient ground for revocation of the license.
The second error was that insufficient consideration was given to the fact that
Amco had not capitalised the joint venture in accordance with its original
arrangement with BKPM. This impropriety in capitalisation was an indepen­
dent ground for the termination of the foreign investment. This was not
appreciated by the tribunal.

The rejection by the first tribunal of the relevance of the transfer of the
management of the hotel to third parties was approved by the ad hoc
committee. The reasoning behind the approval is unclear. The management had
been transferred nine years prior to any adverse reaction by the state authority.
The initial transfer was to a consortium which involved Garuda, the state-
controlled airline. The facts could give rise to a presumption of knowledge and

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36 Paragraph 60.
condonation of this transfer by the state. There may have been an estoppel operating against the state taking up this issue.

The *ad hoc* committee took a different attitude on the significance of the fact that Amco had not satisfied up to one sixth of the capitalization requirements. It pointed out that only investments registered with the Bank of Indonesia amounted to investments under Indonesian law and that the amount of qualified investments under Indonesian law could be proved only by the determination of the Bank of Indonesia. The *ad hoc* committee found that the sum of foreign capital registered with the Bank of Indonesia as required by the law amounted to only US $983,992. It held:

The Tribunal in determining that the investment of Amco had reached the sum of US $2,472,490 clearly failed to apply the relevant provisions of Indonesian law. The *ad hoc* Committee holds that the Tribunal manifestly exceeded its powers in this regard and is compelled to annul this finding. 37

The computation of the amount of Amco’s legitimate investment by the tribunal by including loan capital in the amount was regarded as a manifest excess of power. The annulment of the award was based on this ground.

2.3. The Final Tribunal

2.3.1. Decision on Jurisdiction38

The case was resubmitted to a fresh tribunal which had Professor ROSALYN HIGGINS as its Chairperson and Messrs. LALONDE and MAGID as its members. The tribunal considered the issues of jurisdiction presented to it. The principal issue at this stage was the *res judicata* effect of the annulment decision. The award on jurisdiction contains a contribution to the law on the subject of *res judicata* effect of previous tribunals which had considered the dispute. Its essential finding was that, while the decision of the annulment tribunal on issues raised was binding on a subsequent tribunal seized of the same dispute, the reasoning used did not have any binding effect.39

37 Paragraph 95.
2.3.2. Award on Merits: Resubmission

The salient points in the award of the last tribunal are analyzed below.

Applicable law: there was no issue on the question of applicable law raised before the first tribunal or the ad hoc committee. Yet, the final tribunal made a pronouncement on the subject after indicating that there was a disagreement between the earlier tribunals which had considered the Amco dispute. The counsel for Indonesia had maintained that international law was only relevant to the resolution of the dispute if there was a lacuna in the Indonesian law or if the law of the host state was incompatible with international law, in which case the latter prevailed. The ad hoc committee had agreed with this view that international law was “supplemental and corrective” of the law of the host state. But, the first tribunal had given co-equal status to both legal systems. Referring to this conflict, the final tribunal observed:

This Tribunal notes that Article 42(1) [of the ICSID Convention] refers to the application of host-state laws and international law. If there are no relevant host-state laws on a particular matter, a search must be made for the relevant international laws. And, where there are applicable host state laws, they must be checked against international laws, which will prevail in case of conflict. Thus international law is fully applicable and to classify its role as “only” “supplemental and corrective” seems a distinction without a difference. In any event, the Tribunal believes that its task is to test every claim of law in this case first against Indonesian law, and then against international law.

This formulation goes even further than the formulation of the first tribunal in that it makes international law superior to the host-state law, for the assumption is that if a result from the application of international law to any point in issue differs from the result of the application of the host state’s law, the former result should prevail. This conclusion is one which can hardly find support in the travaux preparatoires of the ICSID Convention. Such expansive claims to the role of international law will result in hesitation on the part of host states to accept ICSID arbitration.

The revocation of the license: the tribunal did not pay much attention to the interference with management rights of Amco as a result of the take-over of

40 Decision of 31 May 1990, 89 ILR 580.
41 Paragraph 40.
the hotel by the army. It found that there was no evidence to show that the entitlement of Amco to profits had been lost as a result of the intervention.

Much of the discussion of the law centred on procedural illegality attached to the revocation of the license of Amco by BKPM, the administrative body responsible for licensing foreign investment in Indonesia. Amco’s contention was that, although there was a power in BKPM to revoke the license in situations where the foreign investor had not acted in accordance with the approved investment plan, the revocation of the license in its case was not done in accordance with the requirements of due process. Amco raised the interesting point that even if BKPM’s revocation was substantively valid, damages would be due for the procedural violations. The tribunal reformulated this issue as requiring a determination as to:

“whether there exists a generally tainted background that necessarily renders a decision unlawful, even if substantive grounds may exist for such a decision. This background includes, but is not limited to, the question of procedural irregularities.”

Such a reformulation again widened the scope of the inquiry of the tribunal. A preliminary question would be whether the state party ever intended to give such a wide jurisdiction to the tribunal to scour around the whole process of the investment in order to determine whether or not the transaction was tainted. Another issue is whether the inquiry as to the taint should be restricted to the state party and whether the errors of the foreign investor are not relevant. Again, the formulation introduces factors that are partial to the situation of the foreign investor and not to the host state. There is also no indication in the ICSID Convention or in its travaux préparatoires as to whether ICSID tribunals are to be vested with jurisdiction to inquire into responsibility for the conduct of administrative authorities in the host state or whether their jurisdiction is to be confined to the issue of whether or not the foreign investment contract has been wrongly breached.

Having formulated the issue in such wide terms, the tribunal then went on to deal with the history of the dispute between Amco and Wisma, the intervention of BKPM and the manner in which BKPM dealt with the allegations made by Wisma against Amco that Amco had acted in violation of the investment plan relating to capitalization and other matters. The officer investigating the matter for BKPM had, in the tribunal’s view, acted in haste, had not done a thorough examination of relevant matters and had relied on inaccurate infor-
mation. The errors of the officer had not been rectified by the superior authorities who reviewed his findings.

The finding of the officer that there was no capitalization according to the investment plan was supportable as a matter of fact for there was no Bank of Indonesia certification as to the required capitalization. Such certification, as has been pointed out previously, was the only method of proof of capitalization under Indonesian law. But, the tribunal held that it was not concerned with the substantive correctness of the decision of the BKPM, "but rather the background to its decision and the climate in which it was made." Again, the question is whether an arbitral tribunal which draws its jurisdiction largely from the contract of the parties can go into the whole 'climate' in which the investment was made. Such a course would enable the arbitration tribunal to go into matters such as the political and economic conditions of the state while the state party to the contract could not have intended to give the tribunal such a wide jurisdiction. Neither is there any indication in the Convention that the ICSID tribunals are to be vested with such wide and arbitrary powers. The approach of the final tribunal may have been in excess of its jurisdiction.

The tribunal considered other instances of alleged misconduct on the part of Amco, such as falsification of accounts and failure to file investment reports, but found that the revocation of license was tainted by bad faith. It did, however, state that the "evidence also reflects discreditably on Amco" but that this discreditable conduct could not justify BKPM's approach to the question of revocation. On the basis of the findings that the manner of revocation of the license by BKPM was improper, the tribunal considered the responsibility of Indonesia.

The application of the law to the findings: the tribunal considered the legal consequences of its findings under both Indonesian and international law. It found that "Indonesian law does not clearly stipulate whether a procedurally unlawful act per se generates compensation or whether a decision tainted by bad faith is necessarily unlawful". The tribunal then examined the international law authorities on the point and found that the writings of publicists cited had not discussed the situation in which there was procedural illegality

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42 The Tribunal said: "The manner in which Mr USMAN prepared his summary must be described as rushed, over-reliant on Wisma's characterizations, factually careless and insufficiently based on detailed and independent verification with the authorities concerned. This is so whether or not any of the charges were in fact sustainable." (paragraph 83).
43 Paragraph 88.
44 Paragraph 121.
but such illegality had not lead to any loss or diminution of the substantive rights of the affected party.

The tribunal considered three arbitral awards as relevant to the issue before it.\(^{45}\) The tribunal found that in these awards the emphasis was on denial of justice. The tribunal stated that not every procedural unfairness amounts to a denial of justice but, using the words of the International Court of Justice in the *ELSI Case*,\(^{46}\) it said that a procedural error which shows “a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety” will amount to a denial of justice. The tribunal also held that although in the cases discussed liability for a denial of justice arose from the conduct of judicial bodies, there could be liability arising from the misconduct of administrative bodies as well. The tribunal was making obvious extensions to the law. An administrative tribunal is hardly a final disposer of any matter in a state and the idea that state responsibility could arise from the activities of a subordinate body sits uneasily with the law that has been developed thus far. Under the international law of state responsibility, there could be responsibility for the acts of the highest judicial tribunal or of lower tribunals in cases where appeals to a higher tribunal would have proved illusory. But, there is no authority for the view that responsibility could arise from the acts of an administrative tribunal. The tribunal concluded that “although certain substantive grounds might have existed for the revocation of the license, the circumstances surrounding BKPM’s decision make it unlawful”.\(^{47}\)

The finding of a denial of justice is a major step to take against a state. A simple miscarriage of justice will rarely be seen as an internationally wrongful act. There must be a “serious and intentional perversion of justice as a result of malicious and false evaluation of the evidence or determination of the law”.\(^{48}\) It is difficult to find such circumstances where the substantive rights of the affected party would remain the same despite the administrative error. In this dispute, the rights of Amco were revocable the moment undercapitalisation was established but the quarrel was about the manner of revocation. The

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\(^{45}\) The *Idler Case (US v Venezuela)* decided by a Claims Commission in 1898 (discussed in para. 130); *Chattin Case*, 4 AD (1927) 248 (decided by a Mexican Claims Commission); *Walter Fletcher Smith Case*, 5 AD (1929) 264.


\(^{47}\) Paragraph 139.

procedure followed was not acceptable but it is debatable that there was in fact a “serious and intentional perversion of justice”.

**Valuation of damages:** having found that there was a denial of justice, the tribunal proceeded to state the principles on which damages should be assessed. In doing this, the tribunal used principles which had been used for calculating damages for the taking of foreign property. Thus a mental leap was made here from a procedural irregularity to a denial of justice and then a massive leapfrog into the taking of foreign property. The philosophy behind this magical leap is difficult to fathom. If substantive rights had not been affected, it is difficult to determine what was in fact taken. If what was taken away was only the right to a fair hearing, compensation should have been accordingly.

But, the tribunal found that what was taken was the whole of the package of rights involved in the foreign investment. Thereafter, the tribunal followed a predictable course and calculated damages on the basis of an unlawful taking of property. Thus, a new category of unlawful takings was created, the category being takings of any of a bundle of rights associated with the investment without a proper hearing. Any revocation of the rights of the foreign investor, except in accordance with an internationally existent procedure, will amount to a taking even in circumstances where the rights of the foreign investor are properly terminable. This creates a new category of takings of foreign property. There is hardly any precedent for such a category in the literature of international law. The great weakness of the award is that it is establishing a connection between procedural irregularity, denial of justice and taking of property.

**Compensation:** the tribunal held that the purpose of compensation was to put Amco in the position it would have been in had it received the profits of the contracts. Future profits of the hotel were taken into account in assessing damages. The tribunal rejected the book value method of assessing compensation and used the discounted cash flow (DCF) as the more flexible and appropriate method of calculating damages.

2.3.3. **Evaluation of the final award**

The final award is based on several unsupportable hypotheses. Firstly, there is the assumption that procedural irregularity of an administrative tribunal will result in damages, even if the decision arrived at by the administrative tribunal is inevitable on the facts of the case. This assumption is a difficult one to establish in the systems of administrative law of most states, let alone a
developing state like Indonesia. Quite apart from assuming that there are universally applicable standards of administrative efficiency enforceable through notions of denial of justice in international law, the tribunal plucks out a standard out of thin air, without exploring whether there is adequate basis for it, at least, in general principles of administrative law. In the past, arbitral tribunals resorted to the subterfuge of finding that there was a general principle of law before applying a principle. The final tribunal does not even seek to engage in such a subterfuge.

If one would examine the English system of administrative law (with which at least two of the members who sat on the tribunal would have had some familiarity), it were difficult to establish that procedural irregularities assumed the significance which the tribunal thought they had, in circumstances in which substantive rights were not affected.

The term “due process” which the final tribunal used is a term of American administrative law. There is a marked resemblance between due process in American law and natural justice in English law, although there are also differences. It is sufficient to consider English administrative law which has wide currency within the Commonwealth. Even within English law, the content of natural justice did not remain constant. In times of war, the content of natural justice was slim and the concept achieved a degree of cogency long after the end of the Second World War. Even in its modern form of the doctrine of fairness, the rules of natural justice have a variable content depending on the nature of the function that was exercised, the wording of the statute that created the function and the exigencies of the circumstances in which the decision had to be made. The law is unclear in England as to what the position would be where a fair hearing would have made no difference to the eventual outcome of the substantive rights of the parties, though even in these circumstances a fair hearing is advisable.

49 The best study is B. SCHWARTZ and H.W.R. WADE, Legal Control of Government: Administrative Law in Britain and the United States (1972) 245.
50 English texts contrast the decision in Nakkuda Ali v. Jayaratne, AC (1951) 66 with the decision in Ridge v. Baldwin AC (1964) 40. The latter decision considerably widened the scope for natural justice by introducing the new notion of fairness and doing away with the old dichotomy between administrative and quasi-judicial acts. Under the older law, hearings had to be held only if the decision was made in the course of an exercise of a quasi-judicial power. For the transformation in English law, see H.W.R. WADE, Administrative Law, 5th ed. (1982) 475.
Given this situation in English administrative law, the certitude of the application of due process which the final tribunal showed is amazing. The tribunal purported to apply international law. There was not even a modicum of effort made to show that there was indeed a universally accepted standard of due process and that that standard of due process applied equally to developed and developing states. In a world in which there are varied types of governments and varied styles of administration, is it indeed possible to demonstrate that there is a uniform standard of public administration?

Assuming that there is a due process requirement in international law, the next step taken by the final tribunal that the failure to afford due process results in a denial of justice even though the substantive rights may not be affected by the irregularity is even less tenable. The authority used to support this proposition is slim. Denial of justice by a state is to be assumed in the most serious of instances. It is unlikely that there is authority for such a denial of justice to be assumed in circumstances where Amco was acting in a manner which the tribunal itself considered disreputable. In any event, where there is a procedural illegality, the result is that the decision of the administrative officer is invalidated. Compensation is provided, if at all, for the right that was suspended as a result of the improper decision and for the period it would take for the right to be cancelled through regular means. Where the substantive right could properly be cancelled this is the obvious result, for the administration had an accrued power to cancel the right of the holder due to his non-satisfaction of the conditions attached to the exercise of the right. This was the position of Amco. Its right to enter Indonesia and function as a foreign investor was conditional on several factors, including the capitalization of the approved venture in accordance with the plan as submitted to BKPM. That right became defeasible when capitalization was not made in accordance with the plan. BKPM was within its rights in terminating the investment, for the only method of proving capitalization through certification by Bank Indonesia was not available. The only quarrel was with the manner of termination. On this analysis, at best, if damages were to be granted, it could be granted for the period of time it takes for the BKPM to terminate the investment in accordance with proper procedure.

Instead of such an analysis, the tribunal drew the startling conclusion that the procedural irregularity amounted to an unlawful taking for which restitution should be made. There could be little support for such a conclusion even in the

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53 The position of an alien foreign investor is very much akin to any other alien. On the question of the protection of the rights of aliens, the English administrative system has been weak. English courts have traditionally required little or no hearing for interference with the rights of aliens, until intervention by the European Court of Human Rights.
literature of foreign investment disputes which has so far been partial to the foreign investors. There was justification for a taking in this situation, as the tribunal itself admitted. The substantive rights of the foreign investor were not affected, for BKPM could have properly terminated the foreign investment. The question of an unlawful taking was not relevant at all. The award justifies cynicism. It indicates that arbitral tribunals are prone to contort the law in order to ensure that the foreign investor comes out best, whatever the situation.

It also indicates an inability on the part of the law relating to foreign investment protection, which has hitherto been developed in the context of contractual principles and an emphasis on contractual sanctity, to come to grips with increasing state intervention in the foreign investment process. Whereas the old arbitral tribunals developed the law on the basis of the initial contract and the notion of *pacta sunt servanda*, these ideas have now become irrelevant to the foreign investment process in developing countries which is constantly subject to administrative review to ensure that it ties in with the development goals of the state. The modern investment contract is very much a public law instrument with the state as a silent partner from the very inception of the foreign investment. Entry of foreign investment has to be approved. Conditions are imposed upon the manner of operation of the foreign investment in the host state. There is constant supervision of accounts, export targets, performance requirements and other matters by administrative bodies. The BKPM was performing such a function in Indonesia. The old, contract-based law on foreign investment protection could not cater to this development. A new strategy had to be thought out. What the final tribunal did was to think out a strategy based on state responsibility for denial of justice, in circumstances where the administrative organs supervising the foreign investment did not adhere to standards of procedure. There are great difficulties with this strategy. There is no universally accepted standard of administrative procedure. It is difficult to establish that failure of an administrative tribunal to afford due process amounts to a denial of justice. The final tribunal falls flat on its face in trying to establish a theory for which there is no theoretical

54 It is not impossible that full damages arise for consequences of an improper administrative decision. Thus, in the English case of *Cooper v. Wandsworth Board of Works* where a house was demolished as a result of a wrongful administrative decision, full damages was ordered. But, in the case at stake, the right had become defeasible the moment capitalization was not made according to the plan.

55 This change in the approach of developing states is discussed at greater length in M. Sornarajah, *International Law on Foreign Investment* (1994) Chapter Two.
support. The award of the final tribunal in Amco v. Indonesia furnishes yet another example of the trend to create international law that is favourable to foreign investment protection without taking the interests of the host state into account.

3. AAPL v. SRI LANKA

The second ICSID award involving an Asian state is AAPL v. Sri Lanka. A unique aspect of the award is that it was the first time an ICSID tribunal assumed jurisdiction over an investment dispute on the basis of a bilateral investment treaty. The award has received wider commentary than Amco v. Indonesia within a short time.

The Facts: Asian Agricultural Products Limited (AAPL) was a Hong Kong company which had started a prawn farm in joint venture with Serendib Seafoods Limited, a Sri Lankan public company, on the east coast of Sri Lanka. The farm was destroyed by Sri Lankan security forces while they were conducting operations against Tamil guerrillas. The government contended that the action was made necessary, as the guerrillas (known as the Tigers) had used the farm as a sanctuary. The claimant, however, contended that the destruction and the killing of civilians on the farm was caused by a "murderous overreaction" by the security forces. The tribunal considered the issues on the basis of these facts.

The applicable law: the tribunal pointed out that it was the first case where the ICSID was seized of jurisdiction over a dispute on the basis of a bilateral investment treaty and not on the basis of an arbitration clause or agreement between the parties. The tribunal concluded that both parties had agreed to use the bilateral investment treaty as the lex specialis which applied to the dispute.

An argument of AAPL based on the treaty was that the requirement that the investments of one of the contracting parties "shall enjoy full protection and security in the territory of the other contracting party" went beyond the minimum standard protection given in customary international law and created

56 For reports see 17 Yearbook Commercial Arbitration (1992) 106.
absolute liability in circumstances of damage to the property of the foreign investor. AAPL relied on the provision of the treaty which provided for compensation where destruction was caused during war or civil disturbance. AAPL also argued that the exemption for liability provided in the treaty for destruction caused during war or civil disturbance was not applicable to its case as the act was not caused in combat action but amounted to the wanton destruction of property and the cold-blooded killing of its staff.

The government rejected the strict liability interpretation of AAPL. Instead, it argued that, for responsibility to arise it must be shown to have acted without due diligence and that there was nothing to suggest that this duty had not been satisfied. It argued that the burden was on AAPL to show that the security action was avoidable.

The tribunal’s findings: after an essay on the interpretation of treaties, the tribunal rejected the notion of absolute or strict liability contended for by AAPL. It then found that Article 4(2) of the bilateral investment treaty, which imposes responsibility for damage arising from wars or civil unrest, did not provide relief to AAPL as the conditions necessary for the operation of the article did not exist. The evidence did not show that the government troops were responsible for the destruction. There was a combat action and the acts were necessary in the circumstances. The tribunal held that responsibility could not arise under this provision of the treaty. But, the tribunal also held that Article 4 (1) of the treaty makes reference to the standards of treatment of the foreign investor both under domestic law as well as international law.

The tribunal then discussed the standard of protection that AAPL is entitled to under international law. After an examination of the authorities the tribunal concluded that international responsibility arises from a failure to observe the duty to exercise due diligence towards the foreign investor.

AAPL’s case was that the type of action taken by the security forces of the government was unnecessary. It had involved the wholesale destruction of the farm and the murder of 21 of the employees at the farm. The tribunal examined the evidence and found that the allegations as to destruction and murder were proved. The government claimed that there were suspect elements among the employees of the farm and that the action was necessary to root them out. But, the tribunal felt that there were other less risky means of getting these elements out of the farm, particularly in view of the fact that the management of the farm was prepared to cooperate with the security forces.

The tribunal also adverted to the existence of an objective standard of investment protection. The tribunal observed:
contemporary international law authorities noticed the sliding scale, from the old subjective criteria that take into consideration the relatively limited existing possibilities of local authorities in a given context towards an objective standard of vigilance in assessing the required degree of protection and security with regard to what should be legitimately expected to be secured for foreign investors by a reasonably well organized modern state.\textsuperscript{58}

Though there was no evidence that the security forces were directly responsible for the damage, the tribunal suggested that the issue was whether under the circumstances the forces were capable of providing protection to the foreign investor. The entire area was under the control of the government forces and such protection could have been given. Liability arose for the failure to provide such protection. The tribunal awarded damages based upon the discounted cash flow method of valuation.

The dissent: there was a dissent by the arbitrator appointed by the respondent state. The main thrust of the dissent was that there should not have been resort to general principles of international law in situations where there was a bilateral investment treaty, the treaty containing an exhaustive statement of the responsibilities of the parties. In any event, the dissent pointed out, there was no clear responsibility in customary international law for damage caused during civil strife.

Analysis: the award was novel in that jurisdiction of the tribunal arose from the provisions of a bilateral investment treaty. The range of uses to which such treaties can be put to have yet to be fully explored. Here, an issue of state responsibility arising from the conduct of security operations came to be raised before what is essentially a foreign investment tribunal meant to deal with contractual matters dealing with foreign investment, and not with state policy and the laws relating to the conduct of war. The competence of the tribunal to deal with such issues must be raised. It was never intended by the creators of ICSID that ICSID tribunals should have jurisdiction to deal with general areas of state responsibility.

It is also a pity that a situation involving a violation of human rights arises before an international tribunal only in an indirect fashion. Obviously, innocent lives were lost. It is a sad commentary on international law that while it has succeeded in creating institutions for the protection of property of foreigners,

\textsuperscript{58} Paragraph 79.
the compensation for the loss of lives can be made only where it is accompanied by the destruction of foreign property.

4. CONCLUSION

The two awards made by ICSID involving Asian states have unsatisfactory features which will make Asian states wary of ICSID arbitration. The award in Amco failed to face up to the fact that foreign investment is well integrated into the economy of the host state through administrative machinery and has ceased to be a pure contract. The earlier tribunals dealing with the dispute used old and outdated principles of contract law to deal with the problem. The final tribunal realized the importance of the change that had taken place but sought to retrench the position of the foreign investor by using notions of denial of justice which were inappropriate to the context of the situation. The AAPL decision had novel features. It indicated that the use which could be made of bilateral investment treaties is yet unascertained and that the host state may have made itself responsible for a range of liabilities it had never contemplated at the time of the agreement. Both awards will make developing states wary of ICSID arbitration. The award involving Sri Lanka has already met with disapproval from academic commentators. The award involving Indonesia has surprisingly escaped attention but the assumptions on which it rests are no less weak.